Draft

Governance Arrangements

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1. Overview

Governance of financial sector:

- Division of responsibilities among oversight agencies
- Relation between government and agencies
- Internal governance practices of agencies

1. Overview

- Components intertwined
- Interest relatively recent
- Debate about optimal structures in flux

2. Reasons for Increased Attention

- Liberalization of financial markets,late 1970s
- Move towards central bank independence,1980s
- Collapse of command economies, early 1990s

2. Reasons for Increased Attention

- Deep systemic banking crises, 1990s
- Financial stability a policy objective
- Breakdown of barriers among institutions

3. Institutional Division of Labor

- Which agencies?
- Agencies with ongoing functions versus crisis management
- Division of labor differs
- Agencies have delegated powers

3. Institutional Division of Labor

Mandate and conflict of interest:

- Need for a clear mandate
- Clear mandate facilitates accountability
- Clear mandate avoids conflicts of interest

3. Institutional Division of Labor

Potential sources of conflict of interest

- Liquidity support versus solvency support
- Monetary policy versus banking supervision
- Lender of last resort for banks versus for other institutions

3. Institutional Division of Labor

Need for coordination:

- Exchange of information
- Communication of decisions
- Respect for confidentiality requirements

4. Relationship with the Ministry of Finance

Division of responsibility

- Government (Ministry of Finance) bears ultimate responsibility
- Power of oversight agencies is delegated power
- Government deals with general framework (primary legislation)
- Government accountable to legislature and public at large

4. Relationship with the Ministry of Finance

To avoid conflict of interest

- No involvement in licensing and withdrawing licenses

- No direct involvement in issuing prudential rules and regulations

- No involvement in appeals procedures – leave it to courts

4. Relationship with the Ministry of Finance

Coordination

- Receiving delegate powers = sharing information
- Government needs information for general policies
- Respect for confidentiality for individual bank data

4. Relationship with the Ministry of Finance

Rules of the game change when:

- Public funds are involved – more coordination is needed

- In systemic crisis – temporary overhaul of institutional responsibilities might be necessary

5. Internal Governance Arrangements

Quality of financial systems depends on quality of governance (government, oversight agencies, market participants)

- Good public sector governance supports governance of oversight agencies

- Good governance of oversight agencies promotes good governance by market participants

5. Internal Governance Arrangements

Four institutional underpinnings for good governance:

- Independence
- Accountability
- Transparency
- Integrity

5. Internal Governance Arrangements

- The elements reinforce each other
- Equally important, irrespective of the type of agency
- They support the two others

5. Internal Governance Arrangements

Independence:

- Never “absolute” - power is “delegated”
- “Goal” independence versus “instrument” independence
- Accountability supports independence giving legitimacy

5. Internal Governance Arrangements

Integrity

- Procedures for appointment
- Procedures for internal audit arrangements
- Standards for the conduct of personal affairs
- Legal protection while discharging official duties

5. Internal Governance Arrangements

Issues for deposit insurance

- Funded systems recommended
- Limited coverage,moral hazard
- Limited deposit insurance not in systemic crises
- Risk-based premia useful in theory, hard to implement

6. Conclusions

- Importance of governance for financial soundness recognized
- FSAPs important instruments to detect strengths and weaknesses
- Discussion about proper agency structure remains in flux
- MFD is developing guidelines for governance of supervisory agencies to assist membership