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## Governance Practices at Financial Regulatory and Supervisory Agencies

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**IMF Working Paper**

Monetary and Capital Markets Department

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**Abstract**

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This paper summarizes the results of a survey of financial supervisory agencies in IMF member countries conducted in 2007. Responses were received from 140 financial sector supervisors in 103 countries. A majority of these are separate stand-alone agencies, though, a majority of bank supervisors are part of a central bank. The survey asked respondents about their governance structure and practices, as well as practices and policies related to public transparency and accountability. Most agencies reported having operational independence. Bank supervisors were unique in viewing financial stability as part of their mandate.

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## I. INTRODUCTION

Financial sector supervisory bodies are organized in different forms in different countries. These structures range from independent stand-alone agencies to consolidated supervisors responsible for supervising the entire financial sector, including banks, insurance companies and securities firms. In some countries financial sector supervisors function under the ministry of finance, while in others the supervisory body may be a department of the central bank.

The financial landscape has changed, and banks, insurers, and securities firms have begun to offer similar or even identical products, or have common ownership. This, in turn, has caused some countries to reexamine their regulatory structure and consider changes. Frequently this has led to the creation of a new agency, forcing authorities to make decisions about governance of the new entity. While there is an extensive literature on corporate governance, guidance on governance issues for public entities is not so clear. Moreover, given the public nature of these bodies, it is unlikely that the governance practices will, or should, depart dramatically from those in the rest of the government.

The International Monetary Fund, as part of its technical assistance program, offers guidance and assistance in the strengthening of financial sector supervision. Fund staff, along with the World Bank, also undertake formal assessments of financial sector supervisors utilizing the standards and codes promulgated by international standard setting bodies (the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO)).

As countries have faced a changing financial sector, requests for guidance on governance and structures for supervisory bodies have become more common. A number of governments have been considering consolidating supervisory functions in an effort to both achieve efficiencies and to improve the quality of the supervision of financial conglomerates. In addition, in response to the assessments under international standards and codes, supervisory bodies have been working to improve their performance and this has led some of them to review their placement within the government.

Given the lack of good information regarding governance practices at supervisory and regulatory bodies, the Fund surveyed financial sector supervisory bodies in its member countries. This study presents the findings of the survey and provides a reference for countries considering changes to their structures. While there are no clear standards for what is “good” governance within governmental bodies, beyond what already exists within the principles established by the Basel Committee, IAIS, and IOSCO, this study does not make any judgments as to whether countries’ practices are good or bad, optimal or sub-optimal. Rather, it presents a body of information so that member countries can see what their peers are doing and researchers can use this information to subsequently determine whether governance practices affect regulatory performance.

### Box 1. The Survey in Numbers

The Survey was conducted between February and April 2007. A total of 140 financial sector regulatory and supervisory agencies from 103 countries representing 56 percent of the IMF's membership, participated. Out of this total, 60 percent of the respondents indicated having responsibility for banking supervision, either on a unitary basis<sup>1</sup> or in some form of consolidated or integrated arrangement. The responding countries account for about 91<sup>2</sup> percent of the world's GDP as of June 30, 2006

The majority of the participants, 60 percent, are *unitary agencies*, that is, agencies dedicated solely to the supervision of a single segment of the financial sector, not combined with any other agency and responsible for supervising multiple types of financial entities. The second largest group is represented by agencies with various degrees of supervisory integration, usually supervising a variety of combinations of any two-types of financial intermediaries (e.g., banks and insurance companies, banks and security firms, and so forth). These *integrated*<sup>3</sup> supervisors represent 23 percent of the participating surveyed agencies. Within the integrated group, those that combined banking and insurance supervision were the most prevalent, making up 38 percent of this group. Only 13 percent (18 agencies) of the participants are single, fully *consolidated supervisors*, who oversee the entire financial sector (banks, insurance and security firms). In terms of areas of responsibility, 60 percent of the respondents have responsibility for bank supervision, 41 percent for insurance supervision, and 44 percent are responsible for securities supervision.

#### By Type of Supervision

|                 | Number | Percent |
|-----------------|--------|---------|
| Banking only    | 44     | 31      |
| Insurance only  | 16     | 11      |
| Securities only | 25     | 18      |
| Consolidated    | 18     | 13      |
| Integrated      | 32     | 23      |
| Other           | 5      | 4       |

The Survey also includes responses received from other supervisory-type agencies, including two *regional banking supervisors* who supervise banks in 6 countries located in Africa and 4 countries in Latin America & the Caribbean.

Regionally, respondents of the survey represent countries from:

| Region                              | Participants<br>(In percent) | Participation Rate<br>(by region) |
|-------------------------------------|------------------------------|-----------------------------------|
| Africa (AFR)                        | 15%                          | 34%                               |
| Asia Pacific (AP)                   | 19%                          | 61%                               |
| Europe (EUR)                        | 31%                          | 74%                               |
| Latin America & the Caribbean (LAC) | 24%                          | 78%                               |
| Middle East and Central Asia (MC)   | 9%                           | 29%                               |
| North America (NA)                  | 2%                           | 100%                              |

By stage of development<sup>4</sup>, most respondents are from *emerging/developing countries*. About 68 percent of the surveyed agencies are in emerging/developing countries, whereas 32 percent are from advanced economies.

<sup>1</sup> Unitary agencies are agencies not combined with any other agency(ies). They are specialist, dedicated supervisors for each area of the financial system.

<sup>2</sup> As per the World Bank's *Key Development Data & Statistics, Year 2006*.

<sup>3</sup> Agencies which follow a model where the prudential supervision of *the entire financial sector* is located within a *single agency* are referred to herein as "*consolidated supervisors*".

<sup>4</sup> As defined by the International Monetary Fund's *World Economic Outlook* (WEO).

All financial sector supervisors in each IMF member country were approached and asked to participate in the survey that had been prepared by Fund staff with input from the Basel Committee, IOSCO, and IAIS. Box 1 describes the survey procedure and summarizes the participation rate. Appendix I lists the participating financial sector supervisory and regulatory agencies.

This paper reviews the governance practices of these supervisors. It looks at the legal framework under which supervisors operate, including whether supervisors have operational independence and clear mandates. It examines their governance structure, funding, and legal protection. The paper also looks at practices related to agency decision making, transparency, and integrity. Differences in governance practices across governance structures and types of supervisory activities are highlighted. In addition, an analysis is conducted on whether governance of bank supervisors is influenced by their location, either in a central bank, as a stand-alone agency, or as part of a consolidated supervisory agency.

## II. KEY FINDINGS

- The majority of financial sector supervisors surveyed are separate stand-alone agencies within the government. The notable exceptions are bank supervisors where a majority are part of the central bank. Also, about 20 percent of insurance-only supervisors are part of a ministry of finance, as compared to about 5 percent each for securities and banking supervisors.
- About 75 percent of stand alone agencies reported that the law gave them operational independence with respect to supervisory decisions. Only 58 percent reported that they had operational independence regarding regulatory activities.
- Almost all (90 percent) of banking-only supervisors view *monitoring systemic risks and maintaining financial stability* as mandates, whereas most insurance and securities supervisors did not consider these to be mandates. Virtually all agencies viewed oversight and supervision of the financial sector and institutions, ensuring compliance with regulations, developing regulations, prevention of financial crimes, and protection from market misconduct and/or bad business practices as their core mandates.
- 60 percent of all financial sector supervisory agencies are governed by a board of directors or a supervisory council. However, unitary securities supervisors tend to be less frequently governed by a board or supervisory council, with 56 percent having their policies set by agency heads or ministers.
- Three-fourths of the respondent agencies do not have industry representatives on their boards of directors. However, 44 percent of insurance-only supervisors have industry representatives on the governing body.
- About 60 percent of the agencies have a combination of part-time and full-time directors.

- More than 70 percent of agencies indicated that the grounds for the termination of a member of the governing body, prior to the end of the term of appointment, are spelled out in law. The notable exceptions are in North America.
- Two-thirds of supervisors, at all agency types, have legal protection for acts taken in good faith in the course of performing their duties. However, only 17 percent of supervisors believe that this protection carries over after they leave office.
- Central bank funds, followed by fees charged to the industry are the two most important sources of funding for supervisory agencies. However, 45 percent of securities regulators rely on budget allocations as their second most important funding source.
- A majority of banking, securities, and consolidated supervisory agencies have the ability to set staffing, salary, and benefit levels. However, less than half of integrated and insurance-only supervisors can set salary levels.
- There is a high degree of accountability and transparency by financial sector supervisors. Most agencies are accountable to either their parliament or a minister. Almost all agencies prepare financial statements and 81 percent have these subject to external audit.
- Financial sector supervisors report having well developed appeal processes, both for regulatory and supervisory decisions. In cases where individual institutions appeal a supervisory/enforcement action, more than half the supervisors reported that courts can perform their own *de novo* assessment of the appropriateness of supervisory judgments and are not constrained to only reviewing whether the supervisor had followed proper procedures. This holds for a higher percentage of insurance-only and consolidated supervisors than others. Despite this, 85 percent of agencies reported that they could go forward with an action pending its appeal.

### III. THE RESPONDING AGENCIES

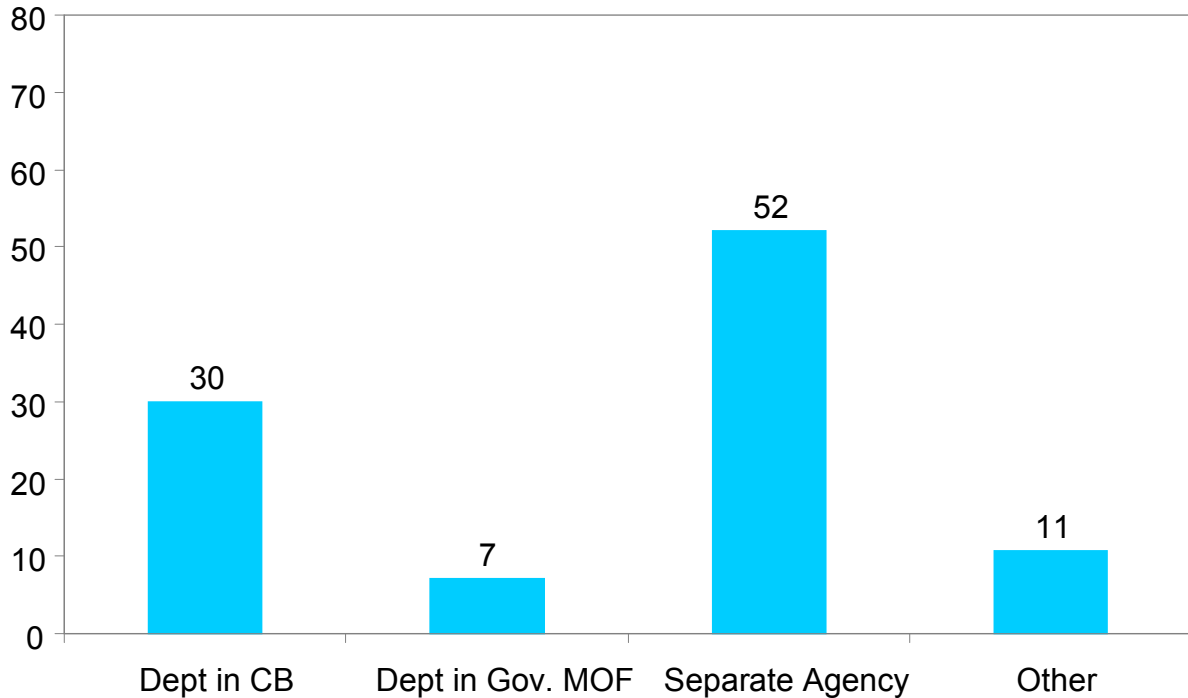
In this section, the attributes of the financial sector supervisory bodies that responded to the survey are presented. The description focuses on the entities' location within the government hierarchy, the types of institutions they supervise, their age, and how independent they are.

#### A. Demographics within the Government

About half of the agencies are *stand-alone agencies* that are not part of another governmental body. While units of the government, they are not part of a ministry, central bank, or other government department or agency. Thirty percent of the financial sector supervisors are departments or entities within a central bank (Figure 1). Not surprisingly, most of these (55 percent) are bank supervisors. In Latin America, slightly more supervisors (45 percent) are housed in central banks than are free standing or housed in a ministry.

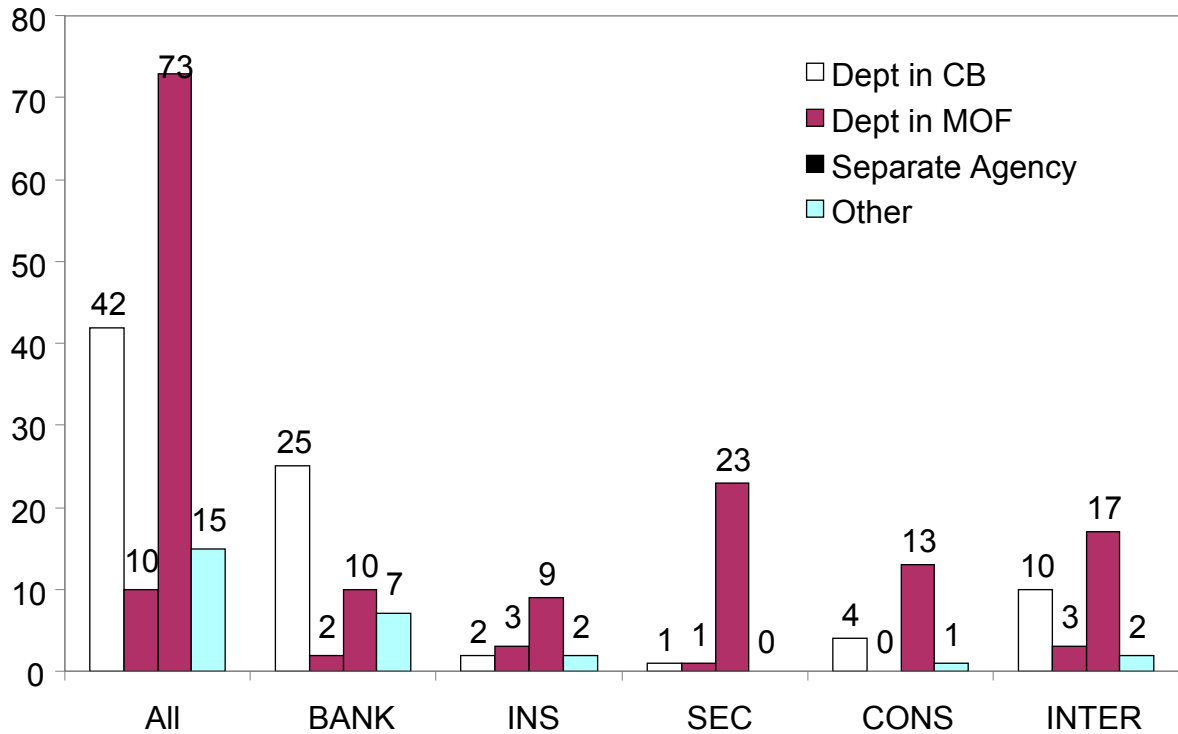


Figure 1. Location of Supervisors  
(In percent)



Bank supervisors are unique among financial sector supervisors in that the majority of them are housed within central banks, whereas other supervisors tend to be stand-alone agencies (Figure 2). Of course, central banks are typically independent in their own right. The practice of placing financial sector supervisors in central banks is particularly pronounced in Africa and Latin America. Also noteworthy is that a higher percentage of insurance-only supervisors are part of a ministry of finance than other type. For the purposes of this analysis, agencies are classified into five types: bank-only supervisors, insurance-only supervisors, securities-only supervisors, consolidated supervisory agencies that are responsible for supervision of all three industries, and integrated supervisors who are responsible for two of the three (banking and insurance, banking and securities, or insurance and securities). As Figure 2 shows, most agencies are separate stand-alone agencies followed by a significant number that are housed within a central bank. In North America, a larger share (25 percent of respondents) are housed within ministries of finance than in other parts of the world.

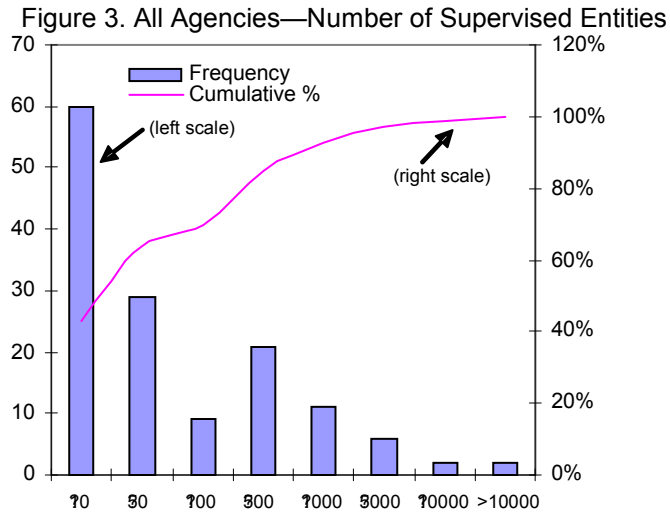
Figure 2. Location of Agencies by Type



Financial sector supervisory agencies tend to fall at both ends of the age spectrum. Slightly more than half the agencies have been in existence for less than 20 years, while 27 percent have been operating for more than 40 years. Most of the agencies (64 percent) supervise less than 50 financial institutions, although the dispersion across supervisors is quite great (Figure 3). Securities-only and consolidated supervisors report having the largest number of firms to supervise. Given the correlation between financial market depth and stage of development, supervisors with the largest number of supervised entities tend to be located in high income countries.

### B. Independence

Independence of a financial sector supervisor is one of the major factors affecting the effectiveness of supervision. Because the supervisory body is part of the government, its broad policy direction will be that of the government. Therefore, for the purpose of the survey, independence is defined as the ability of the agency to carry out its operations without undue political or commercial interference. Rather than undue political independence, the focus here is on operational independence.



Most supervisors that are separate agencies (77 percent) indicated that the legal basis for their existence also makes clear their operational independence within the government on matters of financial sector supervision. Moreover, where financial sector supervision activities are housed in the central bank, the central bank law or other laws recognize the operational independence of the central bank with regards to *financial sector supervision*. Most supervisors housed in a ministry reported that they are operationally independent.

The findings with respect to independence when it comes to *regulation* are less compelling. Only 58 percent of stand-alone supervisory agencies have operational independence when it comes to regulatory activities. This holds fairly consistently across the various types of supervisory agencies, except those located in central banks. Eighty percent of supervisors housed in central banks indicated that they had operational independence when it comes to setting regulatory policy.

#### IV. AGENCY MANDATES

One of the critical governance issues for official bodies is that they have clearly defined mandates. This is equally true for financial sector supervisors and even more important in countries where there is more than one supervisory body.

##### A. Mandates

Virtually all agencies report that the foundation for their existence and their mandates are set in legislation. This holds across types of supervisor and across countries irrespective of development status. Equally notable is the commonality in mandates across agency types. Virtually all of the agencies listed the following as mandates:

- Oversight and supervision of the financial sector and institutions;
- Ensuring compliance with regulations;

- Developing regulations<sup>5</sup>;
- Prevention of financial crimes, and
- Protection from market misconduct and/or bad business practices.

In addition, 90 percent of banking-only supervisors and about two-thirds of consolidated supervisors also listed *monitoring systemic risks and maintaining financial stability* as mandates. What is noteworthy is that this mandate was not confined to bank supervisors inside central banks, but also held for agencies with bank supervisory responsibilities located within a ministry or those that are separate agencies. Insurance and securities supervisors did not as commonly see financial stability and systemic risk as mandates.

### **B. Avoiding Overlap and Conflict Resolution**

Having a strong legislative framework in place seems to have prevented unnecessary regulatory overlap in most countries. More than two-thirds of the supervisory agencies reported that they are able to refer to legislation and most of the others to MOUs to determine how to allocate responsibilities with other agencies that also supervise the same financial entities.

The existence of more than one supervisory agency in a country will invariably lead to inter-agency disagreements that need to be resolved. Two-thirds of the agencies rely on ad hoc meetings between the agencies and/or coordination committees to resolve these inter-agency conflicts. In North America and Europe, interlocking directorships among supervisory agencies are more common and help avoid conflicts.

## **V. HOW ARE FINANCIAL SECTOR SUPERVISORS GOVERNED?**

Within the supervisory community, there are a number of governance models, including a board of directors, an independent agency head, and ministerial responsibility for the governance of the agency. Aside from statutory mandates and independence, the governance structure can be critical to the effectiveness of the supervisory body. While there is no clear empirical evidence as to which framework is superior, it is interesting to see the evolution towards reliance on boards of directors and the roles of the board vis-à-vis the chief executive of the agency.

### **A. Structure of the Governing Body**

About 60 percent of all financial sector supervisory agencies are governed by a board of directors or a supervisory council. This is the case for banking and insurance supervisors, as well as for consolidated and integrated agencies. Unitary securities supervisors tend to be

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<sup>5</sup> While most agencies reported that developing regulations is a mandate, as noted above, 42 percent of respondents reported that they lacked independence to issue regulations.

about equally divided in having their policy direction set by boards, agency heads, or ministers.

**Functions.** Most of the agencies (70 percent or more, depending on type) indicated that the following were the top three functions of their governing body:

- Setting and overseeing the agency’s strategic direction;
- Establishing regulatory and supervisory policies; and
- Approving/ratifying major supervisory interventions, including sanctions and license revocations.

**CEO.** Consistent with good governance practice, many agencies that are governed by boards leave the management of the agency’s operations to a CEO. In a slight majority of the agencies with a board or supervisory council, the chairman of the board is the CEO of the agency. This is most prevalent among unitary bank and securities supervisors and less so for insurance, consolidated, and integrated supervisors.

**Full-time vs. part-time.** Most of the agencies with boards of directors have a combination of outside/part-time and full-time directors. This practice is most prevalent among insurance supervisors. Typically, other government agencies or ministries are not represented on the board, especially in Europe. In Africa, it is more common for representatives from ministries or other government agencies to sit on the board of financial sector supervisors.

## **B. Appointment of Members to Governing Bodies**

In virtually all countries, the process for the appointment of members to the governing body of a financial sector supervisory agency is spelled out in legislation. Typically the legislation will include requirements for legislative confirmation of appointees, skill or education requirements, length of term, and grounds for dismissal.

**Legislative confirmation.** In most countries, the head of government appoints the members of governing bodies, and for 65 percent of the agencies these appointments are made *without* a requirement for legislative confirmation. The notable exceptions are supervisors in North America where legislative confirmation is required. It is also interesting to note that more banking-only supervisors (45 percent) than other types of agencies require confirmation of appointments.

**Skill requirements.** In the majority of countries (60 percent) there is a skill requirement for appointment to the governing body of a financial sector supervisor. However, less than one-third of the agencies indicated a requirement to have a balance of skills among members of the board.

**Industry representation.** While most agencies (73 percent) do not have industry representatives on their boards, in the case of the boards of insurance-only supervisors, 44 percent have industry representatives.

**Terms of office.** The vast majority (82 percent) of the agencies have their governing body appointed for a *fixed term*. The most common term is six years, followed by four years; this holds for all agency types and across all regions. Where there are multiple members of the governing body, most agencies, with the notable exception of insurance-only supervisors (81 percent) and consolidated supervisors (68 percent), *stagger the terms* of board members.

### C. Legal Protection for Supervisors

Legal protection for supervisors for actions taken in good faith in the course of performing their duties is a critical measure for effective financial sector supervision. The fear of suits brought by regulated entities against supervisors in their personal capacity would have a chilling effect on their willingness to take appropriate supervisory measures. This has been recognized by the standard setters for banking, insurance, and securities supervision and they have included legal protection as a key element in their core principles for effective supervision.

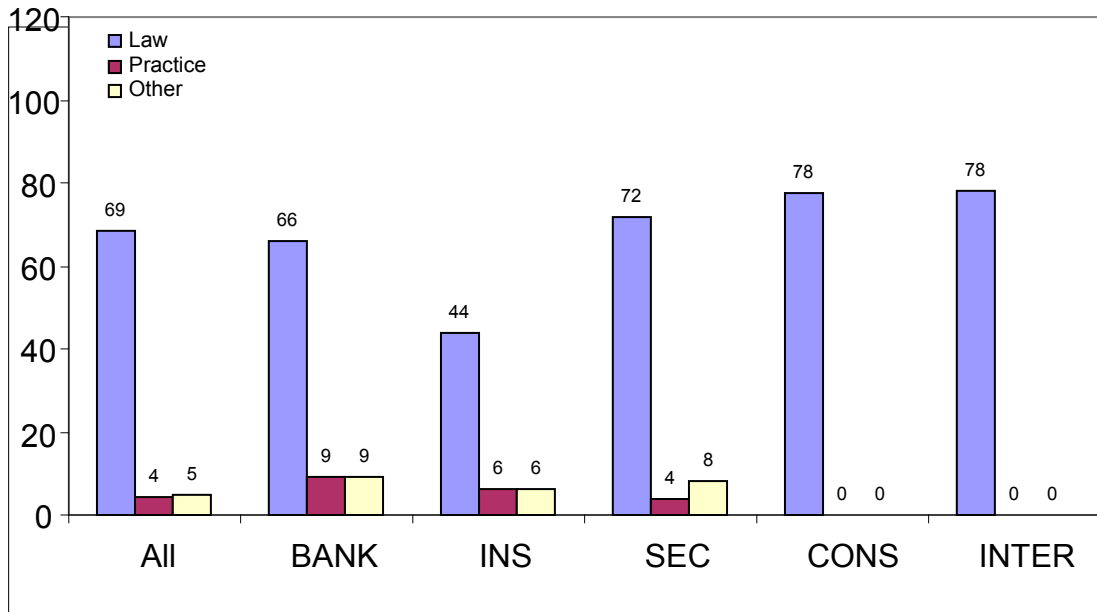
As Figure 4 shows, most financial sector supervisors have legal protection for acts taken in good faith in the course of performing their duties. With the notable exception of insurance supervisors, more than two-thirds report that this protection is afforded by law.

*A major weakness in the legal protection regimes for supervisors is that most supervisors do not believe that this protection carries over after they leave office.* Recent frivolous suits against former agency heads have resulted in either ad hoc decisions to provide such coverage ex post on a case-by-case basis or in the supervisors incurring legal expenses.

### D. Termination of Governing Body Members

More than 70 percent of agencies indicated that the grounds for the termination of a member of the governing body, prior to the end of the term of appointment, are spelled out in law. The notable exceptions are in North America, where the more general rules applicable to all political appointees apply. The leading grounds for dismissal, in order of highest frequency are: gross misconduct, incapacity, bankruptcy (though this is less important in Europe), and ministerial discretion (this is a significant criterion in Latin American countries). Eighty four percent of agencies indicated that members of governing bodies did not have to resign upon a change in government.

Figure 4. Legal Protection by Type of Institution  
(In percent)



## VI. RESOURCES AND AGENCY MANAGEMENT

### A. Funding

A critical factor for both the independence of a supervisory agency and its effectiveness is whether it can determine its budget and funding allocations. Almost 60 percent of all financial sector supervisors indicated that they had this capability. Just under 70 percent of all banking-only and insurance-only supervisors could determine their budgets, but slightly less than half of integrated supervisors had budget autonomy.

#### Sources of Funding

**Central Banks.** The most important source of funding for financial sector supervisors is central bank funds. Ninety percent of agencies housed in central banks are primarily funded by their central banks. Moreover, central bank funds are frequently used to cover the costs of financial sector supervisory agencies located outside the central bank.

**Fees.** The second major source of funding for agencies derives from the fees imposed on regulated entities. It is interesting to note the disparity in reliance on this source of funds across financial sector participants. About 76 percent of insurance-only and securities-only supervisors receive funding from fees. However, only 35 percent of bank-only supervisors are reliant (for over 30 percent of their funding) on fee income, perhaps because a significant number of these supervisors are housed in central banks. The fact that supervisors housed in central banks are less reliant on fee income is supported by the fact that only about 30 percent of all types of supervisors, other than bank-only, that are housed in central banks

receive 30 percent or more of their funding from fees. However, a much higher percentage located outside central banks depend on fee income.

***Allocations from the central government.*** Slightly more than a quarter of the agencies receive allocations from their central government. Forty five percent of securities regulators indicate that government appropriations are their second most important source of funding. One-fourth of insurance regulators receive funding from the government budget, while only 8 percent of bank supervisors receive on government funding.

### **Fee setting**

For those agencies that use fees as a source of revenue, half report that fees charged are set in legislation. Most of the rest (36 percent) set fees by regulation, though some of these have to consult with a ministry. Supervisors in North America and Africa consult with the industry when setting fees more often than those in other countries. Insurance supervisors, in particular, consult with the industry when setting fees.

## **B. Budget Authority and Compensation**

With the exception of integrated supervisors, the majority of agencies report that they have de facto authority to determine their final budgets and allocations. This relationship holds geographically, with the notable exception of Latin American countries where it is more common for supervisors not to have budgetary independence.

Given that the quality of financial sector supervision is heavily dependent on the ability of agencies to attract and retain sufficient qualified staff, the ability to determine salaries and staffing levels is critical. Most financial sector supervisors report that, as part of their budgetary independence, they have the authority to make salary and staffing decisions. Specifically survey respondents indicated that they have the authority to:

- Decide on staffing levels (68 percent);
- Take hiring decisions (79 percent);
- Set salary levels and structure (56 percent); and
- Establish benefits structures for their employees (60 percent).

The notable exceptions are that less than half of integrated and insurance-only supervisors could set salary levels. By contrast, about two-thirds of the other types of supervisors could set salaries for their staff (Table 1).



Table 1. Ability to Set Salary Level and Structure

(In percent)

|              |      |
|--------------|------|
| Banking      | 65.9 |
| Insurance    | 31.3 |
| Securities   | 68.0 |
| Consolidated | 66.7 |
| Integrated   | 43.8 |

It is interesting to note that a majority of all respondents indicated that their pay scales and benefits are: (i) *higher* than that of the general government; (ii) the *same* as the central bank's; and (iii) *lower* than the private sector. It is particularly notable that half of insurance-only respondents, however, indicated that their pay was the same as the government's and 69 percent indicated that their supervisors' salaries were lower than the central bank's. A slight majority of supervisors in transition economies reported that their pay scales and benefits were the same as that for all government employees.

### C. Code of Conduct

Almost 90 percent of all financial sector supervisors reported having a code or rules of conduct for their governing bodies, management, and staff. This practice is universal and holds across countries, regardless of region or development stage. The codes are promoted, monitored, and enforced most commonly through a combination of employee training, use of internal audits, financial disclosure reporting, and conflicts of interest reporting. The majority of agencies require annual financial disclosure reporting, whereas the reporting of conflicts of interest is not subject to fixed periodic time frames.

A concern frequently raised in the literature relating to governance practices at regulatory agencies is the practice of senior officials leaving the agency and taking positions with firms they regulated or supervised. This issue of the revolving door nature of appointments to governing bodies and senior management at regulatory agencies has been addressed by the adoption of "cooling-off" periods. Nonetheless, slightly less than half of all agencies have cooling-off periods for their governing bodies and managements. More than half of banking-only and consolidated supervisors have adopted this practice, while it is least common among securities and insurance supervisors. This practice is most common in Europe and North America and least common in Africa and Latin America.

## VII. ACCOUNTABILITY AND TRANSPARENCY TO STAKEHOLDERS

### A. Accountability

Most agencies report that they are accountable to their parliament/congress and or the minister of finance/economics. The primary requirement for accountability stems from legislation. Accountability requires that the supervisory agency be held accountable by someone representing the public for actions taken by the agency. Typically this entails a process whereby the agency reports on its policy actions, the use of funds under its control,

its performance in achieving its policy objectives, and significant actions taken in carrying out its mandate. Some agencies also use these reports as an opportunity to report their views on developments in the regulated sector.

The arrangements that are used most commonly by financial sector supervisory bodies to account for their performance are annual reports and annual and ad hoc meetings. Many consolidated supervisors reported that while they hold annual meetings with their president or parliament, they also hold quarterly meetings with a minister. Most other supervisors reported these latter meetings as ad hoc occurrences.

## **B. Financial Statements**

Most agencies prepare their financial statements following national accounting standards (39 percent), International Financial Reporting Standards (IFRS) (35 percent), or government accounting standards applicable to government agencies. Twenty three percent of bank supervisors, significantly more than other regulators, use accounting policies established by their own governing body or management. The use of IFRS is most prevalent among agencies in countries in the Middle East and Africa.

## **C. Rulemaking and Appeals of Agency Decisions**

Over 90 percent of all agencies responded that they *always or usually* consulted supervised entities and/or other interested parties on issues related to the formulation of policy rules and regulations. In response to a question as to whether this was required “under legislation, regulation, or MOU” the majority of those who answered indicated that it was a legislative requirement.

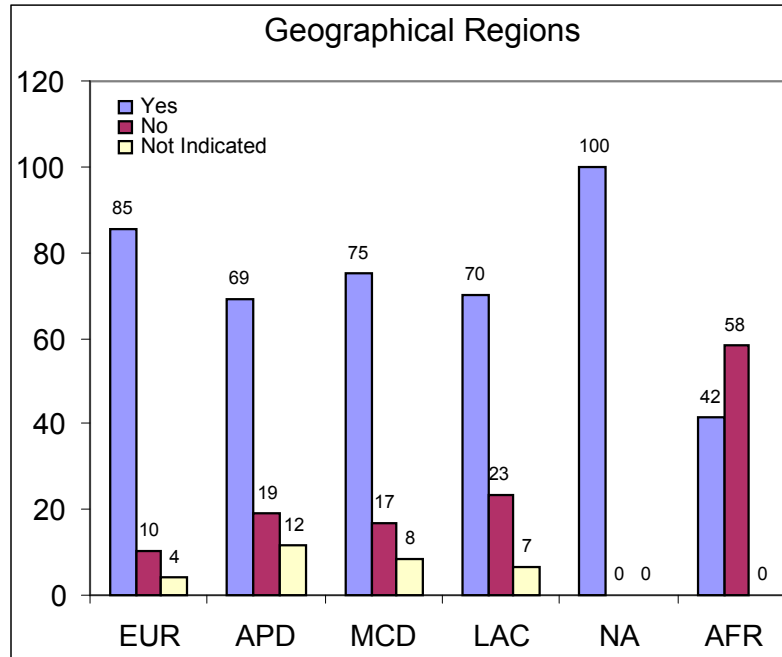
The ability of parties to appeal the decisions or rulemaking of financial sector supervisors is well established in legislation, with both the basis and time limit for an appeal specified. Agencies report clearly defined processes that call for agency reconsideration, administrative court review, or full judicial review. The survey distinguished between appeals by the industry of agency rulemaking and appeals by individual institutions of supervisory actions.

In the event that the regulated industry does not agree with the agency’s decision or rulemaking, they have the ability to appeal the decision. The majority of agencies indicated that there is a clear process for appeal. Almost two-thirds of the agencies have internal review processes that allow for review of an appeal by the governing body and 54 percent have processes in place whereby an administrative court will review an agency decision that is appealed by the industry. Judicial reviews are least common in low-income countries.

In the case where an individual financial institution appeals a supervisory/ enforcement decision, agencies indicated that these decisions will be reviewed by the agency (66 percent), an administrative court (59 percent), and/or a civil court (51 percent). The use of administrative courts is more common in Europe and North America than elsewhere.

Three-fourths of the agencies indicated that they can continue to take supervisory actions pending an appeal. That said, there is a disparity across regions, with only a minority of African supervisors reporting that they can act pending an appeal (Figure 5).

Figure 5. Supervisors' Ability to Take Actions Pending Appeal  
(In percent)



Fifty-six percent of the supervisors reported that courts can perform their own assessment of the appropriateness of supervisory judgments and are not constrained to only reviewing whether the supervisor had followed proper procedures. This was noted more prevalently by insurance-only, securities-only, and consolidated supervisors but also by a significant number of bank-only and integrated supervisors.

#### D. Independent Review

About half of the responding agencies indicated that have in place an independent review mechanism to assure quality control over their operations and activities and this is either mandated in legislation or is done by practice, convention, or informal arrangement. While this practice crosses all types of supervisory organization structures, there are regional differences. Requirements for such reviews are less common in countries in Latin America and the Middle East and Central Asia.

## External Audits

Annual audits of financial statements are done for 81 percent of all agencies and are performed equally by private audit firms and government auditors. In addition, about 39 percent of all financial sector supervisors have annual audits of their operations, though these are primarily conducted by government auditors. Interestingly, a higher proportion of consolidated and integrated agencies have operational audits. Annual operational audits are most prevalent in countries in Asia and Africa.

A slight majority (56 percent) of agencies' audits are guided by the International Standards on Auditing (ISA), while 42 percent of the agencies' auditors used either national professional standards or government audit standards. Reliance on government auditing standards was most pronounced in North America, whereas ISA was the most commonly used standard to guide auditors in the rest of the world.

## Internal Review Mechanisms

The vast majority of all agencies (79 percent) indicated that they rely on their internal audit function as the internal review mechanism to review internal and external control requirements. The second most important internal review mechanism was the audit committee of the governing body (40 percent of agencies cited this) and one-third of the agencies accorded it high importance as a review mechanism. These findings were consistent across regions and stages of economic development. Securities regulators appeared to rely less on internal review mechanisms than other financial sector supervisors.

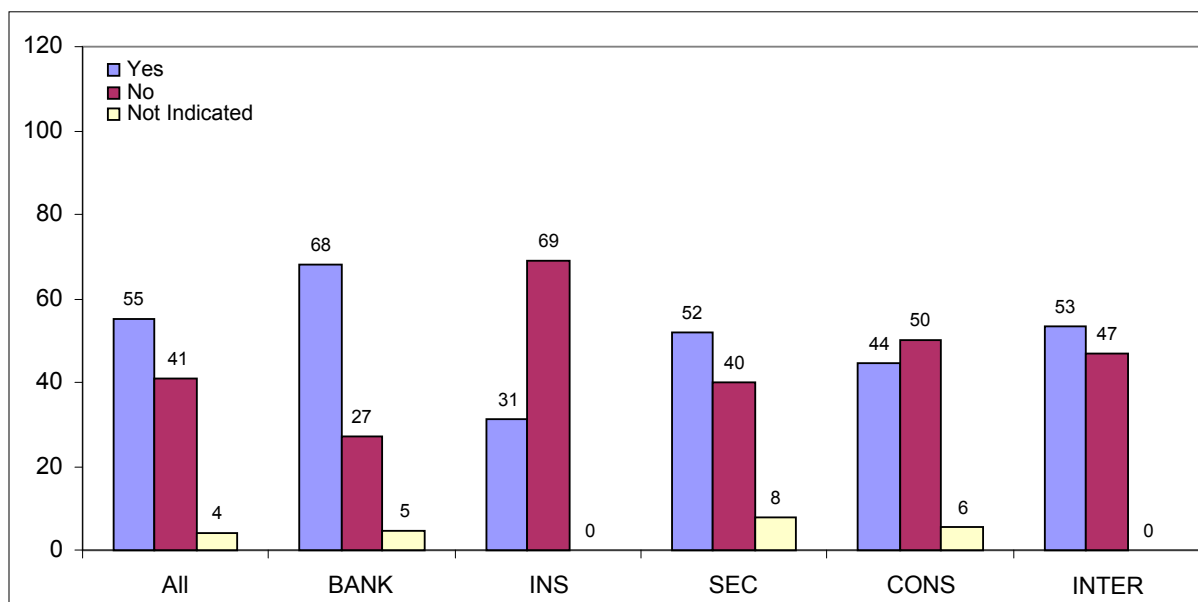
Those agencies that have an internal audit function reported that the function:

- Has access to *all* areas of operations (78 percent);
- Reviews the effectiveness of management and internal controls (73 percent);
- Has a direct reporting line to the audit committee (60 percent);
- Generally does *not* report to top management, with the exception of insurance-only supervisors where 44 percent report to top management compared to 16 percent for all agencies; and
- About half of internal auditors also report to the government ministry responsible for state audits.

## Benchmarking and performance reviews

The majority of all supervisors, except for insurance-only supervisors, have in place a *periodic internal benchmarking* or performance review process (Figure 6). This is the case across all regions except Latin America where 65 percent of the agencies reported that they did not have such a process in place.

Figure 6. Periodic Internal Benchmarking—Per Type of Institution  
(In percent)



However, only 46 percent of all financial supervisors indicated that the periodic benchmarking of their regulatory/supervisory functions was undertaken by external experts or peers (Figure 7). Bank and insurance-only supervisors make the most use of external reviews, while securities-only supervisors have the lowest usage rate. Regionally, countries in Asia showed the lowest number of agencies (33 percent) having external reviews.

## VIII. AGENCY COMMUNICATION WITH THE PUBLIC

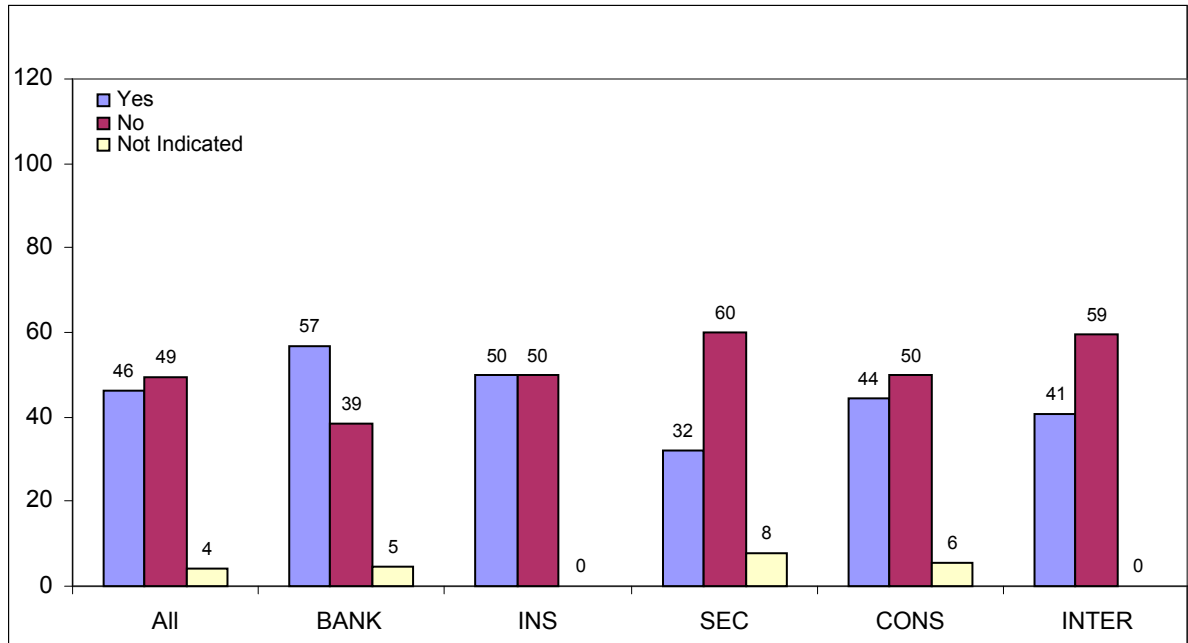
Communication with the public is an important aspect of governance for public institutions. For financial sector regulators/supervisors it is critical that the public, directly and through elected officials, understand the missions of the agencies as well as their role in assuring the stability of the financial system. Also, given that these agencies regulate private sector activities, the survey also examined the use of regulatory impact analysis by the agencies, as well as their policies for the disclosure of supervisory sanctions and confidential data.

### A. Communications with the Public

Most agencies rely on the media or a combination of communication techniques that include publications, outreach, and the media to make available to the public information about their organization and objectives as well as their governance structure. Agencies tend to use the same approaches to communicate their performance objectives and any major new policies and initiatives.

Figure 7. Periodic External Benchmarking—Per Type of Institution

(In percent)



Consolidated supervisors rely more on the media as a communications tool than other agency types. This is particularly the case when these agencies wish to communicate new policies or organizational framework/governance structure changes. By contrast, securities commissions overall rely more on publications as the preferred vehicle for communicating with the public. Banking-only supervisors seem to use publications as the primary vehicle for reporting on their performance and budget/annual work plan.

The majority of agencies (69 percent) have a public information service/communications office to communicate with the public or to facilitate contact with the supervisors. However, it is notable that 61 percent of all agencies do *not* have toll-free telephone lines for the public to use in contacting them. Rather, this seems to be a North American phenomenon where 83 percent of the agencies reported having such facilities. This finding probably reflects the general widespread use of toll-free numbers in North America and their relative scarcity elsewhere. The vast majority of agencies use their website and e-mails to facilitate public contact with them.

About half of all agencies (51 percent) have complaint bureaus or ombudsmen. However, they are least common at bank-only supervisors (35 percent) and at supervisory agencies in Africa (42 percent).

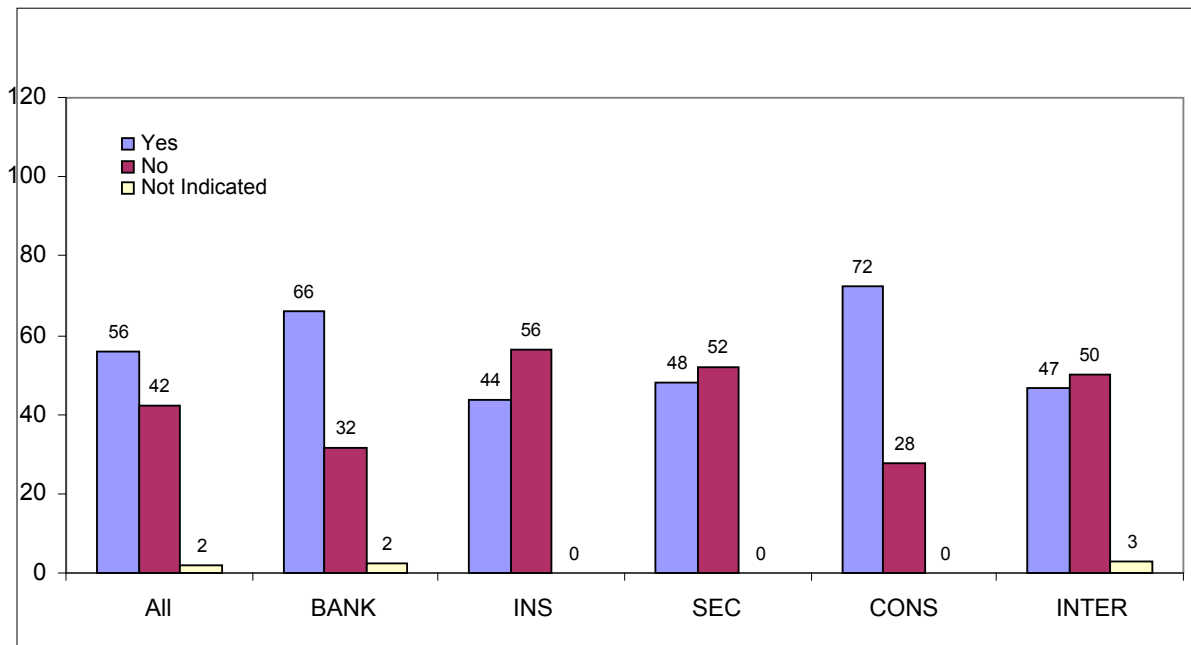
## B. Regulatory Impact Analysis

A slight majority (55 percent) of supervisors prepare a regulatory impact or cost benefit analysis when implementing rules, policies, or standards. As Figure 8 shows, insurance-only supervisors are less likely than others to undertake this analysis. What is more noteworthy is that a clear majority of bank-only and consolidated supervisory agencies perform this analysis without there being a legal requirement that they do so.

Informing the public and legislators of the results of a regulatory impact analysis is a way to solicit feedback on regulations from the public, regulators and legislators. This process ensures that the proper balance is considered between the protective benefits of regulation and the burdens that such regulations may impose on firms and the market. However, the majority of agencies do not publish their regulatory impact analyses. Moreover, with the exception of supervisors in North America, when they publish final rules and regulations, most supervisory bodies do not include an account of how they responded to comments received from the public.

Figure 8. Preparation of Regulatory Impact Assessments—Per Type of Institution

(In percent)



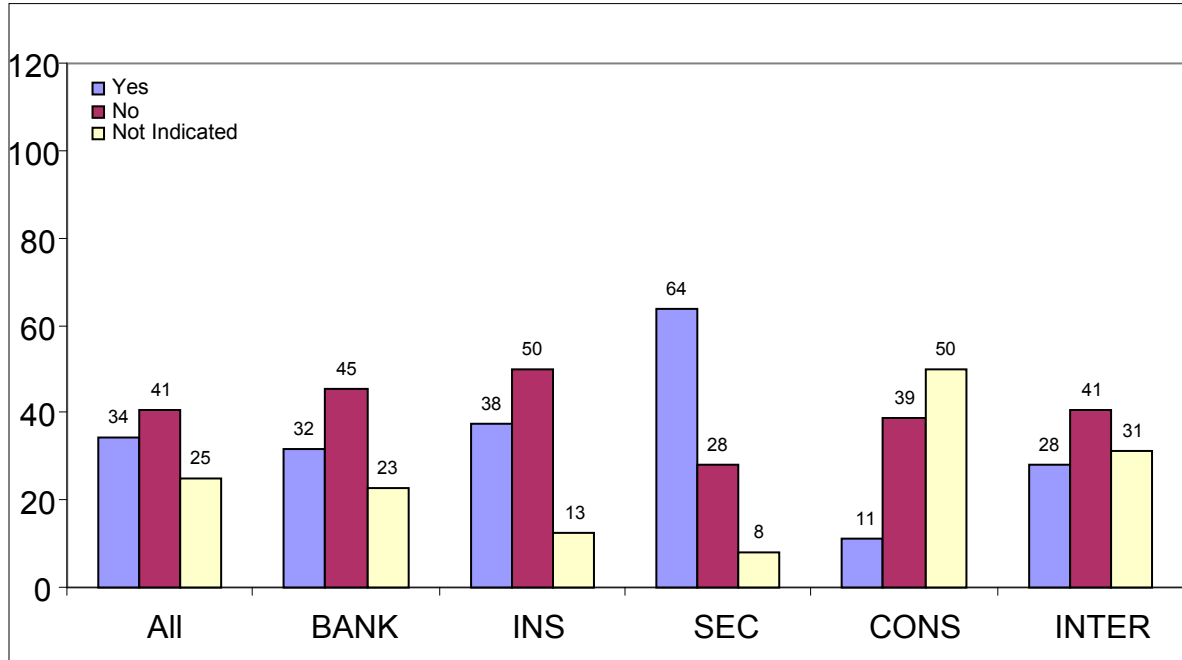
## C. Supervisory Sanctions

The vast majority of all agencies (81 percent) are required to issue written reasons for imposing regulatory or supervisory sanctions. This holds across all agency types and across all regions. However, most supervisory agencies, with the exception of securities regulators, do not release sanction decisions to the public (Figure 9). That said, it is noteworthy that transparency regarding sanctions is greater in emerging market and transition economies.

Less than a quarter of the agencies indicate that the basis for making an exception to requirements for disclosure is clearly spelled out in their rules.

Figure 9. Release of Sanction Decisions

(In percent)



#### D. Confidentiality of Information

Virtually all of the agencies had rules and policies governing the protection of confidential information and these rules were mandated by legislation. However, the vast majority of these agencies could share information with other domestic and international governmental entities, including criminal and tax authorities.

#### IX. ARE THERE DIFFERENCES BETWEEN BANK SUPERVISORS THAT ARE IN THE CENTRAL BANK AND THOSE OUTSIDE?

Of the 140 agencies responding to the governance survey, 84 have some responsibility for bank supervision. The agencies can be classified as banking-only supervisors, consolidated (FSA) agencies, and integrated agencies that have responsibility for two industries within the financial sector (banking and securities or insurance). Forty four agencies reported that they



were banking-only supervisors and of these 24 were housed in central banks.<sup>6</sup> Among the survey respondents were 18 consolidated supervisors and 18 integrated supervisors with responsibility for bank supervision.

As a result of the recent financial crisis, the role of central banks in supervision is being reconsidered. Clearly, central banks, both as lenders of last resort and monitors of financial stability, need access to timely data and supervisory information about banks and possibly other financial firms. While the governance survey made no attempt to explicitly address whether this need is being met, some of the governance differences between bank supervisors within central banks and those outside are evident.

Bank supervisors, in general, view financial stability as a clear mandate. Both bank supervisors housed in central banks (including consolidated and integrated supervisors) and those outside the central bank appear to view financial stability and systemic risk as mandates. However, among the minority of bank supervisors (mostly consolidated or integrated agencies) who do not see these as mandates almost all are outside the central bank.

The major differences between bank supervisors inside central banks and those that are either unitary supervisors outside the central bank or are integrated and consolidated agencies housed outside the central bank are:

- **Funding.** Surprisingly, the resources of central banks are used not only to finance the activities of supervisors housed within central banks but also in some countries to fund bank supervision outside the central bank.
- **Fee setting.** A slightly higher percentage of consolidated and integrated bank supervisors indicated that they need to consult with a ministry and with the industry when setting fees to be charged to banks.
- **Compensation.** Supervisors inside the central bank are paid at or above the central bank pay scale, which is higher than the civil service scale. Similarly, most stand-alone bank supervisors are paid salaries that are the same as the central bank employees. A larger percentage of bank supervisors in consolidated and integrated agencies outside the central bank are paid salaries that are lower than those of the central bank.
- **Ability to take action.** A higher percentage (95 percent) of bank supervisors who are stand-alone and are *outside* the central bank report that they can continue with a supervisory action while it is under appeal. One-fourth of central bank supervisors report that their actions are stayed pending a court decision.

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<sup>6</sup> In addition, four consolidated supervisors and 10 integrated supervisors are also housed in central banks.

- **Financial reporting.** A higher percentage of supervisors in central banks prepare their financial reports following international financial reporting standards. This reflects the accounting practices of central banks relative to that of other government agencies that are more likely to follow national or government accounting standards.

## X. CONCLUDING COMMENTS

Given the experience with the recent global financial crisis, it is clear that all financial sector supervisors need to see broader financial stability as part of their mandate. Also, regardless of the governance structure chosen, there is a need for greater cooperation and information sharing among supervisors. It is critical, however, that several weaknesses in the governance framework be addressed. These relate to the independence of insurance supervisors, necessary enhancements to the legal protection afforded to all supervisors, and a clarification of the role of courts in the supervisory process.

Insurance supervisors appear to be less independent than other types of supervisors. Less than half of insurance supervisors have the ability to set salary levels for their staff. Moreover, they are more dependent on fees than most other supervisory types. Given that they are more likely than their peers to have industry representatives on their governing body, their independence from the industry they supervise is more likely to be compromised.

While the supervisory standard setters have all made legal protection of supervision staff a key principle for effective supervision, it is evident that there is a flaw in the existing regime in many countries. Specifically, most supervisors do not believe that their current protection for actions they take while in office will continue after they leave office. The ability of parties to sue a supervisor after he or she is out of office can serve as a chilling deterrent to supervisors taking certain actions, such as revoking a license. Moreover, a significant number of insurance supervisors reported that they were not afforded legal protection by the laws of their country.

Most agencies also reported clear processes for institutions to appeal both rulemaking and supervisory determinations. In 75 percent of the cases, these processes do not hinder the ability of the supervisor to take necessary actions. However, more than half the agencies reported that the courts have the right to go beyond interpreting the law to de novo reviewing supervisory judgment. The appropriateness of courts going beyond legal issues and substituting its supervisory judgment for that of the supervisor is potentially a dangerous practice and one that invites delay in supervisory action.

**APPENDIX. PARTICIPATING SURVEYED REGULATORY AND SUPERVISORY AGENCIES**

| <b>AGENCY</b>   | <b>COUNTRY</b>           |
|---|--------------------------|
| Albanian Financial Supervisory Authority                    | Albania                  |
| National Bank of Angola                                     | Angola                   |
| Banco Central de la República Argentina                     | Argentina                |
| Superintendencia de Seguros                                 | Argentina                |
| Australian Securities & Investments Commission              | Australia                |
| Australian Prudential Regulation Authority                  | Australia                |
| Austrian Financial Market Authority                         | Austria                  |
| The Central Bank of The Bahamas                             | Bahamas, The             |
| Central Bank of Barbados                                    | Barbados                 |
| The Securities Commission                                   | Barbados                 |
| National Bank of the Republic of Belarus                    | Belarus                  |
| Banking Finance and Insurance Commission                    | Belgium                  |
| Office of the Supervisor of Insurance                       | Belize                   |
| Royal Monetary Authority of Bhutan - Financial Institutions | Bhutan                   |
| Bank of Botswana  | Botswana                 |
| Banco Central do Brasil                                     | Brazil                   |
| Bulgarian National Bank -Financial Supervision Commission   | Bulgaria                 |
| Financial Supervision Commission                            | Bulgaria                 |
| Commission Bancaire de L'Afrique Centrale                   | Cameroon                 |
| British Columbia Securities Commission                      | Canada                   |
| Ontario Securities Commission                               | Canada                   |
| Autorite des marches financières du Québec                  | Canada                   |
| Office of the Sup of Financial Institutions                 | Canada                   |
| Commission Bancaire de L'Afrique Centrale                   | Central African Republic |
| Commission Bancaire de L'Afrique Centrale                   | Chad                     |
| Superintendencia de Valores y Seguros                       | Chile                    |
| The China Banking Regulatory Commission                     | China                    |
| China Insurance Regulatory Commission                       | China                    |
| China Securities Regulatory Commission                      | China                    |
| Superintendencia Financiera de Colombia                     | Colombia                 |
| Superintendencia General de Valores                         | Costa Rica               |

| AGENCY   | COUNTRY                |
|--|------------------------|
| Central Bank of Cyprus                                       | Cyprus                 |
| Czech National Bank  | Czech Republic         |
| Ministry of Finance & Planning                               | Dominica               |
| Superintendence of Banks                                     | Dominican Republic     |
| Superintendence of Securities                                | Dominican Republic     |
| Commission Bancaire de L'Afrique Centrale                    | Equatorial Guinea      |
| Reserve Bank of Fiji   | Fiji                   |
| Financial Supervision Authority, Finland (Rahoitustarkastus) | Finland                |
| Comite des établissements de crédit (CECEI)                  | France                 |
| Central Bank (Banque de France)- Commission Bancaire         | France                 |
| Autorite de Contrôle des Assurances et Mutuelles- ACAM       | France                 |
| Autorite des marches financiers                              | France                 |
| Commission Bancaire de L'Afrique Centrale                    | Gabon                  |
| National Bank of Georgia                                     | Georgia                |
| Insurance State Supervision Service                          | Georgia                |
| Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)      | Germany                |
| National Insurance Commission                                | Ghana                  |
| Bank of Greece   | Greece                 |
| Hellenic Capital Market Commission                           | Greece                 |
| Eastern Caribbean Central Bank                               | Grenada                |
| Bank of Guyana   | Guyana                 |
| Guyana Association of Securities Co. and Intermediaries Inc. | Guyana                 |
| Comisión Nacional de Bancos y Seguros                        | Honduras               |
| Hungarian Financial Supervisory Authority                    | Hungary                |
| The Financial Supervisory Authority                          | Iceland                |
| Reserve Bank of India  | India                  |
| Bank Indonesia   | Indonesia              |
| BAPEPAM  | Indonesia              |
| The Central Bank of the Islamic Republic of Iran             | Iran, Islamic Republic |
| Financial Regulator of Ireland                               | Ireland                |
| Israel Securities Authority                                  | Israel                 |
| ISVAP-Insurance Supervision                                  | Italy                  |
| Commissione Nazionale per le Società e la Borsa - CONSOB     | Italy                  |

| AGENCY   | COUNTRY                 |
|--|-------------------------|
| Banca d'Italia   | Italy                   |
| Financial Services Commission (Insurance & Securities)   | Jamaica                 |
| Financial Services Agency                                | Japan                   |
| Insurance Commission                                     | Jordan                  |
| Jordan Securities Commission                             | Jordan                  |
| Central Bank of Kenya                                    | Kenya                   |
| Financial Supervisory Service                            | Korea, Republic of      |
| Bank of the Lao PDR                                      | LAO PDR                 |
| Lebanon's Banking Control Commission                     | Lebanon                 |
| Insurance Control Com. - Ministry of Economy and Trade   | Lebanon                 |
| Lithuanian Securities Commission                         | Lithuania               |
| Commissariat aux Assurances                              | Luxembourg              |
| Commission de Surveillance du Secteur Financier          | Luxembourg              |
| National Bank of the Republic of Macedonia               | Macedonia               |
| Securities and Exchange Commission                       | Macedonia               |
| Securities Commission Malaysia                           | Malaysia                |
| Bank Negara Malaysia                                     | Malaysia                |
| Maldives Monetary Authority                              | Maldives                |
| Malta Financial Services Authority                       | Malta                   |
| Mauritius Financial Services Commission                  | Mauritius               |
| Comisión Nacional Bancaria y de Valores                  | Mexico                  |
| BSM Banking Board  | Micronesia, Fed. St. of |
| National Bank of Moldova                                 | Moldova                 |
| Insurance Board  | Nepal                   |
| The Netherlands Authority for the Financial Markets      | Netherlands             |
| Central Bank   | Netherlands Antilles    |
| Securities Commission                                    | New Zealand             |
| State Bank of Pakistan                                   | Pakistan                |
| Financial Institutions Commission                        | Palau                   |
| Superintendency of Banks                                 | Panama                  |
| Comision Nacional de Valores                             | Panama                  |
| Superintendencia de Bancos del Paraguay                  | Paraguay                |
| Banco Central del Paraguay - Superintendencia de Seguros | Paraguay                |

| AGENCY   | COUNTRY                      |
|--|------------------------------|
| Comision Nacional de Valores                             | Paraguay                     |
| Superintendency of Banking, Ins. & Private Pension Funds | Peru                         |
| Securities and Exchange Commission                       | Philippines                  |
| Polish Financial Supervision Authority                   | Poland                       |
| Banco de Portugal  | Portugal                     |
| Comissao do Mercado de Valores Mobiliarios               | Portugal                     |
| Commission Bancaire de L'Afrique Centrale                | Republic of Congo            |
| National Bank of Romania                                 | Romania                      |
| CNVM   | Romania                      |
| Romanian Private Pension Superv. Commission              | Romania                      |
| Banca Centrale Della Repubblica Di San Marino            | San Marino                   |
| Monetary Authority of Singapore (MAS)                    | Singapore                    |
| Banka Slovenije  | Slovenia                     |
| Central Bank of Somalia                                  | Somalia                      |
| Bank Supervision Dep. of the South African Reserve Bank  | South Africa                 |
| Financial Services Board                                 | South Africa                 |
| Banco de España  | Spain                        |
| Dirección General de Seguros y Fondos de Pensiones       | Spain                        |
| Central Bank of Sri Lanka - Bank Supervision Department  | Sri Lanka                    |
| Eastern Caribbean Central Bank                           | St. Kitts and Nevis          |
| Eastern Caribbean Central Bank                           | St. Lucia                    |
| Eastern Caribbean Central Bank                           | St. Vincent & the Grenadines |
| Insurance Supervisory Authority                          | Sudan                        |
| Central Bank of Suriname                                 | Suriname                     |
| Finansinspektionen                                       | Sweden                       |
| Swiss Federal Office of Private Insurance (FOPI)         | Switzerland                  |
| Swiss Federal Banking Commission                         | Switzerland                  |
| Central Bank of Syria - Banking Supervision Department   | Syrian Arab Republic         |
| Bank of Tanzania - Directorate of Banking Supervision    | Tanzania                     |
| Bank of Thailand   | Thailand                     |
| Securities and Exchange Commission                       | Thailand                     |
| Banking & Payments Authority of Timor-Leste              | Timor-Leste                  |
| Central Bank of Trinidad and Tobago                      | Trinidad and Tobago          |

| <b>AGENCY</b>   | <b>COUNTRY</b>       |
|---|----------------------|
| Banking Regulation and Supervisory Agency                   | Turkey               |
| Capital Markets Board                                       | Turkey               |
| Uganda Insurance Commission                                 | Uganda               |
| Capital Markets Authority of Uganda                         | Uganda               |
| Securities & Commodities Authority                          | United Arab Emirates |
| Financial Services Authority                                | United Kingdom       |
| Office of the Comptroller of the Currency (OCC)             | United States        |
| Federal Deposit Insurance Corporation (FDIC)                | United States        |
| National Credit Union Administration (NCUA)                 | United States        |
| Office of Thrift Supervision (OTS)                          | United States        |
| Board of Governors of the Federal Reserve System            | United States        |
| Commodity Futures Trading Commission (CFTC)                 | United States        |
| Office of Federal Housing Enterprise Oversight (OFHEO)      | United States        |
| National Association of Insurance Commissioners (NAIC)      | United States        |
| BCU- Superintendencia de Seguros y Reaseguros               | Uruguay              |
| BCU- Superintendencia de Inst. de Intermediación Financiera | Uruguay              |
| Supervision de Mercados de Capitales                        | Uruguay              |
| Reserve Bank of Zimbabwe                                    | Zimbabwe             |