

Central Bank Governance and Operations in the MECA Region—The Legal Foundations of Oversight Boards

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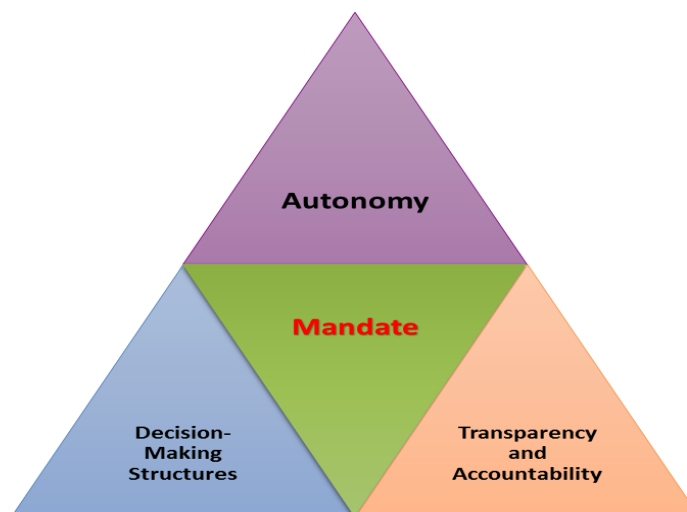
This background paper gives a brief overview of some key legal design variables of Oversight Boards, a cornerstone of central bank governance. The conclusion of this paper is that, while many countries in the region have taken important steps to strengthen their central bank governance legal framework, more can be done in respect of Oversight Boards.

The paper will first briefly introduce the concept of “central bank governance” and next summarize some key legal design variables of Oversight Boards in the MECA region, based upon the analysis of all relevant central bank organic laws.

Central Bank Governance: The Concept

Central Bank Governance consists of four interlinked, key concepts that define who is granted decision-making power and for what objectives, how decisions are taken, and how account is rendered to relevant stakeholders. As such, these concepts focus on (i) the central bank’s mandate, (ii) its decision-making structures, (iii) its autonomy, and (iv) its accountability and transparency (see Figure 1).

Figure 1. Central Bank Governance: Key Concepts



Source: IMF Staff.

The central bank mandate should be backed by a sound *decision-making framework*, providing for a balanced distribution of powers and separation of responsibilities and reporting lines, as needed to establish “checks and balances” and monitor performance and

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compliance. The central bank law will need to allocate responsibilities for executive management, policy formulation, regulatory decision-making and oversight to two or more decision-making bodies of the central bank. In doing so, gaps and overlaps must be avoided.

For central banks to effectively fulfill their mandates, they have to benefit from a significant degree of autonomy. Central banks should be able to formulate and execute their policies without (the perception of) undue influence of political and private interests. Central banks should enjoy financial, institutional, personal, and functional autonomy.

Transparency is pre-requisite to preserve the central bank's autonomy and gain public confidence, credibility, and support. There is an expectation with the political institutions and the general public to periodically obtain information about the policies and activities of the central bank. The central bank law should require the financial statements to be audited and certified before their publication in accordance with international standards on auditing.

A central bank should be *accountable* to the government and the public at large through a transparent framework for the discharge of its mandate. This accountability is a corollary to high levels of autonomy; transparency and accountability should be seen as safeguarding—not undermining—central bank autonomy.² Accountability has an inherent link to transparency and should be facilitated by adequate disclosures of all relevant policy and financial matters.

Strong Oversight Board – Role, Definition and Legal Foundations

Oversight Boards play a central role in ensuring sound governance within central banks.³ Decision-making bodies qualify as Oversight Boards when their central banks' organic laws provide them with oversight response, such as overseeing the executive management of the central bank and formulating its broad internal policies that are conducive to sound governance. These policies pertain mainly to internal controls, audit, financial reporting, human resources practices and risk management. The purpose of this form of oversight is to ensure that the central bank is well-managed.

To be effective tools of good governance, central bank Oversight Boards should have (i) a robustly formulated internal oversight mandate, (ii) a composition in line with sound governance principles, and (iii) effective decision-making procedures.

The key aspects of these tools of good governance all need to be established in the organic law of the central bank. However, more detailed aspects of Oversight Boards (such as the

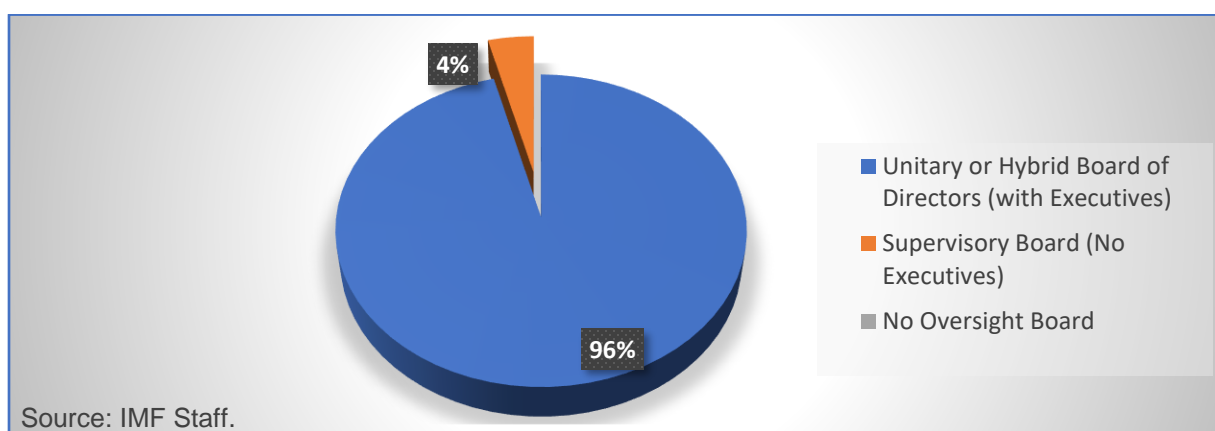
² See Bossu, W., Hagan, S., and Weenink, H., *Safeguarding Central Bank Autonomy: the role of transparency and accountability*, in “ECB Legal Conference 2017—Shaping a New Legal Order for Europe: a tale of crisis and opportunities”.

³ For a broader and deeper introduction to the topic, see Bossu, W., and Rossi, A., *The Role of Board Oversight in Central Bank Governance: Key Legal Design Issues*, IMF, WP/19/293.

charter of the audit committee) are well placed in the by-laws or other secondary legal instruments, as they may contain very lengthy provisions that are subject to rapid changes.

Legal-Institutional Set-up of Central Bank Oversight Boards – Survey of MECA Region

Chart 1: *All central banks of the MECA region have nominally a Board charged with Internal Oversight.*



As demonstrated by the chart, all countries of the MECA region have a central bank law that charges a collegial decision-making body (“board”) of the central bank with the internal oversight task. This could be good news, if those boards are legally well designed. If, in contrast, their legal design has weaknesses, consideration should be given to explore avenues for reform.

In the MECA region, the vast majority (96%) of those Oversight Boards are so-called “unitary boards.” For the purpose of this paper,⁴ boards are defined as “unitary” if it has executives of the central bank serving on it.⁵ Unitary boards need to be distinguished from “supervisory board” structures, which only include non-executives⁶—in the MECA region only one central bank (4%) has a supervisory board-type of structure.

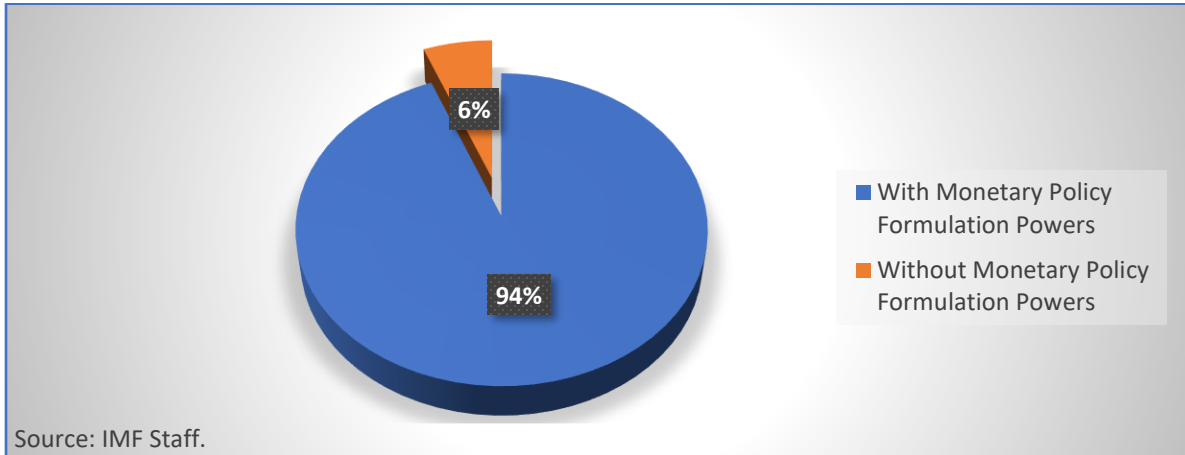
The design of “Unitary Boards” poses distinct legal challenges from a governance perspective. Given the prevalence of these types of Boards in the MECA region, those challenges are the focus of the remainder of this section.

⁴ In fact, the adjective “unitary” refers to the fact that the board is the *only* board in the decision-making structure, as opposed to dual board structures. But for this paper, what matters more is the focus on the fact that such unitary boards should present a right balance between executive and non-executive members.

⁵ There are three types of unitary boards: (1) the ones that are composed only of executives, (2) the ones that have a majority of executives and (3) those that have a majority of non-executives.

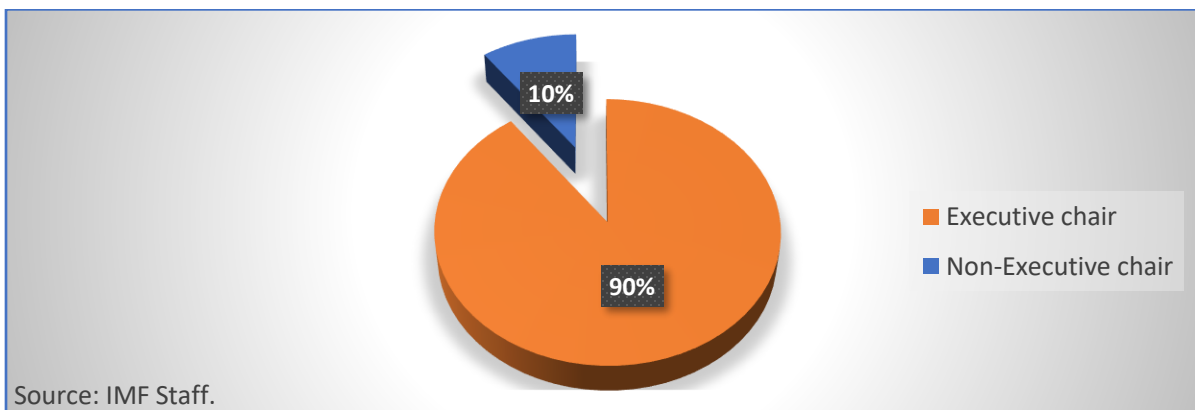
⁶ For more details on this important distinction, see Bossu, W., and Rossi, A., *o.c.*, para. 53 *et seq.*

Chart 2: *In most MECA central banks, the Oversight Board is also charged with monetary policy formulation.*



In the MECA region, almost all (94%) central bank Oversight Boards are also charged with monetary policy formulation. This is a typical institutional design choice, which can be found in many central banks around the world. In other words, the MECA region has not followed a trend among several central banks to establish a specialized decision-making body (“monetary policy committee”) charged with monetary policy formulation only. The relevance for this paper is that from this choice, important governance consequences flow, notably in regard of the composition and chair of the Oversight Boards.

Chart 3: *This explains why almost all of those Boards are chaired by the Governor, the central bank’s chief executive—while this is understandable, it also gives rise to specific governance risks that must be mitigated.*



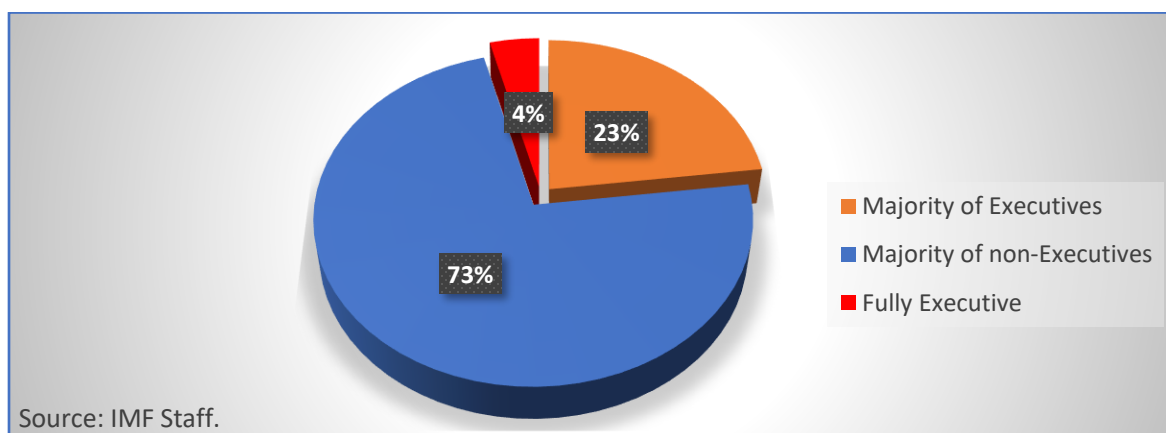
As can be seen from the chart, in the MECA region, 90% of Oversight Boards with a monetary policy formulating task have the chief executive, that is the Governor, as chair. This is understandable from a monetary policy perspective, given that (1) the Governor ensures that internal views are given due regard when the Board formulates monetary policy

and (2) the Governor is the face of the central bank, which allows the central bank to have a unified and clear guidance as to its monetary policy stance to the markets. This said, it is quite interesting that 10% of the region’s central banks have a non-executive chair for this type of boards.

Having an executive chair of Oversight Boards poses specific challenges from a broader good governance perspective.⁷ In the MECA region, often the executive management of the central bank is concentrated in the person of the Governor. In other words, there is not a dual board set-up where, aside from the Oversight Board, a stand-alone Executive Board takes management decisions collegially. If the Governor, in whom executive management decision-making is thus concentrated, then chairs the Oversight Board, the question arises as to the degree of autonomy of that Board from executive management. Such autonomy is a critical component of sound governance.

Chart 4: A significant group of those Boards does not have a non-executive majority—which could be an important mitigating factor. This is a major governance weakness.

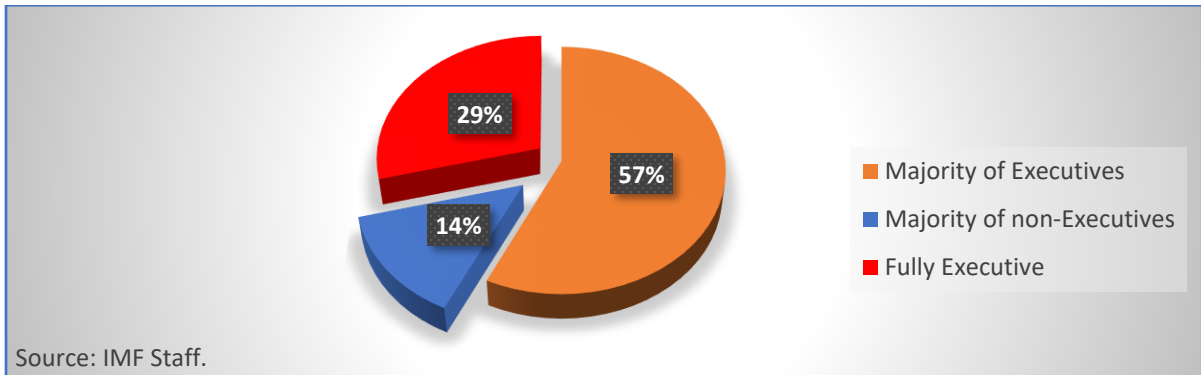
4.1 MECA Countries⁸



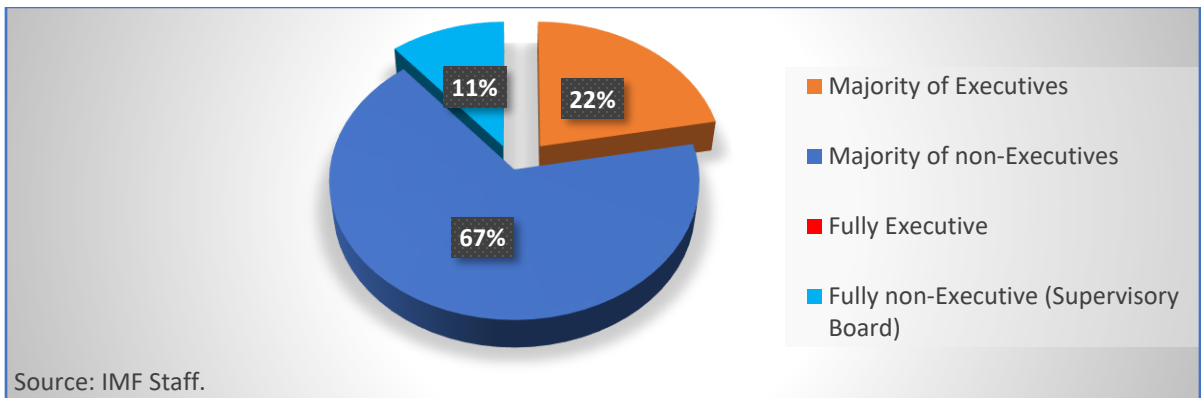
⁷ For more details, see Bossu, W., and Rossi, A., *o.c.*, p. 44-47.

⁸ Turkmenistan is not counted, as the percentage of non-executives serving on the Board is uncertain.

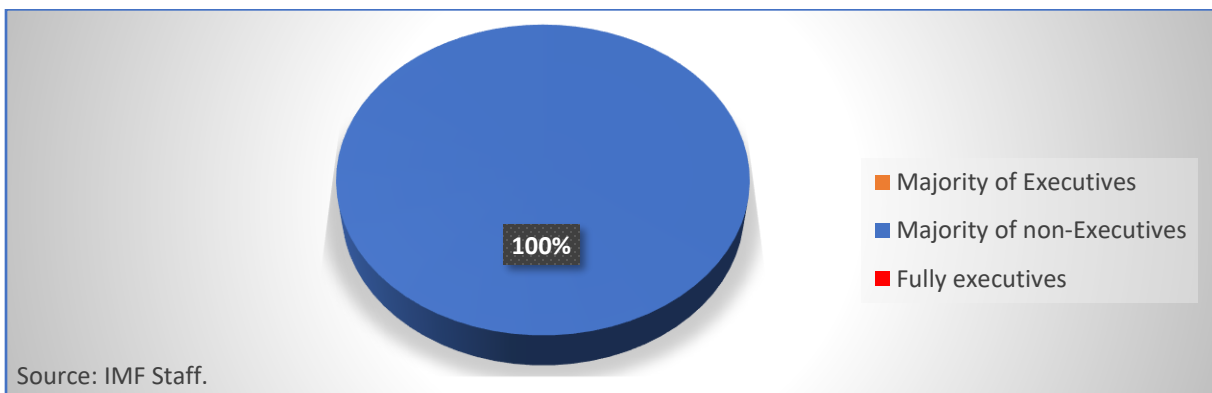
4.2 CCA Countries⁹



4.3 MENA LIC + Conflict¹⁰



4.4 North Africa¹¹

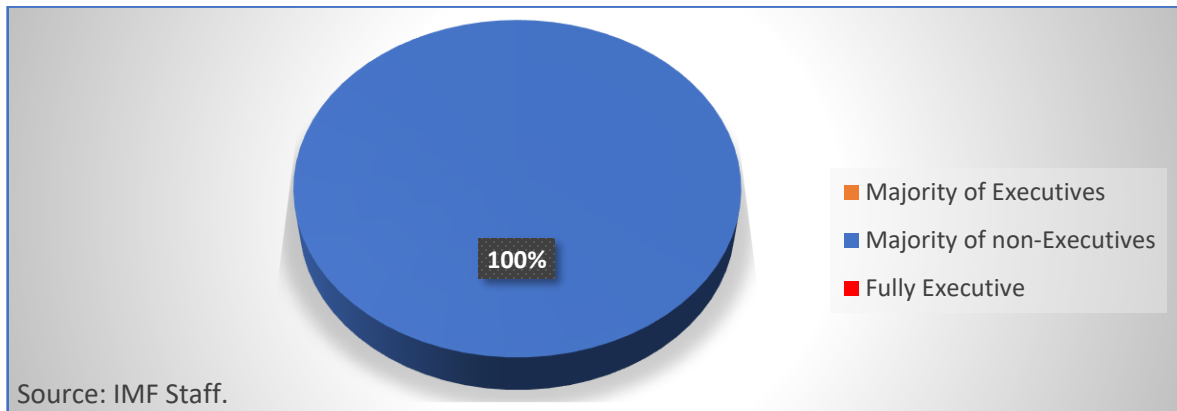


⁹ CCA countries include: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Turkmenistan, Tajikistan and Uzbekistan.

¹⁰ MENA LIC + Conflict consists of Afghanistan, Iran, Iraq, Jordan, Lebanon, Pakistan, Syria, West Bank and Gaza and Yemen.

¹¹ North Africa includes: Algeria, Djibouti, Egypt, Libya, Mauritania, Morocco, Somalia, Sudan and Tunisia.

4.5 Gulf Cooperation Council¹²



With the Governor chairing the Oversight Board, it is imperative that non-executives constitute the majority of the Board, to ensure a sufficient level of Board autonomy from executive management.¹³ (This is a difference with the above-mentioned “monetary policy committees,” which can well have an executive majority.)

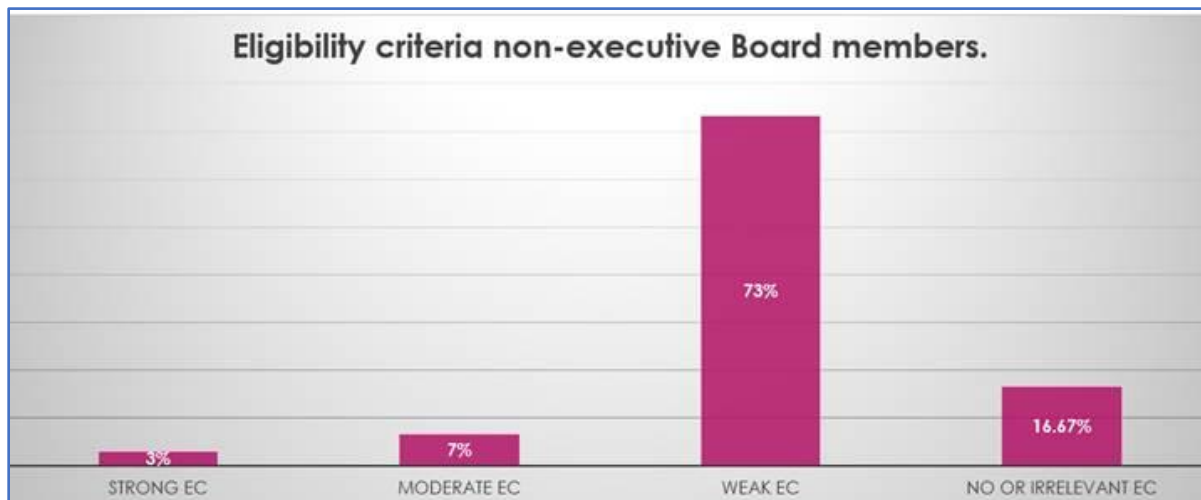
In the MECA region, 73% of central bank Oversight Boards commendably have such a majority, but 27% of central banks lack a non-executive majority in their Oversight Board: either executives have a majority, or the Board is actually entirely composed of executives (i.e. there are no non-executives). In those cases, executive management is basically in control of the internal oversight process, which is a major governance weakness.

However, it is important to note that there are several MECA sub-regions (North-Africa, GCC), where a non-executive Board majority is well established.

¹² The Gulf Cooperation Council includes: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

¹³ Indeed, organic laws, more often than not, establish that decisions of Oversight Boards are to be taken by the majority of members present during the Board meeting with a casting vote attributed to the chair in case of a tie. Hence, having a majority of executives on the Board ensures that, if they all attend the meeting, the concerns of non-executives will not be voiced in the decision adopted by the Oversight Board.

Chart 5: *Moreover, most of those Boards have weak eligibility criteria for their non-executive members, which is another serious governance weakness.*



Source: IMF staff.

In addition to a clear non-executive majority, Oversight Boards require non-executive directors with high professional qualifications so that they can fulfill their oversight tasks well, including by questioning and assessing executive management.¹⁴

Legally, this is achieved by the so-called *eligibility criteria*, which are the positive legal criteria that must be met for a central bank official to be able to be appointed by the appointing authority(ies).¹⁵ As can be seen from the chart, 80% of the MECA region central bank laws have no or weak eligibility criteria.

Conclusion

In conclusion, the legal foundations of many MECA region central bank Oversight Boards feature characteristics that could give rise to significant governance challenges. Given that almost all Oversight Boards in the region are chaired by the Governor—which is explainable given their monetary policy tasks—the central bank laws of those monetary institutions should require a robust non-executive majority of highly qualified nonexecutive directors. In the region, there are still many central banks without such non-executive majority, and

¹⁴ The presence of high caliber professionals on the board with the ability to express dissenting opinions to the ones of the Governor chairing their meetings is necessary. Indeed, Governors are often more informed as to the functioning of their complex institution than the independent directors and are often very well-respected professionals. Hence, it is only reasonable to expect a check on the activities of the Governor and the executives from experienced and independent-minded non-executive directors.

¹⁵ Eligibility criteria must be distinguished from the above-mentioned *incompatibility criteria*, which are the negative legal criteria that must not be met for the said appointment. Such *incompatibility criteria* may also reinforce the integrity of the judgement of the non-executive directors towards the Governor when they *inter alia* foresee that they cannot have a common parent or family member.

eligibility criteria for non-executive directors are often weak. This should be a central attention point of future reforms.

This being said, it is also important to recognize that many countries in the region have taken important steps to modernizing and improving the legal underpinnings of their governance framework. For instance, over the past years, Egypt, Tunisia, Morocco and Mauritania have enacted new central banks laws that are very meaningful steps in the right direction.