



WP/05/51

IMF Working Paper

The Accountability of Financial Sector Supervisors: Principles and Practice

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IMF Working Paper

Monetary and Financial Systems Department

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Authorized for distribution by David S. Hoelscher

March 2005

Abstract

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Policymakers' uneasiness about granting independence to financial sector regulators stems to a large extent from the lack of familiarity with, and elusiveness of, the concept of accountability. This paper gives operational content to accountability and argues that it is possible to do so in a way that encourages and supports agency independence. The paper first elaborates on the role and purposes of accountability. Second, it shows that the unique features of financial sector supervision point to a more complex system of accountability arrangements than, for instance, the conduct of monetary policy. Finally, the paper discusses specific arrangements that can best secure the objectives of accountability and, thus, independence. Our findings have a wider application than financial sector supervision.

JEL Classification Numbers: G18, G28, H83, L51, N20

Keywords: Financial regulation, regulatory agencies, public administration accountability

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I. INTRODUCTION

Unlike the case for central bank independence, which has won a broad following in both academic and policy communities, the case for independence for financial sector supervisors (hereafter called Regulatory and Supervisory Agencies (RSAs)) remains controversial. Policymakers remain reluctant to grant independence to regulators, despite strong arguments developed in its favor, supported by results of emerging empirical research, which indicates that independence for RSAs² is beneficial for financial system soundness.³

In part, this reluctance stems from the genuine concern that an independent regulatory agency, if not structured properly, will be able to act as “an unelected fourth branch of government” (Majone (1993)), not subject to the usual checks and balances of constitutional systems. In the specific case of RSAs, because supervisory actions often involve issues that can become highly politicized—such as the decision to intervene or close a bank—and which can also have a significant impact on individual property rights, their independence can, with some justification, be seen as a delegation of authority too far. Moreover, theories of regulatory capture (Stigler, 1971) also continue to make an impact on the debate. These theories entail that, without proper political oversight and control, regulators will act to promote industry interests at the expense of those of consumers.

At the same time, an element of self-interest may be discernible in politicians’ reluctance to grant agency independence, as is suggested by the formal model recently developed in Alesina and Tabellini (2004). The model explains that politicians choose to retain (as opposed to delegating to bureaucrats—or agencies) those tasks that are likely to generate rents, campaign contributions or bribes, or that have redistributive effects (from which they can benefit during the next elections). This explanation fits the political preference for retaining (some) control over RSAs very well. In many parts of the world, the political class (still) sees the financial system as a vehicle for redistributive policies (directed and connected lending), and is able to generate rents from the sector (politically connected banks). Hence, their desire to remain formally or informally (through interference in the regulatory and supervisory process and granting regulatory forbearance) involved in financial sector regulation and supervision.⁴

² This paper focuses on banking supervisors, but the arguments evidently apply equally to supervisors of other parts of the financial sector. The terms regulators and supervisors are used interchangeably, although it is recognized that both functions involve a set of different tasks.

³ The Basel Core Principles (BCP) for Effective Banking Supervision, first issued in 1997, was the first official document to stress the importance of operational independence for bank supervisory authorities. Until recently, academic interest in the topic was scarce. The need for independence is mentioned, for instance, in Lastra (1996) and Goodhart (1998). Quintyn and Taylor (2003) were the first to discuss the case for independence in a systematic manner. Empirical support is presented in Das, Quintyn, and Chenard (2004) (see also footnote 9).

⁴ O’Neil Brown and Dinc (2004) lend strong empirical support for this proposition. For a sample of emerging market countries, they show that failing banks are much less likely to be taken over by the government or to

(continued...)

To the extent that the reluctance to cede independence to RSAs has its source in a genuine concern for ensuring constitutional checks and balances, the purpose of this paper is to shed new light on the notion of accountability, on the interaction between independence and accountability, and on the proper design of accountability mechanisms. A clearer understanding of these topics should help clarify the nature of accountability and overcome the reluctance to grant independence.

While the necessity for establishing accountability arrangements has been widely recognized, pursuing it in practice has often proven to be difficult. This is partly so because accountability is an elusive, multi-faced, and complex concept, but even more so because accountability is often—incorrectly, as we shall argue—seen as inimical to independence. Indeed, the independence-accountability interaction seems to be clouded by several misconceptions, culminating in the often-heard statement that there is a “trade-off” between the two concepts. This paper will argue that there is no such trade-off.

The thesis of this paper is that agency independence need not imply the creation of a regulatory bureaucracy that is answerable to no one, and that subjecting RSAs to checks and balances is not necessarily incompatible with agency independence. The paper argues that properly structured accountability arrangements are fully consistent with agency autonomy. Good accountability arrangements make independence effective because they provide legitimacy to the independent agency. By contrast, poorly structured accountability arrangements can undermine agency independence. An accountability arrangement is bad if it enables third parties to exercise de facto control/influence through what is a de jure accountability arrangement.

The standard theory of political control of bureaucracies, starting from the principal-agent theory, conceptualizes the delegation of authority as the formation of a contract between the two parties. Conceived in this way, the problem of accountability can be thought of in terms of the conventional principal-agent problem of ensuring agreed-upon contractual performance. However, this conceptual framework impales agency independence on the horns of a dilemma: either the agency determines whether it has performed according to the contract (independence) or another body or institution makes that determination (control). The dilemma is that if the agency itself makes the determination, it becomes an “unelected fourth branch of government” that cannot be properly held to account for its performance. If another body or agency makes that determination, the RSA cannot be genuinely independent. Thus, many analysts have presented the relationship between independence and accountability in terms of a “trade-off.”

lose their license before elections than after. This paper also corroborates the time-inconsistency parallel that Quintyn and Taylor (2003) drew between bank supervision and monetary policymaking.

This approach to analyzing the independence-accountability pair is flawed and inhibits the development of the full benefits of accountability. The idea of a simple trade-off between independence and accountability profoundly distorts the relationship between these important concepts, as well as our thinking about appropriate accountability arrangements.

We will argue that accountability of an independent agency cannot be conceived as a simple vertical relationship between a principal and an agent that can be reduced to a single question (has/has not the agency's performance been in accordance with the terms of the contract?). To arrive at that point, it is necessary to recognize from the start that accountability is not synonymous with control and that independence is never absolute. The agency has received delegated power; hence, it needs to give account and, if need be, take actions to redress faults and shortcomings. Thus, accountability, as opposed to control from one point in the system, aims for the establishment of a network of complementary and overlapping checking mechanisms (Majone, 1994). Accountability is established through a **combination of control instruments** in such a way that "no one controls the independent agency, yet the agency is 'under control'" (Moe, 1987). Hence, the complexity of accountability relationships and mechanisms needs to be recognized.

This complexity applies especially to RSAs that inevitably operate in a multiple principals environment, often have multiple objectives, of which most are nonmeasurable, and have far-reaching intervention powers in supervised entities. In short, accountability has many different dimensions, and answers to the questions, "Accountability to whom?" and, "Accountability by what means?" will vary depending on the context. The conclusion is that more attention needs to be given to accountability and the proper structuring of accountability arrangements in order to bolster agency independence and governance.

The paper is structured as follows: Section II provides an analysis of the role and functions of accountability; Section III discusses features of RSAs that differ from central banks (considered exclusively as monetary policy agencies) and that introduce a greater need for, and level of complexity into, accountability arrangements; Section IV lays out the design of accountability arrangements in light of the conclusions of the two previous sections; and Section V brings together the conclusions of this paper.

II. ROLE AND FUNCTIONS OF ACCOUNTABILITY

The Oxford English Dictionary defines accountability as "obliged to give a reckoning or explanation for one's actions; responsibility." Responsibility is defined as "legally or morally obliged to take care of something or to carry out a duty; liable to be blamed for loss or failure." Implicit in this definition is that the person/agency that is held accountable (the accountee) has been given a mandate, an objective against which he/she has to give account to the person/agency from which the mandate has been received (the accountor). The accountor gives the mandate, delegates the power, while the accountee receives power. Thus, the traditional conception of accountability has two elements: the idea of checking on the accountee's performance—literally, "holding to account," and the requirement that the

accountee takes responsibility for failure, goes on to make amends for any fault or damage, and takes steps to prevent its recurrence in the future.

The contemporary view on accountability has shifted and broadened.⁵ Changes in the socio-political environment have prompted changes in accountability relationships. In modern democratic societies, the traditional vertical accountability relationships are being complemented by horizontal relationships with multiple principals. Developments such as the emergence of participatory democracy, the greater role of the media, and the growing need to keep citizens and civil society directly involved in agency work, which in itself is becoming more complex, are prompting accountability relations to become more diversified and pluralistic. As noted by Behn (2001), the concept of accountability is more extensive now than in the past, and properly structured accountability arrangements can play an enabling role by providing legitimacy and improving agency governance and performance.

Against this background, accountability for independent RSAs can be thought of as fulfilling four main functions. These are to (i) provide public oversight; (ii) maintain and enhance legitimacy; (iii) enhance agency governance; and (iv) improve agency performance.⁶ The recognition that accountability fulfills four main functions helps to bridge to a large extent the different emphasis that lawyers (political dimension of accountability) and economists (performance) tend to put on accountability and that, at times, also confuses our thinking about accountability (see Lastra (2001) and (2004) on the difference between both views).

A. Provide Public Oversight

This is **the** classical function of accountability. Historically, the function of parliaments and legislatures was to exercise oversight of the way that the executive branch of government performed its functions. In the case of independent RSAs, the fact that authority is delegated by the government—and not simply forsaken—implies that there is a hierarchy within which the ultimate responsibility for the consequences of the implementation of the delegation is retained by the principal, i.e., the legislative or the executive power. This gives rise to a tension between retaining the ultimate responsibility, which implies also safeguarding political legitimacy, and ensuring the autonomy of the agency. On the one hand, the RSA needs to be independent of political pressures, while on the other hand it also needs to be held accountable for its activities.

⁵ For a detailed argumentation and analysis, see Romzek (1996) and (1997), Behn (2001), and Bovens (2004).

⁶ Bovens (2004) lists a fifth function—to provide public catharsis (in cases of tragedies, fiascos). This function is less important from the point of view of this paper. It can, however, have a role of importance in the aftermath of, for instance, a systemic banking crisis.

The position of the accountable agency is, ultimately, embedded in a country's constitutional system that governs the relationship between the branches of government, as well as the hierarchy of legal norms. The allocation of public powers to an independent agency will be limited to those powers necessary for the agency to achieve its objectives. Accountability in that context is, by definition, toward its main principals, the legislative and executive branches of government.

B. Maintain and Enhance Legitimacy

Only if the actions of an independent regulatory agency have legitimacy in the eyes of the political principals, the regulated firms, and the broader public can it be genuinely effective and use the granted independence effectively. If the agency's actions are perceived as lacking legitimacy, its independence will not be long-lasting. Legitimacy can be generated not only by having in place clear legal foundations for RSA action, but also through various accountability mechanisms and relations.⁷ Accountability permits the agency to explain the pursuit of its mandate to a broader public. This is essential to build understanding of, and broad-based support for, the way it performs its duties and, hence, provide a necessary precondition for agency legitimacy. Many decisions may be too technical for informed public debate, but, as a minimum, the general public needs to understand the purpose for which the agency exists and the principles underlying its approach to specific tasks, including the trade-offs and dilemmas it has to confront.

At the same time, accountability arrangements provide a public forum in which different stakeholder groups can make representations about agency policies. By creating opportunities for transparent and structured public influence, the incentives for private influence are reduced.

Accountability can help transform public understanding into reputation. A strong public reputation for competency, probity, and integrity can help translate a formal grant of independence into the ability to take decisions in the face of strong opposition from vested interests. An agency with a strong reputation is more likely to be trusted by the public and, thus, given the "benefit of the doubt" in controversial cases.

⁷ The narrower notion of legitimacy defined as "according to the law" refers to the fact that, if the agency is established by law (and has a mandate), its legitimacy is ensured and it can take legally binding actions (Lastra (2004) and Zilioli (2003)). While this element of legitimacy is indispensable, we emphasize the broader dimension. Accountability bolsters the legitimacy of the agency's actions. Explaining the actions, involving all stakeholders, boosts support for the agency's actions and may, therefore, also reduce any opposition or challenge of the actions. In other words, if an agency makes the effort to explain itself, chances are greater that stakeholders will accept the decisions.

Once it has been accepted that accountability generates legitimacy, and legitimacy supports independence, it becomes clear that the relationship between accountability and independence does not imply a trade-off, but is one of complementarities.⁸ If correctly understood, the three concepts form a mutually reinforcing triad. This function of accountability plays a crucial role in countries with weak institutional and governance structures, where the agency attempts to establish its credibility.

C. Enhance Agency Governance

Das and Quintyn (2002) singled out independence, accountability, transparency, and integrity as the four institutional underpinnings that RSAs should possess in order to achieve good governance arrangements. An essential feature of these four underpinnings is that they are equally important and that they reinforce each other and hold each other in balance—thereby avoiding excess and dysfunctions in any of them—in laying the foundations for good governance practices. From this work also emerge the conclusions that (i) independence is not a goal in itself, but part of the underpinnings for good governance arrangements; (ii) accountability is complementary and supportive of independence; and (iii) the combination of being held accountable and being transparent assists in enhancing the integrity of the agent's staff, i.e., reduces opportunities for corruption. In sum, accountability is an essential underpinning of good agency governance in its interaction with the other three elements.⁹

D. Improve Agency Performance

Accountability is not only about monitoring, blaming, and punishment. It is also about enhancing the agency's performance. A properly structured system of accountability lays down rules for subjecting the decisions and actions of the agency to review. As such, by reducing the scope for ad hoc or discretionary interventions, it potentially enhances the agency's performance. For example, a properly structured judicial review sets parameters for the grounds on which agency decisions may be subject to challenge in the courts. An

⁸ The thesis that accountability and independence are complementary is slowly gaining recognition. Discussions about the legal position of the European Central Bank have stimulated this debate. For a general presentation of the issue, see Majone (1994). A legal perspective is offered in Zilioli (2003). For an economist's perspective on the issue, see Eijffinger and de Haan (1996) and Bini Smaghi (1998). de Haan, Amtenbrink, and Eijffinger (1999) provide empirical evidence of the complementary nature in the case of central bank independence.

⁹ Das, Quintyn, and Chenard (2004) grant empirical support to the proposition that regulatory governance matters for financial system soundness. They demonstrate that an index of good regulatory governance practices is positively and significantly correlated with an index of financial system soundness for a sample of approximately 50 countries that participated in the joint IMF/World Bank Financial Sector Assessment Program (FSAP). The results also demonstrate that good regulatory governance has a stronger impact on financial system soundness if supported by sound public sector governance.

obligation to give periodic reports to the legislature protects senior management from being subjected to more frequent and deliberately vexatious questioning. Well-designed accountability can thus help to buttress the agency's independence.

In addition, by giving account to the government, the agency provides input to the government as to how to (re)shape its broader economic and financial policies. So, in the accountability process, norms are being (re)produced, internalized and, through accountability, adjusted (Bovens, 2004). Agencies have a domain of expertise that they should share with the government. In this sense, accountability will stimulate coordination with the government and enhance the agency's legitimacy (Majone (1993) refers to this as a dialogue model). This is an often neglected function of accountability which, potentially, is one of its more powerful ones.

III. CONTRASTING ACCOUNTABILITY ARRANGEMENTS FOR CENTRAL BANKS AND FINANCIAL SECTOR SUPERVISORS

In designing accountability arrangements for RSAs, the natural point of reference would appear to be independent central banks. After all, the comparatively more advanced state of the debate about central bank independence has meant that the issue of their accountability has also received more attention than that of RSAs.¹⁰

In the following discussion, we consider a central bank performing only its monetary policy responsibilities. In practice, central banks have performed a diverse range of functions, including banking supervision. However, the increased prominence given to the accountability of central banks in the past two decades has paralleled a clear trend toward focusing central banks more specifically on their monetary policy function,¹¹ and the growing adoption of inflation targeting has provided a relatively clear numerical measure of their success or otherwise in discharging this responsibility. In consequence, much of the recent work on the accountability of central banks has taken place by reference to this background.¹²

¹⁰ The case for accountability of independent central banks is made by, among others, Fischer (1994) and Briault and others (1996). For a theory of central bank accountability, see Eijffinger and others (2000). Lybek (1998) and Amtenbrink (1999) provide excellent overviews of accountability practices.

¹¹ In several countries central banks have lost long-standing functions—such as banking supervision or public debt management—as part of the package of measures that granted them monetary policy autonomy. The case of the Bank of England provides the clearest example, but similar developments have taken place elsewhere. At the same time, however, central banks have also recently begun to articulate more explicitly their financial stability mandate which overlaps to some extent with that of RSAs. This development raises a range of new issues in terms of coordination and accountability which go beyond the scope of this paper. See Oosterloo and de Haan (2003).

¹² From the point of view of this paper, it is also worth reminding that, as Lastra (2004) points out, several central banks (e.g., Banque de France, Bank of Spain) were granted a higher degree of independence with respect to achieving monetary policy objectives than with respect to their role as bank supervisors.

Given the historically close connection between central banking and financial (especially bank) regulation, it would seem but a short step to transpose some of the same mechanisms to RSAs. However, the central argument of this section is that the accountability mechanisms developed for central banks as monetary policy authorities cannot simply be transferred to RSAs. Indeed, given the comparatively greater range of contingencies that can occur in regulation and supervision than in the conduct of monetary policy, as well as the difficulty of precisely specifying objectives, any contract for a regulatory agency is bound to be radically incomplete.¹³ These additional dimensions of complexity need to be reflected in the accountability arrangements for RSAs. Unlike central banks, it is not possible to deal with the problem of complexity by narrowing down the range of functions performed by RSAs in a way that corresponds to the recent focus on monetary policy; it is, rather, a reflection of inherent features of the regulatory process.

Table 1 summarizes the main differences between RSAs and monetary policy authorities that have implications for accountability. The primary differences are as follow: (i) performance against their mandate is typically harder to measure for RSAs than for monetary policy authorities and RSAs very often have multiple mandates and may compete with other regulatory authorities in achieving those mandates; (ii) there is a greater tension between transparency and confidentiality for RSAs than in monetary policy; (iii) RSAs generally have broad regulatory (rule-making) powers, including prudential rules, reporting, and disclosure requirements, as well as organizational prescriptions and rules of conduct, which do not arise in the monetary policy context; (iv) RSAs have broad supervisory and enforcement powers, which require a special accountability relation with the regulated industry and the judiciary; and (v) RSAs operate in a multiple principals environment. Besides the typical principals of a monetary policy authority, such as the legislative and executive branches, the users of financial services are also a main category of principals for RSAs.

A. Agency Objectives

A well-defined statutory objective against which the agency's performance can be measured is traditionally viewed as a key requirement for holding independent agencies accountable. For central banks, this is (increasingly) price stability, and their performance can be measured against the stated objective. For RSAs, the issues are more complicated on three counts. Their objectives are often not explicitly or clearly articulated in the law; they often face multiple objectives and may compete with other authorities in achieving those objectives; and these objectives are typically hard to measure. While the first one can be overcome by amending the law, the two others are inherently linked to very nature of the RSA's work.

¹³ In other words, a Persson-Tabellini type of performance contract developed for monetary policy (Persson and Tabellini (1993)) cannot be applied for RSAs because of the fundamental incompleteness of such a contract in their situation.

Clear objectives

Appendix I and Box 1 indicate that only in relatively few cases have regulatory agency objectives been explicitly and clearly articulated in the law. The United Kingdom stands out in the precision that has been given to the functions of the Financial Services Authority (FSA) in the Financial Services and Markets Act 2000 (FSMA)¹⁴ Even then, analysis of the FSA's objectives suggests that defining the functions of a regulatory agency in a way that facilitates its being held to account is not straightforward.

Multiple objectives

A second important difference, equally clear from Box 1, between an RSA and a monetary policy authority is that the former is likely to face several objectives. Having multiple objectives poses problems of prioritization and weighing when assessing the performance of the agency. The preservation of financial system soundness and the protection of ill-informed retail consumers are the most obvious objectives. However, they might also potentially include preventing market abuse, and fighting economic crime and money laundering. In some emerging markets, the promotion of market development is also mentioned as a regulatory objective.

The existence of multiple objectives creates competing roles and responsibilities for a regulatory agency which, for example, might be faced with a choice between adopting and enforcing strict market-conduct rules and turning a blind eye to it in the name of "market development." Nonetheless, even in the absence of such obviously competing objectives, the problem of defining the relationship between a multiplicity of goals is more likely to arise for RSAs than for a central bank, and requires special attention when designing accountability arrangements.

¹⁴ Given that the enactment of FSMA was preceded by a debate in the United Kingdom, in which the objectives of regulation featured prominently, it is perhaps not surprising that FSMA has stated the regulator's objectives so prominently (Blair and others, 2001).

Table 1. Monetary Authorities and RSAs: Features with a Bearing on Accountability

	Financial Sector Supervisor	Central Bank (Monetary Policy)
Objectives <ul style="list-style-type: none"> • single versus multiple • measurability • criteria to measure achievement 	<p>Multiple</p> <p>Difficult</p> <p>Priorities may change</p>	<p>Single</p> <p>Numerical objective</p> <p>Simple because single and numerical</p>
<ul style="list-style-type: none"> • confidentiality vs. transparency • legal protection 	<p>The tension between public interests and financial stability considerations requires balancing.</p> <p>Necessary</p>	<p>Confidentiality of measures disappears quickly and transparency is considered helpful</p> <p>Desirable</p>
Regulatory function	Broad-ranging	Limited (Monetary Policy-Specific)
Supervisory and enforcement function <ul style="list-style-type: none"> • proactive enforcement • broad intervention and sanctioning powers 	<p>Can act on their own initiative (as opposed to courts)</p> <p>Impact on civil rights (property rights, in particular) must be taken into account</p>	<p>No</p> <p>No</p>
Principal-agent relationships	Multiple and complex	Simple

Box 1. Financial Supervisors' Mandates in Selected Countries

Accountability presupposes that the financial supervisor's actions will be assessed according to certain standards and with respect to defined objectives.^{1/} This assessment forms the basis on which a decision to apply any instrument of democratic accountability (changing the legal basis, refusing an appointment) is taken.

Most laws state multiple objectives. The Financial Services Authority (FSA) U.K states, "maintaining confidence in the financial system," "promoting public understanding of the financial system," "securing the appropriate degree of protection for consumers," and "reducing financial crime." For the Netherlands Bank it is "contributing to the smooth conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial system." The Japanese FSA Act refers to "establishing a stable and dynamic financial system" and "ensuring transparency and fairness in financial administration." In Chile, it is "supervising the entities put under its responsibility" and "issuing instructions and adopting all measures to correct irregularity in the supervised entities to protect depositors, other creditors, and the public interest." The Finnish Act of the FSA stipulates, as the objective of the FSA, "to promote financial stability and public confidence in the operation of financial markets." As its own strategic objectives, the FSA aims at ensuring that "supervised entities' capacity to bear all of their risk-taking is good and corporate governance culture is sound," "publicized information and market practices promote sound market development," and "the regulatory regime is proactive and the FSA's supervision and enforcement meets the requirements of accountability." For the Hungarian FSA, it is "enhancing the transparency of markets" and "maintaining a fair and regulated market competition through the permanent surveillance of the prudent operation of organizations and entities engaged in financial services." In France, it is "maintaining fair and competitive markets," and in Italy, "overall stability of the financial system" together with "efficiency and competitiveness of the financial system." The objective in Switzerland is "to protect depositors and to maintain the trustworthiness and orderly functioning of the banking system in the public interest."

Statutory objectives formulated in rather general terms—like those above—are not operational. Their achievement cannot be measured. Objectives can be described with more precision by *principles of operation*, *procedures*, or by a very *specific result* to be achieved. The approach that is, for instance taken by the United Kingdom. FSMA is to define seven principles of operation that the FSA must bear in mind when discharging its regulatory function (making rules, issuing codes, and giving general guidance). These include considerations regarding the economic and efficient use of its resources and the responsibilities of those who manage the affairs of authorized persons; proportionality of burdens or restrictions on the industry; the impact on innovation and international competitiveness. Similar principles may be defined to evaluate the discharge of the financial supervisor's supervision and enforcement functions. They may relate to a risk-oriented supervisory approach, the most efficient use of resources, and a focused enforcement policy (power enforcement).

1/ Principle 1 of the BCP for Effective Banking Supervision, explicitly provides that "*an effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.*" The Core Principles Methodology cites as additional criterion that "*The supervisory agency sets out objectives, and is subject to regular review of its performance against its responsibilities and objectives through a transparent reporting and assessment process.*"

Measurability

In addition, as Goodhart has pointed out (Goodhart, 2001), the objectives of RSAs refer to something that is difficult—if not inherently impossible—to measure. For example, to decide whether or not the United Kingdom's FSA had met the fourth of its statutory objectives—the reduction in financial crime—would first require data on the extent of financial crime being perpetrated, which does not exist. Similarly, if the number of cases brought to trial is

reduced, this could be either because the regulatory agency is being successful in pursuing its objective or that fewer cases are being detected. Nor, Goodhart argues, do any of the FSA's other objectives fare better when subjected to close analysis. He concludes that "it is difficult to come to any other conclusion except that the achievement of the objectives that have been set for the FSA are nonoperational in the sense that no measurement of success can be achieved. Accountability in terms of these objectives is effectively impossible" (p.153).

The difficulty of formulating RSA objectives in any measurable sense goes to the heart of the differences between an RSA and a monetary policy authority. Whereas it is possible to set a central bank an explicit inflation target or other monetary objective, and then hold it to account for meeting that objective, there is no clear analogue in regulation and supervision of having a single, measurable goal to be attained. Indeed, as Goodhart has pointed out, references to apparently quantifiable objectives (such as the reduction of financial crime) simply are not operational. Regulation and supervision are concerned with the **prevention** of events, rather than the attainment of specific objectives in any positive sense—or with a mixture of both, such as achieving financial sector stability and preventing crime.

Measurability of RSAs objectives is also hampered by the fact that the objectives of regulation and supervision inevitably involve a large element of judgment. For example, an RSA that has as its objective the protection of consumers is immediately faced with a number of choices: What is the appropriate level of protection for retail consumers? At what level of sophistication can individuals be reasonably assumed to be able to protect their own interests? Should the same protection be extended to natural and legal persons? Might not a sole trader reasonably expect the same level of protection as a business person as he or she might expect as an individual? Where to draw the line between these legal persons and a multinational conglomerate? These judgments are hard to make in law and, hence, must inevitably be left to regulatory discretion. However, then we return to the problem that if regulators are to be permitted comparatively broad discretion in interpreting their objectives, it will be difficult to use regulatory objectives to call them to account.

These considerations indicate that the agency's mandate will be of more limited application in holding the RSAs accountable than would be the case for a monetary policy authority. To overcome this drawback, the following options could be considered:

- Regulatory objectives could be carefully expressed in terms of the negative goal of the prevention of certain undesirable outcomes. This can help focus regulatory activities and guide the use of resources.
- The objectives could be complemented by, for instance, principles of operation, procedures, or by a very specific result to be achieved. These tools would describe the mandate or objectives with more precision. In this way, accountability would become more operational if the RSA publishes the strategy or policy it promises to pursue over a given period of time.

- Accountability relations should be built with all stakeholders in order to create and foster a broad understanding of the objectives and the performance of the RSAs. This would allow all stakeholders to see the different aspects of the work of the RSAs. Building understanding will lead to building a reputation.

B. Confidentiality and Transparency

If objectives are unlikely to provide a secure foundation for accountability, can greater weight be placed on procedural issues? Several studies of accountability have stressed the importance of transparency as a key feature of any satisfactory accountability arrangement (Lastra and Shams (2001) and Lastra 2004)).

Increasingly, transparency is being recommended for central banks (see, for example the IMF's Code of Transparency for Monetary and Financial Policies (IMF, 1999)) and is being adopted in practice. For example, more central banks are now following the lead set by the Federal Reserve Board in the United States and are publishing minutes of monetary policy meetings with a suitable delay. By this policy central banks are seeking to explain the process by which short-term rates are set, thus reducing the element of surprise for financial markets and providing a smoother path of interest rates. The same policy also encourages central bank accountability. In the words of de Haan et al, "Where the reasons for a certain monetary policy decision lay open, it is easier to make a judgment and to hold central bank officials and/or government officials accountable for their behavior" (de Haan, Amtenbrink, and Eijffinger, 1999).

This type of transparency is difficult to transpose from the field of monetary policy to that of supervision and enforcement. Whereas the reasons for monetary policy decisions cease to have any commercial sensitivity or importance after a relatively short time, the same is not true of regulatory decisions. In the course of an enforcement procedure, RSAs must protect the interests of all stakeholders and ensure the fairness and impartiality of the process. Publicity could negatively affect the conduct of investigations and prevent impartial decision making. Supervision inevitably deals with matters of acute commercial sensitivity. Because banks depend primarily on maintaining depositor confidence, RSAs have historically been reluctant to disclose the fact that a bank may be failing to meet minimum prudential requirements and that they have required bank management to take corrective action. There is a fear that the disclosure that a bank has been required to take corrective actions, even some years after the event, may be destabilizing and destructive of confidence. For this reason publication of bank supervisory decisions and required actions need to be treated with circumspection.

Nonetheless, the presumption should be that such decisions and the reasoning behind them will be a matter of public record, even if this disclosure occurs well after the event. By encouraging transparency, supervisory agency decisions are more likely to be well-reasoned and grounded in both law and fact; they are also more likely to be consistent with other decisions taken in similar cases. Publicity thus reduces the scope for arbitrary decisions, and

ensures that actions are in accordance with preannounced supervisory policies. This ought to be a key feature of any accountability regime.

One area where transparency has an important role to play for RSAs is in the rule-making process itself.¹⁵ There are potentially a wide range of interested parties in regulatory rule-making: legislators, who have delegated the RSA its rule-making powers; the financial services industry that is most directly affected by the rules; and the industry's customers, including the general public, whose interests regulation is intended to protect. The greater the extent to which the regulatory agency takes into account their views as part of its regulatory rule making, the greater will the legitimacy of its rules be. Thus, an open and public process of consultation during rule making enhances general understanding of the aims and purposes of the rules, helps to ensure that the rules themselves are well-reasoned and properly thought through and, above all, confers a legitimacy on the rules that they would not have if they merely appeared to be the outcome of unfettered regulatory discretion.

C. Enforcement and Sanctioning Powers

The presence and use of the RSAs' enforcement and sanctioning powers is another feature that sets these agencies apart, not only from central banks, but also from the court system. The following features are relevant from the point of view of our discussion of accountability.

First, there is no counterpart to the RSAs' enforcement powers that enable it to sanction violations of its rules and regulations in the powers granted to a central bank in respect of its monetary policy role.¹⁶

Secondly, there are also important differences between the way that an RSA uses its enforcement powers and the exercise of similar powers by the court system. In contrast with judicial enforcement, regulatory enforcement is proactive and RSAs take enforcement action on their own initiative and in accordance with their mandate, as defined in their statutory objectives. The mandate of the RSAs is not enforcement in itself but rather the achievement of its statutory objectives with enforcement being one of the means for achieving them.

RSAs have an extensive tool kit for enforcing rules and regulations, including different forms of intensified monitoring, such as special audits and onsite inspections, as well as formal sanctioning powers. The latter comprise enforcement procedures within the sole competence of the RSAs as well as the power to initiate action of administrative, civil, or criminal nature

¹⁵ See also Key (2003).

¹⁶ Central banks typically have the right to impose a monetary fine when banks do not comply with reserve requirements, but otherwise operate through market mechanisms rather than coercion in achieving their monetary policy goals.

in the competent courts.¹⁷ This situation provides the RSA with a fair degree of discretion. For instance, in some circumstances the RSAs might decide to forego formal enforcement action in favor of cooperative compliance,¹⁸ while uncooperative, intentional violators may be dealt with strictly. Minor violations may not be sanctioned when overall compliance in key areas is high and violators demonstrate good faith.

Similarly, the availability of enforcement resources influences the degree of discretion applied. Faced with a wide range of responsibilities, RSAs are likely to initiate enforcement action only if it is likely to produce the desired outcome in a cost-effective manner. Thus, RSAs may choose to focus resources on certain high-profile cases to enhance the deterrence effect, or use a case as a precedent to demonstrate the application of the law. Quick and effective risk-based enforcement actions aimed at the most egregious areas, focus proper attention to the high costs of breaches of the law.

In deciding how to exercise their extensive enforcement discretion, RSAs need to develop a regulatory enforcement strategy, setting out priorities and policies. They are likely to focus enforcement resources on priority areas that map very clearly to their statutory objectives, and which keep the harm arising from violations and misconduct within tolerable limits. Such a strategy should take into account achieving compliance, promoting deterrence by making an example of a high-profile violator, addressing financial risk, ensuring confidence in the financial system, and enhancing fair competition. Enforcement actions may also be influenced by certain subsidiary purposes, such as the need to maintain the credibility of an enforcement agency or even of specific enforcement instruments or tools.

The enforcement strategy of an RSA is an important aspect of accountability. The RSAs' exercise of discretion in its use of its enforcement powers needs to be publicly justified. The RSAs will have to demonstrate that its enforcement policy achieves the right balance between cooperative compliance-oriented enforcement action and deterrence-oriented coercive action. As opposed to judicial authorities, the performance of RSAs cannot be measured by the number of cases and convictions, but rather by overall compliance and the achievement of the statutory objectives.

¹⁷ Based on the premise that law is inherently “incomplete,” Pistor and Xu (2001) use the term of “residual legal enforcement powers” to describe the enforcement powers of RSAs and the role of regulatory enforcement in “completing” the law and ensuring that rules and regulatory practice keep up with the rapid development of financial markets and the constant innovation that have accompanied it.

¹⁸ In case of criminal misconduct, RSAs generally have the obligation to pass the case to the criminal authorities for prosecution. Oftentimes, however, the facts will be less clear so that there remains some scope for determining the most appropriate enforcement action.

D. A Multiple Principals Environment

A central bank performing its monetary policy functions usually does so under a delegation of authority from either the executive or legislative branch. Thus, the primary responsibility is to that branch of government that has made the explicit delegation of the function. The accountability relationship is especially clear under an inflation-targeting regime where the numerical inflation target is set by a branch of government other than the central bank, such as the minister of finance or parliament.

RSAs also operate under delegated authority and, therefore, must also have a close accountability relationship with the executive or legislative branch. However, unlike central banks, the nature of the regulatory process entails that a wide range of interests will be directly affected by regulatory action.¹⁹ RSAs can have a potentially wide-ranging impact on shareholders, managers, customers, depositors, investors, and the general public. They can, for example, interfere with shareholders' ownership and control rights, with the contractual terms between a firm and its customers, and shape public perceptions of the integrity of the regulated industry.

In view of the range of interests potentially affected, the traditional, vertical "single principal-single agent" model that can be applied to central banks is inapplicable to RSAs. They inevitably operate in a multiple principals environment in which the appropriate accountability mechanisms are diversified and pluralistic, and the vertical dimension of accountability is supplemented by a "horizontal" dimension. As Bovens (2004) argues, the accountee in a multiple principals environment must face an "accountability forum" and Behn (2001) refers to "360 degree accountability."

While the legislative, executive, and judicial branches remain, for obvious reasons, the most important principals or accountors, mechanisms need to be designed to ensure that the potentially broad range of interests affected by regulatory action can be properly represented. Therefore, direct accountability with other groups—such as the supervised entities, the customers, the public at large, and peers—needs to be fostered.²⁰

¹⁹ Monetary policy can, of course, also affect the interests of many people—borrowers and creditors, for example—but it does not do so in the direct manner of regulation.

²⁰ RSAs are also distinguished from central banks because they sometimes operate in a multiple agents environment, for example, where regulation is the responsibility of several different agencies. Accountability arrangements in such cases should be designed in a way that makes it difficult for these competing agencies to "pass the buck."

IV. ESTABLISHING MECHANISMS TO ENSURE ACCOUNTABILITY

Having established that there are several additional layers of complexity in the operation of RSAs compared with monetary policy authorities, we turn now to the question of how these complexities can be addressed, in practice, through accountability arrangements to keep the independent RSA “in check” without curtailing its operational independence.

The guiding principle, which has emerged from the previous sections, is that a highly complex and specialized activity like regulation and supervision of financial markets, involved with such a broad range of principals, can only be monitored and held accountable by a combination of instruments and arrangements. Thus, the task is to create a network of complementary and overlapping checking mechanisms. With such a combination of control instruments, the goal is to arrive at a situation where no one controls the agency, but the agency is nonetheless “under control.” Instrument design and selection should also be such that incentives at “self-policing” are provided to the RSA.

Thus, this section explores mechanisms to enhance accountability for RSAs, taking into account (i) the need to establish a framework of accountability that provides independence through legitimacy for supervisors; (ii) the need to establish accountability toward all major principals (the three branches of government (legislative, executive, and judicial) and the other major stakeholders—the supervised industry and the customers of the financial institutions who overlap significantly with the taxpayers and voters); and (iii) the special nature of supervisory tasks.²¹

A. Typology of Arrangements

The literature on accountability has established distinctions between different mechanisms of accountability:

- **Ex ante** accountability refers to reporting before action is taken, for instance, consultations with the stakeholders on supervisory and regulatory policies. **Ex post** accountability refers to the reporting after action has been taken, for instance, the submission of annual reports to parliament.
- The duty to answer or explain is captured in the notion of **explanatory** accountability, which requires the giving of reasons and the explanation of actions taken. The obligation to redress grievances by taking steps to remedy defects in policy or regulatory rule making can be termed **amendatory** accountability.

²¹ See Appendix I for specific country examples.

- **Procedural** accountability refers to requirements imposed on the process to be followed by the accountee when taking action, for instance, due process rules. **Substantive** (or **functional**) accountability seeks to make sure that regulatory and supervisory actions are justifiable in terms of the objectives to be pursued.
- **Personal** accountability refers to the discharge of responsibilities delegated to individuals (e.g., the president of the RSA).
- **Financial** accountability refers to the presentation of proper financial statements.
- **Performance** accountability refers to the extent to which (measurable) objectives and criteria are met.

The accountability framework will be a combination of these types of accountability, as is shown in Table 2.

B. Relationship to the Legislature (Parliamentary Accountability)

Objectives

Usually, the RSA will operate under an explicit delegation of powers in the form of legislation passed by parliament. The purpose of accountability to parliament is to (i) determine whether the mandate given to the RSAs is appropriate or whether it needs to be reformulated; (ii) determine whether the powers that it delegated are exercised effectively and are suitable to achieve the intended objectives, and whether or not amendments are necessary; and (iii) provide a communication channel to amend legislation, if necessary.

Parliament should not exercise immediate powers on the RSAs and interfere directly in its supervisory activities by issuing concrete guidance. Parliament's influence on the supervisory activities is exerted through its law-making powers. That is, it can directly affect the financial supervisor's actions by making changes to the legal framework.

- **Assessing the mandate.** Since the principles of regulatory regimes are normally promulgated by parliament, the latter should be a principal actor charged with holding the financial supervisor accountable for meeting the stated objectives in its mandate.

Table 2. Mapping Possible Accountability Arrangements

Accountability to Whom	Content and Form	Type of Arrangements
Legislative branch	<ul style="list-style-type: none"> • Regular report (annual) to assembly or committee • Ad hoc questioning and oral presentations • Ad hoc presentations of proposals for new laws • Presentation of budgetary outcome • Audit report 	<p>Ex post—explanatory</p> <p>Ex post—explanatory</p> <p>Ex ante—explanatory or amendatory</p> <p>Ex post—financial accountability</p> <p>Ex post—financial accountability, explanatory or amendatory</p>
Executive branch	<ul style="list-style-type: none"> • Regular report to minister of finance or government • Ad hoc formal presentations, information on sectorial developments • Proposals for new government regulations/ decrees 	<p>Ex post—explanatory</p> <p>Ex post—explanatory, often pure informational</p> <p>Ex ante—explanatory or amendatory</p>
Judicial branch	<ul style="list-style-type: none"> • Judicial review • Supervisory liability for faulty supervision 	<p>Ex post—amendatory, procedural</p> <p>Ex post—amendatory and substantive accountability</p>
Supervised industry	<ul style="list-style-type: none"> • Consultation on new regulations • Regulatory impact analysis and cost-benefit assessments • Information on regulatory and supervisory practices on the website, annual reports, press conferences and public statements of representatives of the RSAs 	<p>Ex ante and ex post—explanatory, amendatory</p> <p>Ex ante and ex post—explanatory</p> <p>Ex ante or ex post depending on issue—explanatory</p>
Customers and public at large	<ul style="list-style-type: none"> • Mission statement • Information on regulatory and supervisory practices on the website, annual reports, press conferences and public statements of representatives of the RSAs • Consumer education • Ombudsman schemes and consumer grievance board (United Kingdom) 	<p>Ex ante and ex post—explanatory</p> <p>Ex ante and ex post—explanatory</p> <p>Ex post—explanatory, amendatory</p> <p>Ex post—explanatory, amendatory</p>

- **Overseeing implementation of legislation.** As a corollary to the law-making process, certain oversight functions are vested in the legislature.²² The objective of the oversight is to ensure that public policy is administered in accordance with the legislative intent. In this way, the legislature should be able to keep control over the laws that it passes. By monitoring the implementation process, members of the legislature may uncover any defects and act to correct misinterpretation or misadministration.
- **Having a dialogue on the quality of the legal framework.** Parliament also possesses the ultimate mechanism for changing the legal basis on which the RSA acts. The right to enact new legislation or amend existing legislation can function, among others, as a mechanism of ex ante or ex post accountability. Parliament should also give the RSA an opportunity to voice its concern and communicate problems in its supervisory practice that could be corrected by parliamentary action in the form of legislative amendments.

Arrangements

To ensure that these objectives are met, the legal framework should provide for regular institutionalized contacts between the RSA and parliament. The flow of information from the supervisor to the legislature is at the core of its accountability, and a necessary prerequisite for parliament to exercise its oversight function. Among the five arrangements discussed below, the first three are widely accepted, whereas the other two, if not implemented properly, can easily cross the border from accountability to interference and control:

- **Annual reporting.** Laws setting up RSAs generally provide for regular, at least annual, reporting to parliament. In jurisdictions where the minister is directly answerable to parliament, the RSA generally submits its annual report to parliament via the finance minister and parliament holds the RSA accountable through the minister (indirect accountability). Such is the case in, for instance, Australia, Canada, and the United Kingdom.
- **Reporting to parliamentary committees.** Reporting to parliament as a whole may not be the optimal medium for effective parliamentary monitoring. Politicians rarely have the time and expertise to absorb the information and make detailed judgments on the complex financial and technical issues dealt with by the RSAs. Many jurisdictions have, therefore, instituted a parliamentary committee system.²³ Members serving on permanent

²² The importance of legislative oversight as a tool in monitoring administrative activities was underscored when Woodrow Wilson, wrote, “*There is some scandal and discomfort, but infinite advantage, in having every affair of administration subjected to the test of constant examination on the part of the assembly which represents the nation. Quite as important as legislation is the vigilant of administration*” (Wilson, 1885, also cited in EGPA Study Group (2001)).

²³ For instance, in the United Kingdom, parliament considers the FSA annual report through the treasury select committee. In Switzerland, the Chairman of the Swiss Federal Banking Commission and the Director are required to appear before the parliamentary committee when the annual report is discussed.

committees develop greater expertise and, hence, have more scope for independent action. Moreover, committees generally can continue working during recess and prorogation and therefore ensure a greater degree of continuity of the monitoring function.

- **Appearances before parliament and ad hoc inquiries.** The obligation to explain and account also implies a duty to submit to scrutiny and to provide an opportunity for parliament to probe and criticize. To this end, it is generally provided that parliament or the designated committee may summon the RSA's chief executive to appear or to report. Oral consultations in the form of hearing and question-time can facilitate the exposure of problems and flaws in the operations. Inquiries can also take the form of written inquiries of members of parliament addressed to the RSAs.
- **Parliamentary representation in an oversight or supervisory board.** Another mechanism through which parliamentary accountability can be carried out is representation in an oversight or supervisory board of the RSAs.²⁴ With this approach, safeguards need to be built in, to avoid (political) interference, and to guarantee the confidential nature of the RSA's work. In general, these representatives should not be involved in operational or policy matters. On the other hand, by appointing interested and knowledgeable delegates, this arrangement circumvents the often-heard complaint that parliamentary accountability is ineffective because of the lack of interest of members of parliament.²⁵
- **Delegation to the finance ministry.** Members of parliament have not always the time and knowledge to go into depth, often show no interest in the subject matter, or fall into partisan discussions. In other countries, parliament has no real power. For these or other reasons, the monitoring function has in some countries been delegated from parliament to the finance minister. Given the complexity and technicality of the RSA's operations, it can be argued that the ministry of finance, given its expertise in financial matters, is well placed to exercise this function. However, the absence of any direct accountability to parliament may increase the risk of political involvement in the activities of the RSA. Therefore, in addition to accountability via the finance ministry, direct contacts between the financial supervisor and parliament, for instance, through the conduct of hearings, are recommended as part of the need for checks and balances.

²⁴ This mechanism has been introduced in Germany for the new financial supervisory authority. The German Parliament is represented by five delegates in the administrative board (Verwaltungsrat), which has a general oversight function.

²⁵ See Graham (1998) for a detailed discussion of the shortcomings of parliamentary accountability.

C. Relationship to the Executive Branch (Ministerial Accountability)

Objectives

A direct line of accountability to the government is needed because the government bears the ultimate responsibility for the general direction and development of financial policies. However, the relationship with the executive branch is different from that with the legislative branch and, therefore, the accountability arrangements need to address several purposes.

- **Information sharing.** First and foremost, the government typically depends on information from the supervisor to fulfill its own governmental functions. The government should be informed about developments in the financial sector; however, without breaching any confidentiality arrangements. Frequent reporting and formal or informal contacts are the best ways to establish and maintain contact. This is a typical case where accountability, within the limits set by confidentiality requirements, helps to build legitimacy and credibility in support of independence.
- **Government as issuer of regulations.** The government may be principal or accountee to the extent that it issues regulations to be implemented by the financial supervisor, or that it can take legal initiatives more generally. Accountability for such cases resembles the accountability arrangements toward the legislators discussed earlier, since a dialogue about the quality of the legal framework is a key part of these arrangements.
- **Government as appointer.** In many constituencies, the chief executive and/or board members of the supervisory agency is/are appointed by or through the government, so there is also an element of personal accountability.

Arrangements

Instruments of accountability to the executive branch may take various forms. Genuine accountability arrangements include reporting by the supervisory agency on a regular basis, as well as the possibility to request information or to conduct consultations. Some governments have the right to arrange independent inquiries into regulatory matters of concern. However, this power should belong to parliament, not to the government. While the right to appoint the chief executive and/or members of the RSA's board for a fixed term enhances independence, the right for removal on clearly specified grounds, is an indispensable accountability mechanism.

- **Reporting of information.** The government depends on information from the supervisor to fulfill its governmental task and rulemaking powers. The minister of finance needs to be aware of developments in the financial system. In most jurisdictions, the government will play an active role in financial crisis management. For these reasons, a channel of communication between the RSA and the government needs to exist at all times. It is, therefore, generally provided that the government, upon request, may have access to information on all activities of the financial supervisor. Formal channels should include

the annual report, as well as regular reporting (monthly, quarterly). Such formal reporting should be complemented with a regular dialogue between the RSA and the minister of finance. Information about the supervised sector, however, should only be disclosed in aggregate format. No individual, confidential, bank data should be shared under normal circumstances.

- **Appointment and dismissal procedures.** In most jurisdictions, the senior officials of the RSAs are appointed by the government or by the head of state upon recommendation by the government or finance minister. Governmental appointment serves to strengthen their position, in particular, in relation to the regulated industry. Reappointment and dismissal procedures may be looked at as mechanisms of personal accountability, and reappointment of officials, in principle, could function as a mechanism of ex post accountability by which an official could be dismissed on grounds of bad performance. However, many regulatory laws lack precise rules on dismissal.²⁶ Laws should, therefore, include clear criteria for dismissal.
- **Ministry of finance as oversight authority.** In some countries, the ministry of finance is the formal oversight authority of the financial supervisor.²⁷ Such a relationship may raise concerns regarding the financial supervisor's independence. Oversight serves to promote accountability and should allow evaluating performance. It should not become a control function whereby political influence is exerted on the RSA. There is a fine line between reporting and consultations, on the one hand, and the exertion of political influence on the other. The ministry's role should be limited to an oversight function and exclude any direct involvement in operational and policy decisions.²⁸ In other words, an arm's-length relationship needs to exist, which can be fostered through transparency of the regulatory process. In these circumstances, the finance ministry should itself be accountable to the legislative for its handling of the relationship with the financial supervisor.
- **Direct governmental involvement in management or oversight functions.** In some countries, the governance structure of the RSA attempts to establish accountability to the executive branch by appointing government representatives on internal oversight

²⁶ Dismissal procedures are of relative value if dismissal is limited to cases of malfeasance. In no instance is serious misconduct interpreted as including the failure to discharge functions properly in accordance with the statutory objectives of the financial supervisor and thus in terms of bad performance (Amttenbrink, 1999).

²⁷ In Germany, the ministry of finance has oversight authority and is required to ensure that the BAFin executes its tasks according to the law.

²⁸ In some countries, the ministry's role goes further, for instance, in Japan, where the minister of financial services is in charge of managing the FSA's operations. In Canada, the minister of finance is the formal head of the OSFI, although the legislation grants supervisory powers to the Superintendent that can be exercised independently.

bodies.²⁹ Representation of government or ministries should be limited to nonexecutive members in an oversight board established without operational or policy functions. Once they are involved in policy matters, operational independence, as defined in BCP 1, is debatable.

D. Judicial Accountability

Objectives

Any independent agency must be accountable to those who are affected by its decisions. The latter should have some right of legal redress in court. Given the extensive legal powers typically conferred to the RSAs, judicial review of supervisory measures is a cornerstone of its accountability relations.³⁰ This form of accountability is exercised on a strictly ex post basis. It is a control mechanism that serves to make sure that the RSAs act within the limits of the law. It applies to the process (procedural accountability) and, in some cases, albeit to a lesser extent, to outcome (substantive accountability).³¹

Natural justice requires that the RSA must observe a number of due-process requirements when it takes decisions affecting individuals or companies, such as issuing or withdrawing licenses and imposing sanctions. These requirements include, for instance, that notice be given of the proposed action and reasons; the parties be given access to the material on which the authority relies in taking the decision and be afforded an opportunity to make representations. Once a formal decision has been taken, the party to whom the decision is addressed must be informed of his or her legal remedies. The purpose of these requirements

²⁹ For instance, in Germany, the finance ministry, the ministry of economy, and the ministry of justice are represented on the Administrative Board, which has a general oversight role. In Korea, the Financial Services Commission consists of the deputy minister of finance and economy. In France, the chairman of the Comité de la Réglementation Bancaire et Financière, which is the body that issues financial regulations in France, is the minister of finance. The French Banking Commission is a college of six members chaired by the Governor of the Banque de France. It includes the head of the treasury. In Italy, the direct oversight function is carried out by the interministerial committee for credit and savings. Its chairman is the minister of the treasury. All members are ministers, among them the minister of finance.

³⁰ The term “judicial review” is generally limited to the review of the lawfulness of a decision or action taken by a public body and, as such, distinguishable from the term “appeal,” which involves a reexamination of all facts and the merits of the case. Here, the term “review” is, however, used in a broader sense, encompassing all legal remedies that can be taken to amend or invalidate a decision or action taken by an RSA.

³¹ There is also another, not necessarily conflicting, view among scholars on the relationship between independent agencies and courts. In light of the weaknesses inherent in parliamentary and executive accountability (lack of interest and expertise in the subject matter and time inconsistencies), some authors have claimed that the judicial branch is the only one that can preserve the continuity of the regulatory process. They, therefore, suggest a partnership—rather than an accountability relation—between RSAs and the judicial system. See, for instance, Shapiro (1988). For a more general discussion on pros and cons of this approach, see Majone (1993).

is to ensure that the procedure be as transparent as possible and that it results in a fair and just decision.

Judicial review not only serves to ensure the observance of procedural requirements, it also serves to verify the legality of its conclusions. Any judicial scrutiny of regulators is constrained by the legislative provisions under which they operate. The difficulty here is that the discretion conferred on a supervisor is typically broad. Courts, in practice, exercise restraint and defer to the expert knowledge of the supervisor, given that they do not normally possess the expertise in financial matters. Substantive accountability is, therefore, of less significance, and judicial review is generally limited to review of legality with a view to ensuring that discretion is not exercised in bad faith or for improper purposes.³² Judicial review needs to be limited and time-bound in order to avoid that the process will stand in the way of regulatory and supervisory efficiency and effectiveness.

Arrangements

- **Administrative review.** Most jurisdictions provide for some form of review within the administrative framework, in addition to judicial review. In jurisdictions where the financial supervisor is directly accountable to the minister of finance, the latter often is given the power to review bank regulatory decisions.³³ While review by the competent ministry may ensure the necessary competence in the field, it interferes with the independence of the RSAs. For these reasons, a review body composed of independent experts in the field may be better suited to review decisions of the financial supervisor.³⁴ Administrative review cannot entirely replace judicial review.
- **Judicial review.** Judicial review of administrative action is a “supervisory jurisdiction” (Radford (1997)). It provides a procedure whereby the courts oversee the exercise of public power. Traditionally, the purpose of judicial review of administrative action is to ensure that the decision maker acts within its powers. The right of individuals or institutions, subject to the RSA’s decisions to apply to a judicial authority for review of those decisions, is generally accepted.³⁵ Judicial review systems vary in the different

³² Hüpkes (2000).

³³ For instance, under Italian banking law, decisions by the Bank of Italy can be appealed to the Interministerial Committee for Credit and Savings. In Spain, both administrative acts adopted by the Bank of Spain, and any sanctions it may impose, are subject to appeal to the ministry of economy and finance.

³⁴ The FSMA established the Financial Services and Markets Tribunal, which act as a court of first instance for decisions of the FSA.

³⁵ It is reflected in the European Convention on Human Rights, as well as in the constitutional law of most countries. In the United States, the Administrative Procedures Act explicitly provides a right of judicial review of agency decisions, “*A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof.*” USA 5 U.S.C. § 703 (1988).

legal systems. In some, administrative disputes belong to the ordinary courts, which consider civil and criminal cases (so-called unitary system of jurisdiction),³⁶ in others, judicial protection is ensured by a quasi-judicial authority that belongs to the executive.³⁷ In the system most common in Western Europe, there are separate administrative courts for administrative judicial appeals (dualist system).³⁸ In addition to judicial review, most jurisdictions provide for some form of administrative review within the RSA or by a higher administrative body. Administrative review looks at the facts and merits of an RSA decision. In jurisdictions where the financial supervisor is directly accountable to the minister of finance, the latter often is given the power to review bank regulatory decisions.³⁹ While review by the competent ministry may ensure the necessary competence in the field, it interferes with the independence of the RSAs. For these reasons, a review body composed of independent experts may be better suited to review decisions of the financial supervisor.⁴⁰ However, administrative review cannot entirely replace review by an independent judge.

- **Supervisory liability.** In the event of a supervisory failure, the RSA may, in principle, be held liable (and therefore accountable) for losses caused by a failure in the exercise of its supervisory duty. The principle of public liability, that is, the obligation of public authorities to make good (either by compensation or by any other appropriate means) the damage caused by acts or omissions of their officials in the exercise of their public functions, is codified in the laws of most countries and reflected in international instruments. Yet, liability for faulty supervisory action is limited in many respects. Any official of RSAs who took action in good faith should not be held personally liable for damages caused in the exercise of his functions. Direct legal action against officials is generally only admitted for reckless behavior. Supervisors should not be dissuaded from acting promptly and decisively for fear of being held personally liable for their acts.⁴¹ Most jurisdictions, therefore, set high standards for admitting liability of the financial

³⁶ For example, Canada, Denmark, Ireland, United Kingdom, and the United States.

³⁷ For example, Belgium, France, and Luxemburg.

³⁸ For example, Austria, Finland, Germany, Greece, Italy, the Netherlands, Portugal, Spain, Sweden, and Switzerland.

³⁹ For instance, under Italian banking law, decisions by the Bank of Italy can be appealed to by the Interministerial Committee for Credit and Savings. In Spain, both administrative acts adopted by the Bank of Spain, and any sanctions it may impose, are subject to appeal to the ministry of economy and finance.

⁴⁰ The FSMA established the Financial Services and Markets Tribunal, which acts as a court of first instance for decisions of the FSA.

⁴¹ Principle 1 of the BCP regards the “legal protection of supervisors” a necessary component of a legal framework for banking supervision.

supervisor and awarding damages to claimants.⁴² Rules on immunity and limited liability of the supervisor are correlates of independence, and are justified by the need for effective supervision. However, given their far-reaching impact, their existence needs to be compensated by appropriate accountability arrangements, including judicial review and a procedure that offers administrative compensation in cases where loss was suffered due to unlawful action by the RSA.

E. Accountability Toward Stakeholders (Industry, Consumers) and the Public (Market-Based Accountability)

Objectives

Most RSAs are financed in full, or in part, by fees levied on supervised institutions and, thus, are, to some extent at least, accountable to those who finance them. To the extent that consumer protection falls within the mandate of the financial supervisor, the consumers and the treatment of consumers' complaints constitute another area of accountability. Finally, RSAs are also accountable to the public at large. Depositors, investors, and consumers are also voters. The public, i.e., the electorate, is the ultimate source of democratic accountability. It exercises its powers in elections and, in some jurisdictions, through veto or referendum powers. Transparency, consultation, participation, and representation are powerful vehicles for accountability toward stakeholders and the public, and help in providing legitimacy to the agency's actions.

Arrangements

- **Transparency**, i.e., the disclosure of relevant information on the RSAs' activities to the general public and the regulated industry—in particular, is a market-based form of accountability. It encourages open administration and serves the function of enhancing public confidence in the financial supervisor.⁴³ Transparency is implemented by way of publications, typically on the website of the RSA of all regulations, supervisory practices, and important decisions (within the confines allowed by confidentiality and market-sensitivity requirements), annual reports, as well as regular press conferences and information events. In most countries, RSAs are required to publish an annual report.

⁴² The approach chosen to limit liability differs among jurisdictions: one approach is to raise the negligence standard required for the admission of liability or to limit liability to acts committed in bad faith. Another approach is to exempt from liability certain acts or decisions that are based on policy consideration (cf. the discretionary function exception under the U.S. Federal Tort Claims Act) or to define the cause of action in a narrow manner to exclude a large number of potential claimants.

⁴³ The IMF Code of Good Practices on Transparency and Financial Policies lays out best practices for disclosure to the public of the activities of the financial supervisor (IMF, 1999).

- **Consultation and participation.** RSAs should consult frequently with supervised institutions on policy issues. Direct participation through consultation procedures serves to achieve greater acceptability and effectiveness of the regulatory process and also increases the RSA's legitimacy. Rules adopted by the RSA in the exercise of its regulatory powers are subordinate legislation. While they are not subject to any form of direct parliamentary or government control, they are of significant practical importance, since they set forth in detail the rules to be implemented by the industry. The supervisor should have arrangements in place for involving representatives of affected interests on the appropriateness and practicality of proposed rules. A formalization of the rule-making process may lead to less covert influence and reduce inequalities in the power of pressure groups. It should define a number of prerequisites of the rule-making process to be observed by the supervisor. Representatives of affected interests should be involved, either through participation in working groups or through the right to make submissions on draft rules.⁴⁴ Draft rules should be published for comment. They should be reasoned, and be accompanied by an explanation of their purpose and a statement of the reasons why their making is compatible with the statutory objective. The RSAs should undertake, to the extent possible, an assessment of the regulatory effectiveness and the costs to the industry.⁴⁵ Finally, the RSAs should publish an account, in general terms, of the comments made on the draft rules and its response to them.⁴⁶
- **Representation.** Accountability to the industry and consumers can also be achieved through appropriate representation on an oversight board. In Germany, the financial industry is represented in the administration and advisory board. The advisory board also comprises representatives from academia, central bank, and consumer associations. Its task is to make recommendations on the further development of supervisory practice. The French Comité de la Réglementation Bancaire et Financière also comprises representatives of the industry among its members. In the Netherlands, the Bank Council, which also counts representatives of the industry among its members, gives advice on general policy matters, including bank supervision.

⁴⁴ In the United Kingdom, these arrangements include the establishment of practitioner and consumer panels to represent their respective interests. The membership of both panels is appointed by the FSA, with the appointment and removal of their chairman being subject to treasury confirmation. The FSA must consider representations made by either panel, and should it disagree with either panel, it should give a written statement of its reasons for disagreeing.

⁴⁵ Ideally, the RSAs should be required to assess the costs and the benefits of the intended regulation, including the costs of enforcement and compliance to the supervisor, the regulated institutions, and the public. Recognizing that some cost or benefits are difficult to quantify, it should provide a reasoned determination that the benefits of the intended regulation justify its costs. The RSAs should consider all available alternatives to the intended regulation and select the best one to achieve the regulatory objective.

⁴⁶ The FSMA has codified this procedural accountability and requires the FSA to conduct public consultations with both consumers and practitioners, with respect to the exercise of rule-making powers.

F. Audit (Financial Accountability)

Objective

A common instrument of explanatory accountability is the presentation of financial accounts, demonstrating the regularity of expenditures. Reporting on the way in which the funds are spent is yet another way to render account of activities. RSAs should be financially independent and financially self-supporting in as much as they finance their expenses for supervision from the regulated entities.

In some countries, however, the financial supervisor is partly or totally funded from the government or finance ministry budget. This is, for instance, the case in Hungary and Japan. In others, e.g., in Spain, the budget of the Bank of Spain, once approved by its governing council, is forwarded to the government, which submits it to parliament for approval. In Germany, the Chairman of the Federal Financial Supervisory Authority submits the draft budget to the administrative board. The budget needs approval of the ministry of finance. In France, the financial accounts are consolidated into the central bank accounts. In Finland, the FSA's account is also consolidated in the central bank's, although the funds come from the supervised entities. In principle, financial independence for supervisors should be guaranteed through the central bank's financial independence in those cases.

Arrangements

- **Financial audit.** Financial accountability should generally be limited to ex post budgetary accountability, which focuses on a review of the annual accounts and balance sheets by independent auditors to determine whether there has been proper financial management, whether the authority is managing its resources in an efficient way, and whether financial reports represent a true and fair view. In the United Kingdom, the treasury may commission an independent financial review of the FSA. In Germany, an independent audit is submitted to the chairman, the Administrative Board, the finance ministry and the Federal Financial Comptroller. In the Netherlands, the annual audit report must be signed by all members of the Supervisory Board and the Governing Council and submitted to the State (the shareholder of the Netherlands Bank).
- **Internal inspectorate.** Another form of accountability may be ensured by an internal inspectorate, which reports regularly to the Board and/or parliament. As such, in the United States, the Inspector General Act provides for the appointment of an inspector general to all major agencies, including RSAs, such as the Board of Governors of the Federal Reserve System. The inspector general conducts independent and objective audits, investigations, and other reviews of the agency, and reports both to the head of the agency and Congress. The inspector general has direct access to all records and information of the agency.

G. Monitoring Outside National Jurisdictions

Objective

International financial integration has intensified calls for the standards applied by RSAs to be subjected to monitoring outside their own national jurisdictions, as it limits the danger of cross-border contagion of local financial sector problems. Foster (2000) argues that agencies dealing with highly specialized and sophisticated areas should also establish accountability arrangements with peers. Two arrangements have recently been developed to provide external monitoring of domestic regulatory and supervisory frameworks. As this is a relatively new area, others can be expected to develop in the near future.

The first mechanism is surveillance by international financial institutions; the other is (bilateral) peer review to assess the equivalence of legislation in jurisdictions.⁴⁷ Although not accountability arrangements in the strictest sense, these mechanisms do require the RSA to give an account of its standards and practices to external experts and can, among other things, contribute to the legitimacy of the independent RSA.

Arrangements

- **Financial sector assessment program.** The FSAP introduced by IMF and World Bank provides a mechanism for external experts to assess the standards being applied by domestic regulatory agencies. The objective of the FSAPs is to assess the quality of the regulatory and supervisory framework. The resulting report and its recommendations provide useful guidance to the authorities of the country, and an incentive mechanism to stimulate and improve the regulatory system. The report, which is made public with the approval of the authorities, also provides an impartial account of the performance of the supervisory system and, as such, constitutes another instrument of accountability to the public.
- **Mutual evaluations and peer review.** Other international organizations and groupings, such as the FATF and its regional bodies, conduct mutual evaluations and peer review in defined areas, such as anti-money laundering, in order to achieve a consistent implementation of international standards. These forms of multilateral monitoring provide a mechanism for accountability to the international community on the implementation of international standards. Peer review can also be organized at bilateral level. Goodhart (2001) discusses the possibility of peer review as an accountability mechanism for RSAs. He notes that the assessment of compliance with the BCP, as part of the FSAP, could be used and extended as an accountability arrangement.

⁴⁷ As such, the European Banking Advisory Committee issues general guidance to EU supervisors on the equivalence of supervision in third countries.

V. CONCLUSIONS

The lingering uneasiness about granting independence to regulatory agencies, in general, and to RSAs, in particular, stems from different sources. Fear exists that such an agency will act as an unelected fourth branch of government, and not be subject to the usual political checks and balances. The regulatory capture theory, although coming from a very different perspective, adds to these fears. Finally, it has also been shown that politicians have a tendency to retain those tasks that are likely to generate political rents or that have redistributive effects. Financial sector regulation and supervision fits this picture very well, which helps in understanding why politicians in several countries do their best to, formally or informally, remain involved in this activity.

Compared with independence, which is a concept that is relatively easy to define and understand, accountability is more elusive. In statutes and laws it typically takes one short article to state that an agency is independent. Accountability, on the other hand is, in the words of the House of Commons Select Committee on the Treasury (1998) “...an elusive concept and trying to find an accurate and comprehensive definition is correspondingly difficult.” This very elusiveness has, in turn, contributed to the widespread perception that independence and accountability must be ultimately incompatible—that more of one necessarily means less of the other. It also hinders attempts to include in the legal framework governing RSAs concrete and workable accountability arrangements.

This paper has addressed these issues. It has shown how the concept of accountability can be given operational content, and that it is possible to do so in a way that encourages and supports agency independence. Starting from the premise that there is a strong case for granting independence to RSAs, this paper’s primary message is that the reluctance to take this step can be overcome by designing strong, and properly constructed, accountability arrangements.

To achieve its goal, the paper has assembled three building blocks. First, based on recent insights—which mainly originated in the public administration literature—the paper elaborates on the role and purpose of accountability. Accountability fulfills at least four functions: to provide public oversight; to provide and maintain legitimacy; to enhance integrity of public sector governance; and to enhance agency performance. Recognizing these four functions allows us to see that good accountability arrangements play an essential role in making independence effective and in supporting good agency governance.

Second, the paper argues that RSAs have a number of features that set them apart from the central bank in its role of monetary policy authority. We have argued that financial sector regulators and supervisors have to cope with a comparatively greater range of contingencies; that their mandate (multiple, nonmeasurable, and often vague) is not easily amenable to simple scrutiny; that they have to cope with issues of confidentiality and market sensitivity; that they operate in an environment of multiple principals; and that they have extensive and far-reaching enforcement and sanctioning powers. These features, taken together, point to the

need for a more complex system of accountability arrangements and relations than, for instance, the central bank in fulfilling its monetary policy functions.

An important conclusion from this analysis is that there might be a need to revisit the accountability arrangements of central banks that perform monetary policy and supervisory functions. Very often, accountability arrangements focus on the monetary policy function, and it is implicitly assumed that similar arrangements would satisfy the supervisory objectives. This paper argues that more elaborate arrangements are warranted for the supervisory functions.

Third, the paper discusses in detail the specific mechanisms by means of which the objectives of accountability can be best secured, as well as a wide range of accountability arrangements that are found in existing law and practice. While our discussion does not aim to be exhaustive, we believe that it will, nonetheless, be valuable to countries and governments that wish to deepen the accountability relations of independent RSAs.

While this paper has focused on accountability arrangements, we also encourage further thinking on ways to facilitate accountability. One such way is to establish the RSA's mandate as concretely as possible and to define functions to meet the mandate. Another approach might be an institutional reform at the supervisory level to limit the number of goals one agency has to pursue. This was an important consideration behind the reform of the Dutch supervisory model (see Jonk and others, 2001).

This paper has focused on financial sector regulators, mainly because the growing interest in their role in contributing to financial stability, but its findings and suggestions are of a wider application. First, the increasing interest in independent RSAs for other economic sectors is a worldwide phenomenon. This paper can certainly contribute to that debate. Second, an growing number of central banks are adding the achievement and maintenance of financial stability to their official mandate. The definition of this mandate suffers from similar problems as the mandate of RSAs, and having a double mandate brings to the fore also the issue of prioritization. A recent survey by Oosterloo and de Haan (2003) demonstrates that the accountability arrangements currently adopted in central bank laws in most OECD member countries are poorly designed and fall short of bringing the necessary assurances that the independent central bank has met its financial stability objectives. Third, according to several scholars (e.g., Amtenbrink (1999)) the debate about the accountability arrangements of the European Central Bank remains open. In addition, there is the emerging debate about the proper financial supervisory structure for the euro-zone, which entails its own accountability discussion (Lastra, 2004). We hope that this paper might contribute to these and other debates.

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Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries					
Part I					
Accountability Arrangements	United Kingdom	Germany	The Netherlands	Australia	Canada
Institution	Financial Services Authority.	Federal Financial Supervisory Authority (BAFin).	De Nederlandsche Bank N.V. (DNB) Authority for the Financial Markets (AFM).	Australian Prudential Regulation Authority (APRA).	Office of the Superintendent of Financial Institutions (OSFI).
Legal basis	Financial Services and Markets Act 2000.	Act establishing the Federal Financial Supervisory Authority 2002.	Among others, Bank Act 1998 and Act on the supervision of the credit system 1992.	Australian Prudential Regulation Authority Act 1998.	Office of the Superintendent of Financial Institutions Act 1997.
Function	Supervision and regulation of banks, insurance companies, collective investment schemes, investment firms, exchanges, and clearing houses.	Supervision and regulation of banks, financial services institutions, insurance companies, securities and derivatives markets (supervision of financial and credit institutions takes place in close cooperation with the Bundesbank).	Central Banking Function DNB is responsible for (prudential) supervision of banks, life and non-life insurance companies, collective investment schemes, securities firms money transaction offices and trust offices. CB objective within the ESCB framework. AFM is responsible for the supervision of market conduct and the conduct of business of participants operating in the financial markets.	Prudential regulation and supervision of banks, life insurance companies, general insurance companies, superannuation, funds, credit unions, and building and friendly societies.	Supervision of banks and other federally incorporated financial institutions (comprising banks, trust companies, loan companies, life and other insurance companies and fraternal benefit societies).
Statutory objectives	<ul style="list-style-type: none"> Maintaining confidence in the financial system. Promoting public understanding of the financial system. Securing the appropriate degree of 	<ul style="list-style-type: none"> Objectives described in the individual acts governing the supervisory activities (e.g., Banking Act, Securities Act and Insurance Supervision Act). Related to the stability and functioning of the 	<ul style="list-style-type: none"> DNB: with respect to the supervisory and regulatory functions <ul style="list-style-type: none"> Within the framework of the European System of Central Banks contribute to the smooth conduct of policies relating to the prudential supervision of credit institutions and the 	<ul style="list-style-type: none"> Provides prudential regulation or advice services according to the Act. In addition to functions described in the Law of the Commonwealth, Law of State or 	<ul style="list-style-type: none"> Supervise financial institutions to determine whether they are in sound financial condition and in compliance with the law. Advise management if this is not the case and require remedial action to be taken.

**Formal Accountability Arrangements for Financial Supervisory Authorities
in Selected Countries**

Part I

<p>Accountability Arrangements</p>	<p>United Kingdom protection for consumers.</p> <ul style="list-style-type: none"> Reducing financial crime. 	<p>Germany financial system.</p>	<p>The Netherlands stability of the financial system.</p> <ul style="list-style-type: none"> Supervising financial institutions in pursuance of the relevant statutory regulations. Promoting the smooth operation of the payment system. Collection statistical data. 	<p>Australia Territory.</p>	<p>Canada</p> <ul style="list-style-type: none"> Promote the adoption by management and boards of directors of risk control policies and procedures. Monitor events at the industry level that may negatively affect the financial condition of institutions. Also responsible for administering federal legislation under the bank, insurance, trust and loan companies, cooperative credit associations and pension benefits acts.
<p>Management structure</p>	<p>A governing body consisting of a chairman and chief executive, Three managing directors (executive members of the governing body) and nonexecutive members.</p>	<p>President and a vice- president.</p>	<p>DNB: Governing Board consisting of a president and between three to five executive directors, all appointed by the government. The president reports to the bank council on the general economic and financial situation and discusses the policy conducted by the bank with the bank council as well as other matters in connection with the bank's objectives, tasks and activities.</p>	<p>APRA is consist of no less than three members and no more than five.</p>	<p>Superintendent and deputy superintendents (the functions of deputy superintendents are currently performed by assistant superintendents).</p>
<p>Direct oversight function (e.g.,</p>	<p>Nonexecutive committee (nonexecutive</p>	<p>Administrative Board (Verwaltungsrat) oversees</p>	<p>DNB: Supervisory Board consisting of between 9 and 12</p>	<p>APRA members determine APRA's</p>	<p>The Financial Institutions Supervisory Committee (FISC)</p>

**Formal Accountability Arrangements for Financial Supervisory Authorities
in Selected Countries**

Part I

<p>Accountability Arrangements Supervisory Board)</p>	<p>United Kingdom members of the governing body) has the responsibility for reviewing the performance (efficient use of resources) of the FSA, internal financial controls and remuneration of executive members.</p>	<p>Germany management composition: chairman and deputy chairman from the finance ministry delegates from the finance ministry, ministry of justice, parliament, banking industry, the insurance industry, the investment industry, and the Bundesbank (Without voting right). The chairman regularly must inform the Administrative Board on management activities.</p>	<p>The Netherlands members: One member appointed by the government, the chairman and other members appointed by the shareholders. Shareholders from a list drawn up by the supervisory Board.</p>	<p>Australia policies, ensures it performs its functions properly, efficiently, and effectively.</p> <p>Canada does not have a direct oversight role, but facilitates consultation and exchange of information among its members on all matters relating directly to the supervision of financial institutions. The FISC consists of the superintendent (chair), the Governor of the Bank of Canada, the Chairperson of the Canada Deposit Insurance Corporation, the Commissioner of the Financial Consumer Agency of Canada, and the deputy minister of finance.</p>
<p>Relationship with the executive (finance ministry and government)</p>	<p>The treasury appoints and removes the chairman of the FSA and appoints the chairman of the nonexecutive committee. The FSA submits an annual report to the treasury together with the report of the nonexecutive committee. The minister of finance is the formal head of OSFI and reports to parliament.</p>	<p>The President of the Federal Republic of Germany appoints the president and vice-president upon proposal by the federal government. The ministry of finance has oversight authority and it is required to ensure that BaFin executes its tasks according to the law.</p>	<p>DNB: the member of the Supervisory Board appointed by the government may at the request of the finance minister or on its own initiative obtained from the Governing Board data and information about the manner in which the bank performs its tasks and communicate his findings to the minister of finance. The Minister can request DNB to provide data and information in connection with its tasks and activities as he deems necessary with the purpose of determining the government's financial and economic policy.</p>	<p>APRA members are appointed by the governor general. One person is appointed as the chair. APRA is to regularly inform the government of APRA's policies. The governor-general upon recommendation of the treasury, acting with the advice of the Federal Executive Council, may determine APRA's policy in case of disagreement between the APRA and the government. The minister of finance can request public disclosure of information for the purposes of analysis of the financial condition of a financial institution. In addition to his role on FISC, the superintendent is a member of the Senior Advisory Committee (SAC) and of the Board of Directors of the Canada</p>

**Formal Accountability Arrangements for Financial Supervisory Authorities
in Selected Countries**

Part I

Accountability Arrangements	United Kingdom	Germany	The Netherlands	Australia	Canada
	Treasury submits the FSA annual report to parliament. Parliament considers the report thru one of its committees (treasury select committee) and may received evidence from the treasury and the FSA.	Parliament is represented in the Administrative Board by five delegates.	DNB presents a report to the ministry involved, on the implementation of the above mentioned acts. The minister may request DNB for data on information that in his opinion is necessary for an examination of the adequacy of the act or its implementation. The president of DNB may be heard by the first or second chamber of parliament at their request. Members of parliament may address inquiries with respect to DNB to the finance ministry.	The treasurer is required to present APRA's annual report to both houses of parliament and recommendations in case of disagreement between the Board and the government regarding APRA's policies.	The minister of finance is responsible for OSFI and reports to parliament. The superintendent submits the annual report to the minister of finance, who presents it to parliament.
Relationship with parliament					
Accountability toward stakeholders (industry, consumers, etc.) and the public (through e.g. publications of reports, consultation procedures on regulations)	Publication of annual report. Public consultation (consumers, practitioners) with respect of the exercise of rule making powers.	Publication of annual report. An Advisory Board (Fachbeirat) with representatives of the central bank, academia, financial industry, and consumer associations may make recommendations on the further development of supervisory practice. The financial industry is also represented in the Administrative Board by	Bank council consisting of between 11 and 13 members (with representation of academia, industry associations, etc.) Composition: The member of the Supervisory Board appointed by the government. One member appointed by the Supervisory Board from its own members and members appointed by the Bank Council itself. DNB publishes quarterly and annual reports on its activities.	Publication of annual report. Consultations with industry and other interested parties with respect to regulations and prudential guidelines. Annual consultations with industry and representatives on budgets and assessments.	Publication of annual report. Consultations with industry and other interested parties with respect to regulations and prudential guidelines. Annual consultations with industry and representatives on budgets and assessments.

Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries

Part I

Accountability Arrangements	United Kingdom	Germany	The Netherlands	Australia	Canada
Audit/budgetary accountability	The treasury may commission independent financial reviews of the FSA.	The president submits draft budget to the Administrative Board for approval. At the end of the fiscal year, the president submits financial statements to the Administrative Board which approves with consent of the federal ministry of finance. Independent audit is carried out according to the charter of the BAFin. The audit report must be submitted to the president, the Administrative Board, the finance ministry and the Federal Financial Comptroller (Bundesrechnungshof).	Representative organizations of supervised institutions are consulted by DNB on draft (changes of) legislation. The general meeting of shareholders commissions an expert to audit the annual accounts. The expert presents the audit report and its opinion on the report to the Supervisory Board and the Governing Board. The annual accounts are signed by all members of the Supervisory Board and the Governing Board and are approved by the shareholders (the state). With respect to supervisory tasks: a draft budget is submitted by DNB to the ministry involved for approval, after prior consultation with representative organizations of supervised entities.	APRA submits an annual report to the treasurer with audited financial statements in accordance with orders made by the finance ministry. Note: The auditor-general conducts an independent audit of APRA and its opinion is published as part of APRA's annual report.	OSFI budget requires the approval of the Treasury Board, although the section in the OSFI Act stipulating this does not apply in practice as OSFI's expenditures usually do not exceed the total of assessments and revenues collected and moneys appropriated by parliament. Accounts are audited by the Auditor General of Canada.

Source: Respective national laws.

<p align="center">Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries</p> <p align="center">Part II</p>					
Accountability Arrangements	Korea	Japan	Chile	Spain	Finland
Institution	Financial Supervisory Commission (FSC).	Financial Services Agency (FSA)	Superintendency of Banks and Financial Institutions (SBIF)	Banco de España	Financial Supervision Authority (FSA)
Legal basis	Law of Establishment of Financial Supervisory Bodies 1999.	FSA Law, 2000.	General Banking Law, 1997.	Law on the Autonomy of the Banco de España, 1994.	Act on the Financial Supervision Authority. 2003.
Function	Supervision of financial institutions and securities markets.	Supervision of the banking, insurance, and securities industries.	Supervision and prudential regulation of banks and financial institutions.	Supervision of credit institutions.	Supervision and regulation of banks, stock, and securities markets.
Statutory objectives	<ul style="list-style-type: none"> The FSC is responsible for the promulgation and amendment of financial supervisory rules and regulations. The approval and permission for the business of financial institutions relating to their operations and for the deliberation. And resolution of agenda with respect to any inspections, examinations, and sanctions on financial institutions, etc. 	<ul style="list-style-type: none"> Establishing a stable and dynamic financial system. Developing a state of the art financial system Development and proper implementation of regulations to protect users. Ensuring transparency and fairness in financial administration based on clear rules. Enhancing the expertise and foresight of the staff and improving the administrative 	<ul style="list-style-type: none"> Supervise the State Bank, the bank and financial entities that are not supervised by another agency. Issue instructions and adopt all measures necessary to correct irregularities in supervised entities to protect depositors, other creditors, and the public interest. Watch over compliance of the supervised entities with laws, rules, regulations, and other legal notifications. 	<ul style="list-style-type: none"> Monitoring and supervising credit institutions Monitoring and supervision of the application of the legal framework governing the mortgage market. Cooperation with the authorities entrusted with similar functions in foreign countries. 	<ul style="list-style-type: none"> Promoting financial stability and public confidence in the operation of financial markets. Statutory tasks of the FSA: <ol style="list-style-type: none"> Supervising activities of supervised entities and financial market participants. Directing financial market participants to comply with good practice. Fostering public awareness of financial markets.

<p align="center">Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries</p>					
<p align="center">Part II</p>					
Accountability Arrangements	Korea	Japan	Chile	Spain	Finland
Management structure	<p>Nine commissioners consisting of the chairman, vice-chairman, one standing commissioner, and six non-standing commissioners.</p> <p>The chairman is the head of the FSC and the Financial Supervisory Service Board whose function is to represent the commission.</p>	<p>The chairman is appointed by the prime minister.</p>	<p>Superintendent and intendents.</p>	<p>Governing body is composed of the governor, deputy governor, governing council and the executive commission.</p>	<p>Board composed of six members, i.e., four members appointed by the PSC, of which two on the proposal of the ministry of finance, one on the proposal of the Bank of Finland and one on the proposal of the ministry of social affairs and health.</p> <p>The director general of the FSA and director general of the insurance supervision authority are also included in the Board. The chairman and vice-chairman are selected from the members proposed by the MoF or BoF.</p>
Direct oversight function (e.g. Supervisory Board)		<p>The minister of financial services is in charge of managing the FSA's operations.</p>		<p>Governing council is composed of the governor, deputy governor, six elected council members, the director general of the treasury and financial policy, the vice-president of the national securities market commission. The governing council approves general guidelines, internal rules, sanctions or proposed</p>	<p>The Parliamentary Supervisory Council (PSC) supervises the overall expediency and efficiency of the operations of the FSA. In addition, the PSC has oversight with respect to certain administrative matters.</p>

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Accountability Arrangements	Korea	Japan	Chile	Spain	Finland
<p>Relationship with the executive (finance ministry and government)</p>	<p>Each commissioner is appointed by the President of the Republic of Korea. The commissioners are the deputy minister of finance and economy, deputy governor of the Bank of Korea, the President of the Korea Deposit Insurance Corporation, experts recommended by the minister of finance and economy, minister of justice and the President of the Korea Chamber of Commerce and Industry.</p>		<p>The superintendent is appointed by the president of the Republic. The SBIF relates to the government via the ministry of finance.</p>	<p>sanctions to be submitted to the minister, bank circulars, the budget, and the annual report.</p> <p>All members of the governing council are appointed by the government.</p> <p>The governing council approves the annual report to be submitted via the government, to parliament.</p> <p>A separate report is produced on banking supervision and after approval by the Bank's decision making bodies it is sent to the government and Parliament.</p>	<p>The director general is appointed by the President of the Republic. Two members of the Board are appointed on the proposal of the ministry of finance and one on the proposal of the ministry of social affairs and health. The ministry of finance is the principal agency for financial sector law-making.</p>
<p>Relationship with parliament</p>		<p>The minister is a member of the cabinet, appointed by the prime minister.</p>		<p>The bank sends an annual report to parliament on actions that have given rise to very serious sanctions and to interventions in supervised institutions.</p> <p>The governor can also appear before parliament to discuss supervisory issues.</p> <p>The estimated budget is sent to the government which submits it to</p>	<p>The members of the PSC are appointed by the parliament. The FSA Board supplies the PSC with an annual report. In addition, the Board supplies the PSC with an annual report on achievement of objectives of FSA operations. In turn, findings are included in the PSC report to the parliament concerning the operations of the Bank of Finland. Thus the</p>

Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries					
Part II					
Accountability Arrangements	Korea	Japan	Chile	Spain	Finland
Accountability toward stakeholders (industry, consumers, etc.) and the public (through e.g., publications of reports, consultation procedures on regulations)	Publication of annual report.	Publication of annual report.	SBIF must inform the general public about the status of supervised institutions at least three times a year.	Publication of Bank of Spain's annual report as well as the report on supervision.	Publication of the annual report for the public. Publication of the annual report for the PSC. FSA newsletters (6 per year) to the public. Open consultation on FSA regulations. Publication of major FSA actions and decisions.
Audit/budgetary accountability	The ministry of finance and economy, the Bank of Korea, and the FSC may request and exchange information from each other.	The FSA is funded from the central government budget.	The SBIF provides information to the ministry of finance and the Central Bank of Chile about the supervised institutions. Accounts are audited by the general comptroller of the Republic.	The annual balance sheet and accounts of the bank, once approved by the government upon proposal by the ministry of finance and economy, is sent to parliament for information.	The financial accounts of the FSA are consolidated into the Bank of Finland financial accounts and are audited by auditors appointed by the PSC. The cost of the FSA activities are covered by fees received from the industry.

Source: Respective national laws.

<p align="center">Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries</p>					
<p align="center">Part III</p>					
Accountability Arrangements	Poland	Hungary	France	Italy	Switzerland
Institution	Naradowy Bank Polski (NBP) Commission for Banking Supervision	Hungarian Financial Supervisory Authority (HFS)	Ministre de l'économie et des finances (MINEFI). Comité des Etablissements de Crédit et des Entreprises d'Investissement (CECEI) Commission Bancaire (CB) Banque de France	Banca d'Italia	Swiss Federal Banking Commission (SBFC)
Legal basis	Banking Law of August 27, 1997.	Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority.	Code monétaire et financier	Consolidated Act, 1993.	Federal Law on Banks, November 8, 1934.
Function	Supervision of banks.	Supervision and regulation of the financial services industry.	Licensing, supervision and regulation of credit institutions and securities firms.	Supervision and regulation of banks and financial intermediaries.	Supervision of banks, investment fund, securities exchanges and securities firms.
Statutory objectives	<ul style="list-style-type: none"> To ensure the safety of funds held on bank accounts. To ensure compliance by the banks with the provisions set by the Banking Law. 	<ul style="list-style-type: none"> To promote the smooth operation of the money and capital markets. To protect the interest of clients and financial institutions. To enhance the transparency of markets. To maintain a fair and regulated market competition through the permanent surveillance of the prudent operations of organizations and entities engaged in 	<ul style="list-style-type: none"> Client asset protection. Enforcement of applicable laws and regulations. Financial soundness of banks and financial institutions-on a solo and on a consolidated basis. Maintenance of market and systemic liquidity. 	<ul style="list-style-type: none"> Sound and prudent management of the persons subject to supervision. Overall stability of the financial system. Efficiency and competitiveness of the financial system. Compliance with the provisions concerning credit. 	<ul style="list-style-type: none"> To protect depositors and to maintain the trustworthiness and orderly functioning of the banking system in the public interest. To preserve the reputation of Switzerland as a financial centre. To protect the Swiss economy against exceptionally high outflows of capital. To protect banks against excessive withdrawals of capital.

<p align="center">Formal Accountability Arrangements for Financial Supervisory Authorities in Selected Countries</p> <p align="center">Part III</p>					
Accountability Arrangements	Poland	Hungary	France	Italy	Switzerland
Management structure	The commission is composed of the chairperson, deputy chairperson, and five public officials.	President and two deputy presidents.	Financial Security Act 2003 vested MINEFI with regulatory powers in the sectors of insurance, banking, and securities firms. MINEFI may adopt regulations following a consultative opinion of Comité Consultatif de la Législation et de la Réglementation Financières (CCLRF). The CECEI, chaired by the governor of the Banque of France, is vested with the powers of licensing credit institutions and examining their shareholders. The CB, chaired by the Governor of the Banque of France, is vested with supervisory and disciplinary powers upon credit institutions.	Banking Supervision Department.	The SFBC is composed of seven to eleven members all appointed by the federal council.
Direct oversight function (e.g., Supervisory Board)	Management Board is composed of the chairperson and six to eight Board members of which two are deputy chairpersons of the NBP, appointed by the government.	The supervision council has 15 members and the president of the HFSA is the chairman. Five members are appointed based on consultations with the minister of finance and	CB and CECEI are independent administrative oversight body. Checks and balances help maintain their operational autonomy.	The interministerial committee for credit and savings is the highest authority for credit and the protection of savings. The chairman is the minister of the treasury and the other	

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Accountability Arrangements	Poland	Hungary	France	Italy	Switzerland
	<p>Its function is to direct the activity of the NBP.</p>	<p>10 members are appointed based on consultations with professional associations. The council is an advisory body.</p>		<p>members are the minister of foreign trade, the minister for the coordination of agricultural food and forestry policies, the minister of finance, the minister for industry, the minister of public works and the minister for European community affairs.</p>	
<p>Relationship with the executive (finance ministry and government)</p>	<p>The chairperson is the president of the NBP and deputy chairperson is a representative of the ministry of finance. Other members are representatives of the President of the Republic of Poland, the Bank Guarantee Fund, Securities and Exchange Commission, ministry of finance and the general inspectorate for banking supervision. Annual assessments on the financial condition of the banking industry are made available to the government (e.g., speakers of the Sejm, senate, central authorities and civil service agencies).</p>	<p>The prime minister elects two deputy presidents submitted by the minister of finance upon recommendation of the president of the supervision. The president of the HFSA reports to the government about its activities each year.</p>	<p>The Governor of the Banque de France and the Head of the Treasury are appointed by the Council of Ministers. The MINEFI is appointed by the President of the Republic. All other members of CECEI and CB are appointed by the MINEFI.</p>	<p>Members of the interministerial committee for credit and savings are appointed by the government. The minister of treasury can act in place of the credit committee in case of emergency.</p>	<p>The SBFC is required to make its annual report to the federal finance ministry. The SBFC reports once a year to the federal council. The SBFC communicates with the federal council via the Federal Department of Finance.</p>
<p>Relationship with parliament</p>	<p>The chairperson and deputy chairperson are both appointed by the Sejm at the request of the President</p>	<p>Parliament elects the president on the prime minister's proposal. The president of the HFSA,</p>	<p>The Governor of the Banque de France may be heard or may ask to be heard by parliament.</p>		<p>The SFBC furnishes an annual report to the legislature. The chairman and senior officials of the</p>

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Accountability Arrangements	Poland	Hungary	France	Italy	Switzerland
	<p>of the Republic of Poland. The annual report is submitted to the Sejm.</p>	<p>following the report provided to the government, informs the competent committee of parliaments about its supervision activities every year.</p>	<p>Banque de France sends annual reports to the president and to parliament. Each year the CCLRE sends the President of the Republic and the parliament (both houses) a report on the regulation of the banking and financial systems. Members of parliament participate to CCLRE sessions (both houses). CECEI and CB also publish annual reports.</p>		<p>commission are required to appear before parliamentary committees when they discuss the report, although the minister represents the commission during the plenary session.</p>
<p>Accountability toward stakeholders (industry, consumers, etc.) and the public (through e.g., publications of reports, consultation procedures on regulations)</p>	<p>Publication of annual report. The CBS consults with the Polish Bankers' Association for proposed technical changes to the structure of financial regulations.</p>	<p>Publication of annual report. Two-thirds of the total members of the supervision council are appointed based on consultations with representative professional associations.</p>	<p>Publication of annual report for each institution. The CECEI includes representatives of the banking and financial community, and of consumers and of worker's unions.</p>	<p>Publication of annual report on supervisory activities.</p>	<p>Publication of annual report.</p>
<p>Audit/budgetary accountability</p>	<p>The Superior Chamber of Control (NIK) audits the activities of the CBS and NBP.</p>	<p>The HFSA is audited by the State Audit Office and its functions are supervised by the ministry of finance. Its accounts are part of the ministry of finance's budget.</p>	<p>The CB and CECEI do not have separate balance sheets because their staff and resources are provided by the Banque de France. Banque de France's accounts are certified annually by two different external statutory auditors.</p>		<p>The SFBC is subject to normal audit arrangements of government agencies. The federal council and the Federal Department of Finance may require special reports.</p>

Source: Respective national laws.