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Governance, Independence, and Accountability for Supervisors. What Are the Trends?

Marc Quintyn, Silvia Ramirez, and
Michael W. Taylor[1]

[1] Marc Quintyn and Silvia Ramirez, Monetary and Financial Systems Department, IMF. Michael Taylor, Hong Kong Monetary Authority. This paper only expresses the views of the authors and not those of their respective institutions.

I. Introduction

The discussion about independence, accountability, and, more broadly, governance of financial sector regulatory and supervisory agencies (hereafter RSA) is still relatively new. Lastra (1996) and Goodhart (1998) were among the first scholars to stress the need for RSA independence. The Basel Core Principles for Effective Banking Supervision (1997) put the need for operational independence in the first principle, and, as such, provided it with a more "official" endorsement.

Attention for the operational aspects of RSA independence came in the new millennium. Quintyn and Taylor (2003) made the notion of independence for RSA operational by defining four dimensions—regulatory, institutional, supervisory and budgetary independence. Because independence cannot survive without accountability, and accountability remains an elusive concept, Hüpkes, Quintyn, and Taylor (2005) subsequently emphasized (i) that proper accountability arrangements are needed to make agency independence effective; and (ii) that a complex undertaking, such as financial sector supervision, needs an elaborate set of accountability arrangements—arguable more elaborate than the arrangements in place for the central banks' monetary policy function. Accordingly, the paper presented a range of accountability arrangements suitable to meet these requirements.

Meanwhile, on the ground, starting roughly in the mid-1990s, the world of financial sector supervision began to go through a major shake-up. For a long time, the organizational structure of supervision had been an irrelevant issue, both in theory and in practice. This perception changed dramatically in the nineties.[2] This new wave of attention was the result of a variety of developments. First, the blurring of the boundaries among financial subsectors, and the emergence of conglomerates—mainly in industrialized countries—forced the supervisors to rethink their organizational structure in order to be in a position to effectively supervise these new realities. Second, the emergence of international standards and codes for a wide range of financial sector supervisors instigated a rethinking of regulatory and supervisory frameworks, often with an impact on the organizational structure. Third, the systemic banking crises of the 1990s also led to revisions of supervisory structures. It was indeed clear that, in several cases, weak regulation and supervision—often, because of intense political interference—had been a contributing factor to the crises.

In addition, the revision of the organizational structure stimulated interest in the governance structure of these agencies, starting with agency independence. The growing tendency to move to unified (or integrated) financial sector supervision was instrumental in this regard. On the one hand, this reorganization often involves removing the banking supervision function from the central bank, where it had previously enjoyed a relatively high degree of independence. So, there were concerns that removing banking supervision from the central bank would create a less independent function than previously existed, also because

[2] Goodhart (2002).

discussions about unification have revealed greatly varying levels of independence among regulatory agencies.

On the other hand, the creation of a supervisory superpower raises fears about too great a degree of power for this institution—in particular, if the institution becomes part of the central bank, as is the case in some countries—thereby drawing attention to the need for well-established accountability.

Against this backdrop, the purpose of this paper is to review current developments with respect to independence and accountability arrangements in a sample of countries that went through a reorganization of their supervisory structures. The paper analyzes (i) whether countries have taken the opportunity of legal and/or organizational reform to strengthen their independence and accountability frameworks; (ii) whether progress in both is balanced or not; and (iii) which aspects of independence and accountability have received more, and which ones less attention, and thus, need more work.

The paper concludes that, in general, there is a positive trend toward more independence and better accountability arrangements, which should lead to better regulatory governance over time. Even though these trends are encouraging, it is also clear that still more attention needs to be given to accountability arrangements in order to match the move toward independence. While encouraging, these trends only cover a limited number of countries, which leads us to believe that there is still a great deal of work to be done in the rest of the world.

The paper is structured as follows. Section II will briefly put independence and accountability in the broader governance framework. Section III will outline the main operational components of agency independence and accountability. As such, it will set the stage for Section IV, which surveys developments in a set of 24 countries that went through changes in their supervisory structure in the past decade. Section V concludes the paper.

II. Governance, Independence, and Accountability

The need for good regulatory governance in the context of financial sector policymaking and crisis prevention has begun to receive more and more attention. It is being recognized that a financial system is only as strong as its governing practices, the soundness of its institutions, and the efficiency of its market infrastructure. This section briefly reviews the importance of regulatory governance as well as its four pillars.

A. The Governance Nexus

Instilling and using sound governance practices is a shared responsibility of market participants and regulatory agencies. The tree components of this shared responsibility were presented in Das and Quintyn (2002) and Das, Quintyn, and Chenard (2004) as the "governance nexus." The governance nexus refers to the impact of governance practices at each layer—government, supervisors, and financial institutions—on practices at the next layer. From bottom to top, we have the following three components and their responsibilities:

- First, financial institutions bear the ultimate responsibility for establishing good governance practices internally in order to gain and keep the confidence of their clients, counterparties, and the markets. Their good practices are also supposed to stimulate good practices with their borrowers.

- Second, regulatory agencies play a key role in instilling and overseeing implementation of the use of such good practices. To fulfill this role, regulatory agencies themselves need to establish and operate sound governance practices. By failing to apply good governance principles, regulatory agencies would lose the credibility and moral authority to promulgate good practices in the institutions under their oversight. This could create a moral hazard problem, contribute to unsound practices in the markets, and, ultimately, accentuate crises in the financial system.

- Third, good regulatory governance cannot be sustained without good public sector governance. The latter includes the absence of corruption, a sound approach to competition policies, effective legal and judicial system, and an arm's length approach to government ownership.

B. Four Pillars of Regulatory Governance

A prerequisite for good regulatory governance—the second link in the nexus above—is firm institutional underpinnings for RSA. Das and Quintyn (2002) identified four components that bring together the elements that form the basis for good regulatory governance: independence, accountability, transparency, and integrity.[3] The essence of bringing together these four components is that they interact and reinforce each other at various levels in supporting good governance. Independence and accountability are two sides of the same coin. Independence cannot be effective without proper accountability. Transparency is a vehicle for safeguarding independence. By making actions and decisions transparent, chances for interference are reduced. It is also a key instrument to make accountability work. Transparency also helps to establish and safeguard integrity in the sense that published arrangements provide even better protection for agency staff. Independence and integrity also reinforce each other. Legal protection of agency staff, as well as clear rules for appointment and removal of agency heads, support both their independence and their integrity. Finally, the pair accountability-integrity is also mutually reinforcing. Because of accountability requirements, there are additional reasons for heads and staff to keep their integrity.
In this paper, we focus on recent developments in independence and accountability. The main reason for singling out this pair is that they seem, among the four components, the hardest to achieve. Establishing proper independence and accountability arrangements needs endorsement by the political process in the enabling legislation. A lingering fear for independence, combined with a lack of understanding of the working of accountability, makes their establishment very often a big hurdle.[4] Once independence and accountability

[3] See Das and Quintyn (2002) and Das, Quintyn, and Chenard (2004) for a justification and presentation of these four pillars.

[4] Hűpkes, Quintyn, and Taylor (2005) summarize the reasons why the political class remains often reluctant to grant independence and establish accountability arrangements.

have been established by law, the agency itself is in an ideal position to make the other two components—transparency and integrity arrangements—operational. The latter two components are more a matter of internal arrangements to support the two others, and, more broadly, good governance practices.

III. Independence and Accountability in Practice

Drawing on earlier work in Quintyn and Taylor (2003) and Hüpkes, Quintyn, and Taylor (2005), this section outlines the main components of independence and accountability in practice. The survey in the next section builds upon the framework established here.

A. The Four Dimensions of Independence

It is useful to distinguish at the outset between **goal independence and instrument independence** (Fischer, 1994). This distinction enables us to separate the overall objective, which the regulatory agency is required to achieve, and which is established in the law creating the agency, from the actual formulation and implementation of supervisory and regulatory policies ("instrument independence") that can be safely left to the judgment of specialist officials. Hence, politicians have a proper role to play in setting and defining regulatory and supervisory goals, but regulators need to have the autonomy to determine how they should achieve them—and also to be accountable in the event that they fail to achieve them.

To make the notion of instrument independence operational, we identify four different dimensions that together make independence operational—institutional, regulatory, supervisory, and budgetary independence. The regulatory and supervisory dimensions form the core, while institutional and budgetary independence are essential to support the execution of the core functions. Regulatory and supervisory independence can hardly be achieved without solid arrangements underpinning institutional and budgetary independence. They provide the operational independence that underpins instrument independence.

Institutional independence

Institutional independence refers to the status of the agency as an institution separate from the executive and legislative branches of government. An agency that forms part of the executive branch, such as the ministry of finance, typically lacks independence. The following are three critical elements of institutional independence:

- The terms of appointment and—even more critically—dismissal of its senior personnel. Independence is best served if there are clear rules on hiring and firing, which should primarily relate to regulators' competence and probity. Under such rules, regulators would enjoy security of tenure, enabling them to speak and take action without fear of dismissal by the government of the day. Ideally, both the executive and legislative branches of government should be involved in the appointment process.

- The agency's governance structure. Multi-member commissions help ensure consistency and continuity of decision-making over time and are less likely to be influenced by the views of any one individual.

- The openness and transparency of decision making. Inevitably, many decisions involve commercially sensitive material that would be difficult to disclose. But the presumption should be in favor of openness in the decision-making process, making it possible for both the public and the industry to scrutinize regulatory decisions minimizing the risk of political interference.

Regulatory independence

Regulatory independence refers to the ability of the agency to have an appropriate degree of autonomy in setting (technical) rules and regulations for the sectors under its supervision, within the confines of the law. It is useful to divide financial sector regulations into three main categories: economic regulations, encompassing controls over pricing, profits, entry, and exit; information regulations, governing the information that needs to be provided to the public at large and to the supervisors; and finally, prudential regulations. Prudential regulations cover general rules on the stability of the business and its activities (legally required minimum amount of capital, and fit-and-proper requirements for senior management), as well as specific rules that follow from the special nature of financial intermediation (risk-based capital ratios, limits on off-balance sheet activities, definition of limits on exposure to a single borrower, limits on connected lending, foreign exposure limits, loan classification rules, and loan provisioning rules).

While economic and information regulations tend not to be subject to frequent amendations and could, therefore, be left to the lawmakers, following a consultation process with the supervisors, the story regarding prudential regulations is different. These are the fundamental rules upon which the supervisory process rests and which have a large impact on the soundness of the banking system. From the point of view of regulatory independence, a high degree in autonomy in setting prudential regulations is a key requirement to ensure that the sector complies with international best standards and practices**.**

Regulatory agencies that need to go through an often lengthy and slow political process to adjust technical rules and regulations face at least two dangers. First, precious time might be lost (typically up to one year and sometimes longer) before new rules or regulations are adopted in the political process. Second, involvement of the political process may bear the risk that rules and regulations, which are technical in nature and which are based on international best practices and standards, become contaminated with political considerations, depending on the strength of checks and balances in the system.[5]

[5] For example, in some countries, the authorities have lowered loan classification standards and provisioning rules for loans to economic sectors that face temporary or structural problems in order to facilitate lending to these sectors. Exposure rules to large borrowers are often relaxed to allow specific industries or companies to survive.

Within the broad confines of the country's constitution and the banking law, legal arrangements should therefore be made to give supervisors large discretion to set and change prudential regulations flexibly. For those countries where legal traditions and practices do not allow independent agencies to have regulatory powers, consideration should be given to whether exceptions can be granted based on the importance of the financial sector regulatory and supervisory function, as has been done in some countries with respect to the central bank.[6]

Supervisory independence

By supervisory independence we mean the independence with which the agency is able to exercise its judgment and powers in such matters as licensing, on-site inspections and off-site monitoring, sanctioning, and enforcement of sanctions (including revoking licenses), which are the supervisors' main tools to ensure the stability of the system. Safeguarding the integrity of the supervisory function is, therefore, a key element in ensuring the soundness of the financial system.

While supervisory independence is crucial for financial sector stability, it is the most difficult of the four dimensions of independence to establish and guarantee. To preserve its effectiveness, the supervisory function typically involves private ordering between the supervisor and the supervised institution. But the privacy of the supervisory process makes it vulnerable to interference, both from politicians and supervised entities. Political interference (and interference from the industry itself) can take many forms and can indeed be very subtle, making it difficult to shield the supervisors from all forms of interference.

The process of licensing institutions and withdrawing licenses should ideally be left to the supervisory agency. "Licensing is the key first step in the supervisory process" (Lastra, 1996) and supervisors should have the final word on who can enter the system and who should exit from the system and how. A typical situation that may lead to problems is one where the government (ministry of finance or council of ministers) has the final say over the licensing of individual banks and may—either through corruption or lack of technical ability to assess business plans—license unviable banks.

The same degree of autonomy should apply to exit procedures, based on the same argument that supervisors are in the best position to decide on the viability of individual banks. Exit decisions that are taken on political, rather than technical, grounds may result in forbearance and the prolongation of the life of insolvent or corrupt institutions, thus, ultimately increasing resolution costs. Moreover, where the supervisor possesses the power to make exit decisions, its other powers are also strengthened. If the power of license revocation is in the hands of another government agency or the minister himself, the threat by the supervisor can be empty.

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[6] Sometimes independent central banks have been granted the ability to make binding regulations over their specific sector.

Ensuring the independence of other supervisory functions—such as sanctioning and the enforcement of sanctions—is also a difficult issue, although the effectiveness of this aspect of supervision is clearly essential to the credibility of the supervisory process. Among the mechanisms that are available to strengthen supervisory independence in these areas, one of the most important is that bank supervisors should enjoy legal protection in the performance of their duties. In many countries, supervisors can still be sued personally for their actions. The absence of proper legal protection in many instances has a paralyzing effect on supervision. Proper legal protection of supervisors should be established in a country's banking law. Other tools to strengthen supervisory independence include appropriate salary levels for supervisors—as a way of attracting better qualified individuals who have more confidence in their own judgment and who may be less prone to bribery—and the use of a rules-based system of sanctions and interventions that removes the scope for discretion in individual cases.[7] Providing for appeals against supervisory actions to be heard only in specialist tribunals may also help to guard against excessive appeals by supervised entities or deliberately vexatious cases being brought.

Budgetary independence

Budgetary independence refers to the ability of the supervisory agency to determine the size of its own budget and the specific allocations of resources and priorities that are set within the budget. Supervisory agencies that enjoy a high degree of budgetary independence are better equipped to withstand political interference (which might be exerted through budgetary pressures), to respond more quickly to newly emerging needs in the area of supervision and to ensure that salaries are sufficiently attractive to hire competent staff.

A supervisory agency that is funded through a ministry that exercises oversight of its operations, or by appropriations from the general government budget, is open to a variety of forms of political interference. Cases can be imagined where the government threatens to withhold funding (or to reduce it) if the supervisors are deemed to be too strict on politically linked financial institutions. Moreover, its budget might be cut at times of fiscal austerity—and those times often coincide with mounting problems in the banking system, needing greater supervisory attention. If, for whatever reason, there is a consensus that funding needs to come from the government budget, the supervisory budget should be proposed and justified by the agency, based on objective criteria related to developments in the markets.

Funding via a levy on the regulated industry has several advantages compared with appropriations from the general government budget, such as reducing the scope for political interference and greater freedom for the agency to set its budget in line with its needs and priorities. But, unless the levy is properly structured, it may produce a sense of budgetary dependence on the industry that could undermine the agency's autonomy in other ways. To avoid industry capture and ensure that the fees are reasonable, in some countries, their level

[7] An example would be prompt corrective action. However, there is a trade-off between the gains in terms of protection and independence and the very real drawbacks of taking away the supervisors' discretion in individual cases.

is determined jointly by the supervisory agency and the government. Fee-based funding is also vulnerable to the risk that the supervisor's resources will be most limited when the industry is under strain. Allowing the agency to build up reserve funds for these periods seems the best solution.

B. The Dimensions of Accountability

For each of the four dimensions of independence, there is a corresponding dimension of accountability. As noted elsewhere,[8] the concept of a "trade-off" between independence and accountability is flawed to the extent that it assumes stronger accountability mechanisms must necessarily mean a less independent regulatory agency. Our view, on the contrary, is that well-designed accountability mechanisms can help to buttress independence. However, where the notion of the trade-off does identify a genuine issue, is that poorly-designed accountability mechanisms—for example, those that give the minister of finance the power to overturn agency decisions—are corrosive of agency independence and, in the long run, are likely to be incompatible with it.

The best way to ensure that mechanisms of accountability do not undermine independence is to observe the principle of transparency. This should be the overarching factor in the design of all accountability arrangements. It encourages open administration and serves the function of enhancing public confidence in the financial supervisor. Transparency is implemented by way of publications, typically on the agency's website 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, regulatory agencies are required to publish an annual report. The agency's relationship with the executive and legislative branches of government should also be open and transparent.

More specifically, the task in designing accountability mechanisms that can be supportive of agency independence 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."[9] The possibility of creating such a network of complementary checking mechanisms is assisted by the fact that regulatory agencies operate in a multiple-principals environment, and, therefore, for each dimension of independence, accountability to more than one principal will be involved. The main principals are the executive, legislative, and judicial branches of government plus the regulated industry itself and the public at large (customers).

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[8] Hüpkes, Quintyn, and Taylor (2005).

[9] Majone (1994) and Moe (1987).

Institutional accountability

Legislative branch

In most systems of government, the legislative branch plays a vital role overseeing the activities of the executive branch in virtue of its representative character and its control over taxation and, therefore, supply. The objective of its oversight is to ensure that public policy is administered in accordance with legislative intent. Since the principles of regulatory regimes are normally promulgated by parliament, the latter should be a primary actor charged with holding the financial supervisor accountable for meeting the stated objectives in its mandate. To ensure that these objectives are met, the legal framework should provide for regular institutionalized contacts between the agency and parliament. Nonetheless, while it is appropriate for the legislature/parliament to play some role in overseeing the activities of the regulatory agency, it should not exercise immediate powers over the agency or interfere directly in its supervisory activities by issuing concrete guidance. Parliament's influence on the supervisory activities ought, instead, to be exerted primarily through its law-making powers. That is, it can directly affect the financial supervisor's actions by making changes to the legal framework.

Laws setting up regulatory agencies generally provide for regular, at least annual, reporting to the parliament. In jurisdictions where the minister is directly answerable to parliament, the agency generally submits its annual report to parliament via the finance minister and parliament holds the agency accountable through the minister (indirect accountability).

In most jurisdictions that have established a mechanism of accountability to the legislative branch, the regulatory agency is answerable to a parliamentary committee. This permits individual members of parliament to develop expertise on the complex financial and technical issues dealt with by the regulatory agency. Committees can also ensure a greater degree of continuity of the monitoring function. These committees generally have the power to summon the agency's chief executive to appear or to report.

Another mechanism through which parliamentary accountability can be carried out is representation on an oversight or supervisory board of the agency.[10] With this approach, safeguards need to be built in, to avoid (political) interference and to guarantee the confidential nature of the agency's work. In general, these representatives should not be involved in operational or policy matters. On the other hand, by appointing interested and knowledgeable legislators, this arrangement circumvents the often-heard complaint that parliamentary accountability is ineffective because of the lack of interest of members of parliament.

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[10] This mechanism has been introduced in Germany for the new financial supervisory authority. The German Parliament is represented by five delegates (without voting rights) in the administrative board (Verwaltungsrat), which has a general oversight function.

Executive branch

An independent regulatory agency needs to have a direct line of accountability—or communication—to the executive branch because the latter bears the ultimate responsibility for the general direction and development of financial policies, and the minister of finance needs to be aware of developments in the financial system. In most jurisdictions, the government will also play an active role in financial crisis management. 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 agency 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.

The involvement of the minister of finance in the agency's accountability is especially important in the case of those jurisdictions (such as Australia, Canada, and the United Kingdom) where constitutional doctrine requires that primary line of accountability for the agency is through the relevant minister to parliament.

In some countries, moreover, the ministry of finance is the formal oversight authority of the financial supervisor. Such an accountability relationship may raise concerns regarding the financial supervisor's independence. 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 exclude any direct involvement in operational and policy decisions.[11] Oversight can easily become a control function whereby political influence is exerted on the agency. The type of accountability arrangements that would be most consistent with agency independence includes reporting by the supervisory agency on a regular basis, as well as the possibility of the executive requesting information or conducting consultations with the regulatory agency.

Some countries have tried to establish accountability to the executive branch by appointing government representatives on internal oversight bodies.[12] However, representation of government or ministries should be limited to non-executive members in an oversight board

[11] 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.

[12] For instance, in Germany, the ministry of finance, 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.

established without operational or policy functions. Once they are involved in policy matters, operational independence as defined in Basel Core Principle 1 is debatable.

In other words, an arm's length relationship needs to exist, which can be fostered through transparency of the regulatory process. To ensure that accountability to the finance minister is compatible with agency independence, the minister should himself be accountable to the legislative branch for his handling of the relationship with the financial supervisor. The involvement of parliament in this process brings in a check-and-balance mechanism to the oversight exercised by the executive branch and, if properly structured, can be used as a buttress to agency independence.

The executive branch also has an important role to play in the appointment of the senior officials of the regulatory agency. In many countries, they 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 a mechanism 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.[13]

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 agency's board for a fixed term enhances independence, the right for removal on clearly specified grounds, is an indispensable accountability mechanism.

Regulatory accountability

A regulatory agency that has rule-making authority needs to be held accountable for the way in which it exercises its authority. Given that the rule-making powers of the supervisory agency will usually be made under a delegation from the legislature, the exercise of this authority will need to be one of the main topics of the reporting to the legislative branch discussed above. Thus, one of the most important functions of the regulatory agency's accountability to parliament should be to ensure that its exercise of rule-making powers are in accordance with the objectives and mandate laid down in law by parliament. Since parliament also possesses the ultimate mechanism for changing the legal basis on which the agency acts, accountability to parliament also provides an opportunity for a dialogue on the quality of the legal framework, during which the agency should have an opportunity to voice any concerns and communicate problems in its supervisory practice that could be corrected by parliamentary action in the form of legislative amendments.

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[13] 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 (Amtenbrink, 1999).

Supervised institutions also form a significant group in the exercise of accountability with respect to regulatory rule making. Their participation in policy making through consultation procedures serves to achieve greater acceptability and effectiveness of the regulatory process and also increases the agency's legitimacy. The agency should have in place arrangements 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. Draft rules should be published for comment. They should be reasoned, be accompanied by an explanation of their purpose and a statement of the reasons why their making is compatible with the statutory objective. The agency should undertake, to the extent possible, an assessment of the regulatory effectiveness and the costs to the industry. Finally, the agency should publish an account, in general terms, of the comments made on the draft rules and its response to them. Accountability to the industry (and, in some cases, to users of financial services) can also be achieved through appropriate representation on an oversight board.[14]

Supervisory accountability

Given the extensive legal powers typically conferred on regulatory agencies, judicial review is a cornerstone of its accountability relations in respect of supervisory measures.[15] 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. Judicial review 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. It applies to the process (procedural accountability), and, in some cases, albeit to a lesser extent, to outcome (substantive accountability).

It is generally accepted that individuals or institutions subject to the agency's decisions have the right to apply to a judicial authority for review of those decisions. Judicial review systems vary across legal systems. In some, administrative disputes belong to the ordinary courts, which consider civil and criminal cases (so-called unitary system of jurisdiction), while in others, judicial protection is ensured by a quasi-judicial authority that belongs to the executive. In the system most common in Western Europe, there are separate administrative courts for administrative judicial appeals (dualist system).

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[14] In Germany, an advisory board (Fachbeirat) comprises, besides representatives from academia, representatives from the financial industry 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.

[15] 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.

Natural justice requires that the agency 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 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 review the merits and facts of the case and 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 and 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 and are, therefore, reluctant to substitute their judgment on supervisors. 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.[16] As observed earlier, 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 and, ultimately, undermine agency independence.

In the event that a regulatory agency is found to have breached its legal duties, the plaintiff must have some remedy available. 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. Nonetheless, the need to ensure agency independence means that there should be a variety of limitations on liability for faulty supervisory action. Any official of an agency 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. Most jurisdictions, therefore, set high standards for admitting liability of the financial supervisor and awarding damages to claimants. While rules on immunity and limited liability of the supervisor are correlates of independence and are justified by the need for effective supervision, 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 were loss was suffered due to unlawful action by the agency.

[16] Hüpkes (2000).

In addition to the judicial review of agency decisions, most jurisdictions provide for some form of review within the administrative framework. 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.[17] While review by the competent ministry may ensure the necessary competence in the field, it interferes with agency independence. For these reasons, a review body composed of independent experts in the field may be better suited to review decisions of the financial supervisor.[18] Administrative review cannot entirely replace judicial review.

Budgetary accountability

An important instrument of agency 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. At the same time, however, this aspect of accountability should not become a way of undermining agency independence by the back door. The autonomy of the agency in the determination of its budgetary needs and the allocation of priorities is the cornerstone of independence.

To maintain agency independence, 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. Another form of accountability may be ensured by an internal inspectorate which reports regularly to the Board and/or parliament.

The various dimensions of accountability are summarized in Table 1.

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[17] 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.

[18] As such, the FSMA established the Financial Services and Markets Tribunal, which act as a court of first instance for decisions of the FSA.

Table 1. Mapping Accountability Arrangements

Accountability to Whom	Content and Form	Type of Arrangements
Legislative branch	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	Ex post—explanatory Ex post—explanatory Ex ante—explanatory or amendatory Ex post—financial accountability Ex post—financial accountability, explanatory or amendatory
Executive branch	Regular report to minister of finance or government Ad hoc formal presentations, information on sectoral developments Proposals for new government regulations /decrees	Ex post—explanatory Ex post—explanatory, often pure informational Ex ante—explanatory or amendatory
Judicial branch	Judicial review Supervisory liability for faulty supervision	Ex post—amendatory, procedural Ex post—amendatory and substantive accountability
Supervised industry	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	Ex ante and ex post—explanatory, amendatory Ex ante and ex post—explanatory Ex ante or ex post depending on issue—explanatory
Customers and public at large	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)	Ex ante and ex post—explanatory Ex ante and ex post—explanatory Ex post—explanatory, amendatory Ex post—explanatory, amendatory

Notes:

- **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 action taken. **Amendatory** accountability refers to the obligation to redress grievances by taking steps to remedy defects in policy or regulatory rule making.

- **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 agency).

- **Financial** accountability refers to the presentation of proper financial statements.

- **Performance** accountability refers to the extent to which (measurable) objectives and criteria are met.

IV. What are the Current Trends?

A. Overview

The purpose of this survey is to detect recent trends in RSA independence and accountability.[19] It tries to find answers to the following questions (i) whether countries have taken the opportunity of legal and/or organizational reform to strengthen their independence and accountability frameworks; (ii) whether progress in both is balanced or not; (iii) does one type of reform yield better progress in terms of independence and accountability than another; and (iv) which aspects of independence and accountability have received more, and which ones less attention.[20]

Sample

The paper selected a sample of 24 countries where the supervisory agencies underwent a drastic change in the past 10–15 years (appendix I). These changes were either organizational in nature (with changes in the enabling legislation) (17 cases) or simply changes in the enabling legislation without touching the structure (7 cases). Organizational changes were, typically, the result of a response to trends in the financial system (for instance, Australia and the U.K.), financial crises (e.g., Indonesia, Korea), or the reorganization of monetary and financial sector responsibilities at the level of the Euro-zone (e.g., Germany). Legislative changes without organizational modifications were a response to financial crises (e.g., Ecuador, Nicaragua), preparation for entry in the European Union (Hungary, Poland), or the search for compliance with the Basel Core Principles. The sample includes countries where bank supervision was moved out of the central bank and a unified (e.g., the U.K.) or a multisector supervisor was established, or where all types of supervision were brought

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[19] The paper focuses on bank supervisory agencies. Evidently, when an integration of supervisory agencies has taken place, the new legislation also covers the supervision of the other segments of the financial system.

[20] Somewhat similar approaches have been undertaken by de Haan, Amtenbrink, and Eijffinger (1999) to measure central bank independence and accountability; by Eijffinger and Geraarts (2003) to measure central bank transparency; and by Oosterloo and de Haan (2004) to measure central bank accountability with respect to its financial stability objective.

together in the central bank (e.g. Ireland), or where a reorganization took place of agencies that were traditionally outside the central bank (e.g., Austria, Belgium).

While we do have a large variety of initial circumstances and reasons for change, the sample is relatively restricted in size. Consequently, the resulting distribution by country income level or by region is not balanced. Nonetheless, the paper offers some comparisons among income levels and regions, however without attempting to generalize the observed trends.

Criteria

Based on the presentation in the previous section of operational aspects of independence and accountability, we identified 15 criteria by which to measure independence and 28 for accountability. These criteria are presented in Appendix II. The rating of each individual question is typically between 0 (criteria not met) and 2 (fully met). Sometimes a 1 is given as a "partly met" (for instance, if the RSA cannot issue binding regulations for constitutional reasons but, instead, issues additional guidelines to the sector which have a formal character). In a few cases, a -1 rating can be given for "bad" accountability practices (as opposed to 0 for absence of any arrangement in that field). This is, for instance, when parliamentarians or a minister sit on the policy board of the RSA, or the law gives direct oversight to the minister of finance. As discussed in Hüpkes, Quintyn, and Taylor (2005), such practices clearly undermine independence and are considered control mechanisms as opposed to accountability mechanisms.

In a number of cases, a specific practice has a bearing on independence as well as on accountability. The presence or absence in the law of clear dismissal criteria for the head of the RSA is such an example. In those cases, we decided to put it where the most logical case could be made. In the end, the decision has no great impact on the results because we are most interested in the general outcome in terms of improvements in the quality of governance.

For each country, we applied the independence and accountability criteria to the legal framework preceding the changes and to the new framework. The results are presented in percentage of the benchmark, i.e., a 2 rating for each criteria. At this stage, no weighing has been applied to the individual criteria. Even though this could be a useful exercise, it would bring additional elements of subjectivity in the analysis.

Sources

Our sources are threefold: the main source is the national legislation before and after the reforms. In addition, we also consulted information from Basel Core Principle assessments, undertaken individually or as part of Financial Sector Assessment Programs (FSAP) and from the database compiled by Barth, Caprio, and Levine (2001). Local agencies were called in a few number of cases to resolve ultimate uncertainties.

B. General Trends

The general results are presented in Table 2 and in Appendix III, Figures 1a and 1b, 2a and 2b, and 3a and 3b. Table 3 provides a summary overview of the trends. Undoubtedly, the most important message from this set of data is a clear improvement almost across the board in independence and accountability arrangements as underpinnings for better regulatory governance. The average of the total ratings (independence and accountability together) (first two columns) has gone up from 52 to 63. Significant improvements can be observed in a large number of countries, including Australia, Austria, Indonesia, Ireland, Turkey, and the U.K. As we will discuss later, with the exception of Turkey, all these countries unified their supervisory structure.[21]

The smallest improvements are made in Chile, China, Nicaragua, and Saudi Arabia, and moved banking supervision out of the central bank into a separate agency. However, just like the People's Bank of China, this new agency remains subject to the constitutional ruling that the State Council remains the supreme authority in the country. According to the rules of our rating system, this ruling allows no real independence for the supervisory authority. However, the new separate agency received some powers not earlier given to the People's Bank.[22] A final observation on the overall ratings is that, if China is not taken into account, the ranges between minimum and maximum ratings remain broadly the same. So the scale has moved up, countries have moved relative positions along the scale, but the range remains unchanged.

Columns three to six of Table 2 provide the ratings for independence and accountability respectively. The main finding here is that both independence and accountability arrangements have improved. The average for independence went up from 65 percent to 75 percent, and for accountability from 46 percent to 56 percent. So, independence arrangements are still closer to the benchmark-value than accountability. However, since we defined more accountability criteria than independence criteria, we can safely say that in absolute numbers countries made a great effort on the accountability side. One might therefore conclude that, in general, the drive for more independence has been accompanied by an awareness that simultaneous attention needs to be given to accountability arrangements. Improvements in accountability, and with it transparency, have to some extent also been driven by external developments, in particular the development of the internet. Annual reports are on websites, communication with the public, and with supervised institutions via the internet has reduced the costs of such actions and has improved efficiency.

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[21] In Austria and Turkey before the reforms, banking supervision was housed in the ministry of finance and the treasury respectively. Hence, ratings for independence and accountability were very low. Both countries had a nonzero rating because the central banks in both countries also played a role in the supervisory process.

[22] In only one country, Estonia, the rating deteriorated because one accountability arrangement was changed.

If one goes into the individual country ratings, some interesting findings and discrepancies are worth noting. For instance, Australia, Indonesia, Mexico, and Turkey made the greatest gains on the independence side. However, in the case of Indonesia, Mexico, and even Turkey—three countries that implemented institutional changes in the wake of a systemic banking crisis—the need for more independence seems to have overshadowed the need for more accountability. The accountability arrangements in Mexico remained basically unchanged in the new structure.

The greatest gains in accountability have been realized in Australia, Ireland, Uganda, and the U.K. All four have an Anglo-Saxon tradition, which has traditionally put more emphasis on accountability than other parts of the world. In addition, with the exception of Uganda, these three countries decided to establish a mega-regulator, which, as indicated in the introduction of this paper, often raises fears about being too powerful. Hence, much attention was given to proper accountability arrangements in the run-up to the establishment of these institutions.[23] Other countries, where more attention was given to improvements in accountability than independence, include Austria, Canada, Ecuador, Japan, South Africa, and Spain.

Even though nearly all countries in the sample improved their arrangements, great discrepancies between independence and accountability ratings remain. Ecuador seems an extreme case, with a very high independence rating, not matched by a high rating on accountability. Having said that, the improvements in accountability were greater than those in independence. The discrepancy in Turkey is also high. According to our methodology, two countries get a higher rating on accountability than on independence—Chile and Poland. Both belong to the mid-range in the overall ratings.

Figure 1 confirms the above trends and observations. The scatter-plot shows that the observations have moved to the upper right part of the graph. The graph also confirms the trend toward an improvement in accountability arrangements, but also shows clearly that the index of accountability continues to lag the independence index. Whereas the independence index after reforms is in the range of 60 to 93—excluding China—the accountability remains in a wider and lower range, from 40 to just above 80.[24]

Table 4 provides a regional perspective on the trends. It shows that arrangements in European countries were, and remain, slightly better than in other parts of the world, both with respect to independence and accountability. The results in Europe are, to a great extent, due to the arrangements in Ireland and the U.K. The improvements in Asia stem mainly from Indonesia (independence) and Australia (both).

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[23] See for instance, for the U.K., Graham (1998), Goodhart (2001), and Page (2001).

[24] Admittedly, by imposing more criteria on accountability, the paper has set the threshold higher than for independence. On the other hand, proper accountability requires a complex set of arrangements, which is reflected by imposing more criteria on accountability than on independence.

Table 2. Independence and Accountability Overview
(In percent of benchmark)

Country	Total		Independence		Accountability	
	Before	After	Before	After	Before	After
Australia	53	77	70	90	45	70
Austria	28	67	30	90	27	55
Belgium	53	63	67	73	46	57
Canada	56	63	70	70	48	59
Chile	56	60	53	53	57	64
China	14	21	20	33	11	14
Ecuador	51	62	87	93	32	45
Estonia	60	59	87	87	46	45
Finland	66	73	77	90	61	64
Germany	60	67	70	77	55	63
Hungary	48	60	60	77	41	52
Indonesia	35	58	33	73	36	50
Ireland	67	86	87	93	57	82
Japan	53	62	67	70	46	57
Korea	51	62	60	70	46	57
Mexico	41	51	33	63	45	45
Nicaragua	65	66	87	90	54	54
Poland	49	55	37	53	55	55
Saudi Arabia	53	58	67	67	46	54
South Africa	50	63	63	67	43	61
Spain	55	64	73	73	45	59
Turkey	26	67	27	87	25	57
Uganda	47	62	67	70	36	57
UK	63	79	80	87	54	75

Table 3. Accountability and Independence: Trends
(Number of countries)

	+	=	-
Total	23	0	1
Independence	19	5	0
Accountability	20	3	1

Figure 1. Independence and Accountability Ratings Before and After

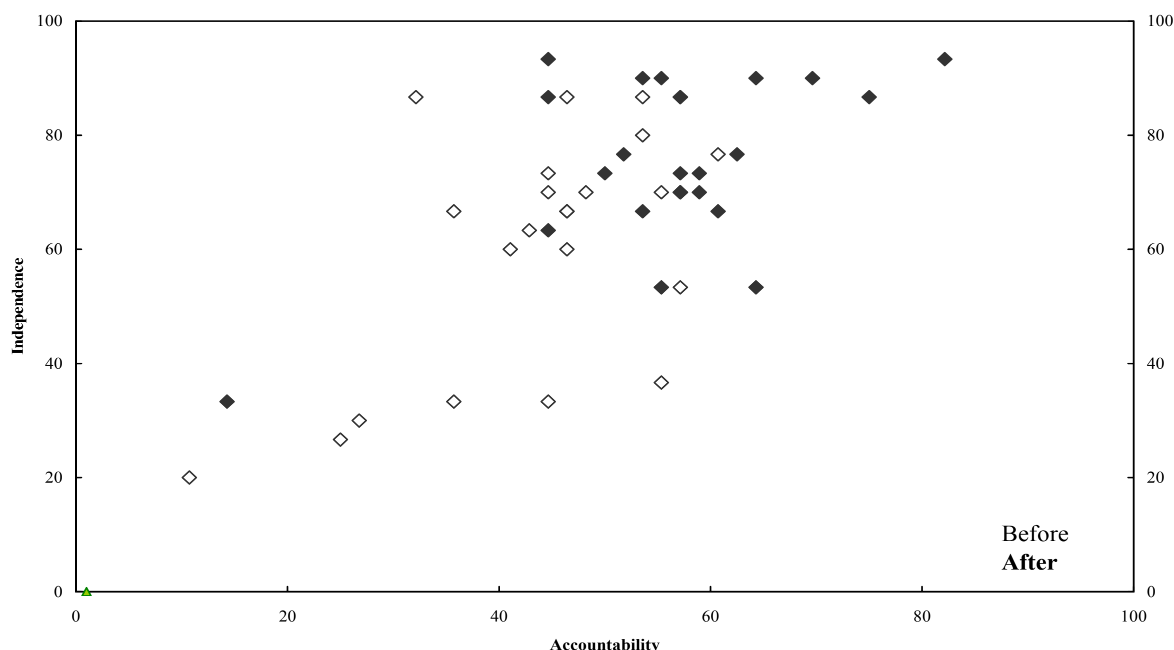

Table 4. Accountability and Independence: Regional Trends
(Average rating for the region)

	Africa	Asia	Europe	Middle East	WHD
Total Rating					
Before	48	41	52	53	54
After	62	56	67	58	60
Independence					
Before	65	50	63	67	66
After	68	67	81	67	74
Accountability					
Before	39	37	47	46	47
After	59	50	60	54	53

A similar picture emerges from Table 5 with a classification according to income levels. The high-income countries are closest to the benchmarks both in terms of independence and accountability. However, the low-income countries in the sample made the greatest progress (although it is only marginally greater). This progress is mainly realized with respect to independence (from 52 percent to 67 percent). Several of these countries are still emerging democracies where the political class struggles relatively more with the idea of an independent regulator than in mature democracies where checks and balances are better established. Accountability arrangements are clearly also not as detailed in low-income

countries as in mature democracies. For instance, consultation with consumer representatives is less (or not) present in many low-income countries than it is in mature democracies.

Table 5. Accountability and Independence: By Income Level
(Average rating)

	High Income	Middle Income	Low Income
Total Rating			
Before	55	48	40
After	69	60	52
Independence			
Before	68	57	52
After	80	72	67
Accountability			
Before	48	43	34
After	63	53	44

Very interesting observations come from comparing the institutional frameworks. Table 6 groups the countries according to the location of banking supervision *after the reforms.* Some supervisory agencies stayed in the central bank, others moved out of the central bank and were merged with other sectoral supervisors, and yet others were already out of the central bank and were merged with other sectoral supervisors. Table 6 distinguishes between those agencies that are in the central bank and those that are outside the central bank, with a subcategory of the latter being the unified supervisors.

The results indicate that the ratings for the new arrangements, taken together, increased more for those agencies that are now outside the central banks than for those who remained a central bank department. All ratings (total, independence, and accountability) were lower than those for the inside-the-central-bank group before the reforms, and exceed them after the reforms. A possible explanation for this result is that the organizational restructuring provided the opportunity to revisit the legal and governance framework more thoroughly than was done for those RSA that stayed within the central bank. Central banks have, most of the time, no specific accountability arrangements for their supervisory function, but just go by the arrangements for the monetary policy function (which, according to the results were also improved, but not as much as for the reorganized agencies).

The last column singles out the completely unified supervisors (a group within the "outside the central bank" group). This group shows the greatest leaps in all respects. It shows that these agencies are determining the better results of the "outside the central bank" group. It also shows that in the countries in the sample, the establishment of unified regulators was typically—and more than in the other reforms—accompanied by a complete overhaul of the legal and governance system, taking into consideration the latest thinking about, in particular, accountability as we will discuss in the next section. The long public debates that preceded the reforms in Australia and the U.K. were, of course, instrumental in these changes.

Table 6. Accountability and Independence: By Type of Institution
(Average rating)

	Inside Central Bank	Outside Central Bank	*Of Which Unified Supervision*
Total Rating			
Before	53	47	52
After	60	63	70
Independence			
Before	67	59	61
After	68	76	83
Accountability			
Before	46	43	44
After	55	56	63

Finally, Table 7 compares the results by type of reform—institutional changes or simple changes in the legislation. This classification is only slightly different from the previous one because the heading “institutional reform” encompasses nearly all those countries that moved banking supervision outside the central bank (“outside central bank” in previous table). What this table reveals is that pure legal reforms, in most cases, did not go as far as institutional reforms. In other words, as was said in the introduction, experience shows that it is easier to reconsider all aspects of governance during a thorough overhaul, than during a revision of the law. The other part of the explanation is that most of the “legal” revisions in the sample concerned supervisors that remained in the central bank and, apparently, the independence and accountability arrangements that the central bank had were deemed satisfactory. As it turns out in the results, agencies that only had legal reforms were (slightly) ahead on both indices before the reforms and had to give up that lead.

Table 7. Accountability and Independence: By Type of Change
(Average Rating)

	Legal	Institutional
Total Rating		
Before	54	48
After	61	63
Independence		
Before	67	59
After	71	76
Accountability		
Before	47	43
After	56	56

C. Specific Issues—Individual Criteria

Apart from knowing what happened to independence and accountability arrangements in general, it is also interesting to know in which specific areas progress was made, and which ones still seem hard to swallow for the political class. To that end, we identified seven criteria on the independence side and eight on the accountability side that can be considered as more vital, crucial, and, therefore, often controversial than some of the others. Table 8 reports the results, expressed in number of countries meeting the criteria (total is 24).

Table 8. Changes in Meeting Specific Independence and Accountability Criteria
(Number of countries fully or partly meeting)

	Before		**After**	
Independence	Fully met	Partly met	Fully met	Partly met
Does the law state that the institution is independent?	8		11	
Who has legal immunity for actions done in good faith? (full met means all staff, partly met means only senior management)?	8	2	16	
Can the agency autonomously issue legally binding prudential regulations for the sector?	13	8	17	6
Has the agency the (sole) right to issue licenses?	13	8	18	3
Has the agency the (sole) right to withdraw licenses?	9	12	15	6
Has the agency the right to enforce sanctions?	15	5	22	
How is the agency funded? (fully met means not through government budget, partly means some part through government budget)	6	4	11	7
Accountability				
Is the agency's mandate defined in the enabling legislation?	23		23	
Does the law/act give the minister of finance oversight power?	10 1/		11 1/	
Have supervised entities the right to appeal supervisory decision to courts?	18		21	
Has the agency issued a mission statement?	23		23	

Table 8. Changes in Meeting Specific Independence and Accountability Criteria (concluded)

	Before		After	
Independence	Fully met	Partly met	Fully met	Partly met
Is there a consumer grievance board?	0		3	
Has the law defined clear criteria for dismissal of the president of the agency?	9	2	14	
Is there a formal ex ante consultation process with the industry about new regulations?	5		17	
Is there a formal consultation process with the public at large about new regulations?	1		4	

1/ “Fully met” in this case means that there is no oversight power given to the minister.

On the independence side, positive developments include: (i) about 66 percent of the countries surveyed have put legal immunity for all supervisory staff in the law (up from less than 50 percent); (ii) in 23 out of 24 countries, the RSA can now issue binding regulations (17) or at least guidelines and directives that have an official character (6); (iii) in 18 countries (up from 13), RSA have the sole right to license new financial institutions. In three countries, another agency (typically, ministry of finance) needs to give its final approval, while the number of countries where the supervisors have no licensing rights is still at 3; and (iv) the right to withdraw licenses is now in the sole hands of 15 RSA in the sample (up from 9), another six RSA need the approval of the government and three have no rights in this respect. Despite the improvements in the area of licensing and delicensing, these are indications that governments remain more reluctant to cede all there rights.[25]

In two areas, still less than 50 percent of the sample qualifies as independent according to the criteria. The first is budgetary autonomy. Despite being on the rise, still only 11 RSA are fully funded outside the government budget and 7 are partly funded by the government. Finally, still less than 50 percent of the surveyed countries have put independence of the supervisory agency explicitly in the law. For central banks as monetary policy agents, this is typically the one, and very often only, clear article in the law about independence. So while several RSA have received a large number of independence-attributes, as defined here, their governing laws do not explicitly recognize the independence of the agency, a situation which, at times, could lead to legal disputes.

On the accountability side, issues such as frequent consultations with the government and the legislature, and having a published mission statement have become generally accepted elements of accountability. The survey indicates that newer territories of accountability, such

[25] Some of these trends are consistent with the findings in de Luna Martinez and Rose (2003), who looked at changes in supervisory arrangements in a sample of countries which established a unified supervisor.

as consultation with the supervised industry, as well as the need to define dismissal procedures are clearly on the rise. Ex-ante consultation with the supervised industry on new rules and regulations is now accepted in 17 countries (up from only 5). Clear criteria for dismissal of heads of RSAs are part of the law in 14 countries, up from 9. These are examples of major progress in accountability arrangements.

On the other hand, more newly acquired ideas in the accountability area such as having consumer boards and consultation fora with the public at large on new rules and regulations still need to mature. Only three countries have a consumer grievance board (up from zero) at this stage (UK, Germany and Ireland), and in four countries (up from 1), there is a legal obligation to have ex ante consultation with the public at large about new regulations. While 50 percent of countries have now established separate judicial processes to handle supervisory cases—which is great progress—specialized judges to handle supervisory cases (a further refinement) have only been established in four countries.

Finally, there is the extremely sobering and confusing finding that a great number of countries are keeping a statement in the law, providing an oversight role to the minister of finance. Before the reforms, 14 countries gave such a role to the minister. After the reforms, this was only down to 13 (still more than 50 percent of the sample). As discussed before, such stipulation tends to undermine the credibility of the independence, as well as the accountability arrangements, as it opens the door to more direct control. The confusion stemming from having such a stipulation grows even further in those cases where such a stipulation is in the law, alongside an article that states that the agency is independent (or that the agency has the sole right to license new institutions or withdraw their licenses). While in some cases the oversight-statement is qualified, it might, nevertheless, lead to confusion at times of crises or other moments of stress between the supervisory agency and the minister of finance. What it de facto may mean is that the claim of independence by some RSA is exaggerated, and that periods of conflict between the two agencies may indicate where the real power is.

V. Conclusions

Unlike the case for central bank independence, which has won a broad following in both academic and policy circles, the case for RSA independence remains controversial. Policy makers have remained more reluctant to grant independence to regulators, despite strong arguments developed in its favor. Several reasons have been brought forward to explain this hesitation.[26] They range from Stigler's regulatory capture theory (without political oversight, regulators will fall in the hands of the industry's interests), over theories of political self-interest, stating that politicians try to keep control over those activities (as opposed to delegating) that can generate rents, or have redistributive effects (Alesina and Tabellini, 2004), to genuine concerns that independence for RSA is a delegation of authority too far. Such concerns often find their origin in a lack of understanding of the nature and operation of accountability arrangements.

[26] See Hüpkes, Quintyn, and Taylor (2005) for an overview.

The main purpose of this paper was to take stock of current developments with respect to independence and accountability. Amidst the wave of reorganizations of supervisory structures around the world, more attention is being given to the governance structures of these institutions. So, the paper surveyed 24 countries that restructured their supervisory landscape in the past decade-and-a-half and identified trends and developments with respect to independence and accountability.

Since many aspects of the RSA independence-accountability debate are still relatively new—as a comparison, it also took the world more than a decade to genuinely embrace the idea of central bank independence—the paper started off by putting the independence-accountability debate in the broader context of regulatory governance. Independence is not a goal in itself. It is one of the four essential pillars to support good governance in the RSA. Good governance itself is necessary to instill good corporate governance in the supervised entities.

Subsequently, the paper gave operational meaning to the notions of independence and accountability. We explained that independence has four main dimensions—institutional, regulatory, supervisory, and budgetary. For each of these four dimensions we identified appropriate accountability arrangements. The purpose of making both notions operational is to take away the mysticism that still surrounds them, often a clear barrier to their implementation. At the same time, spelling out the operational sides of both concepts opened the way to the survey this paper undertook.

We identified 15 criteria to measure independence and 28 for accountability to compose an index of independence and accountability, and tested the legislation governing banking supervision agencies in a set of 24 countries that went through a restructuring of their supervisory structures in the past decade and a half. The test was done on the old and the new legislation in order to have an idea of the trends with respect to independence and accountability.

The results are encouraging, but also raise some flags. As essential building blocks for good regulatory governance, we detected, generally speaking, improvements in both independence and accountability. However, the independence index remains higher than for accountability. In fact, accountability continues to trail independence by nearly as much as before the reforms. This is an indication that unfamiliarity with accountability, its nature, purpose, and operation still lingers on. On the other hand, given the complexities of financial sector supervision, accountability needs to be well-elaborated, and, therefore, we included more criteria on this than on accountability.

On the other hand, these general trends mask interesting individual developments. We pointed out that, in some countries, the distance between the accountability and the independence index remains extremely high. On the other hand, we found that countries with an Anglo-Saxon tradition and those that adopted the mega-supervisor model made great efforts and were very creative in improving accountability arrangements. More generally, the survey pointed out that countries that went through a thorough reorganization have advanced the most in independence and accountability.

The analysis at the level of the individual criteria reveals positive trends, as well as areas for concern. On the positive side, (i) more countries are now giving legal immunity to supervisory staff; (ii) more RSA have the right to issue binding regulations; (iii) budgetary autonomy is on the rise; (iv) consultation with the industry is becoming a rule; (v) more laws define clear criteria for dismissal of president and senior staff; and (vi) new areas, such as consumer boards and consultation with the public, are slowly emerging.

On the other hand, governments seem to remain reluctant in giving RSAs the sole power to license and, even more, to withdraw licenses, despite the fact that these should be essential supervisory prerogatives. The most disturbing finding is that in more than 50 percent of the surveyed countries, the minister of finance still has some oversight role, despite the presence of statements of independence elsewhere in the same laws. This seems to be a clear indication that policy makers are still not convinced that independence for RSA is the right thing. Such stipulations are bound to undermine the credibility of independence and accountability arrangements.

In sum, most of these results are heartening, but also indicate that more work and more convincing of the long-term benefits of an independent and truly accountable RSA is needed. For those countries that are planning a reform of the supervisory structure, surveys like this one could provide inspiration to align with international best practices. With some more time passing, it could also be useful to correlate developments in financial soundness indicators with indices of this type to analyze the impact of better governance arrangements with financial sector soundness.

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Appendix I. Countries Selected for the Survey and their Banking Supervisory Structure before and after the Reforms

Country	Year of Reform	Structure Before	Structure After
Australia	1998	CB	OCB, U
Austria	2002	MinFin/CB	OCB, U
Belgium	2004	OCB	OCB, U
Canada	(2006)	OCB	OCB
Chile	1997	OCB	OCB
China, PR	2004	CB	OCB
Ecuador	2001	OCB	OCB
Estonia	1998	CB	OCB
Finland	1995	CB	OCB
Germany	2002	CB	OCB
Hungary	2000 – 2004	CB	OCB, U
Indonesia	(2002)	CB	OCB
Ireland	(2003)	CB	CB, U
Japan	2001	CB	OCB
Korea	1997	CB	OCB
Mexico	(1996)	CB	OCB, U
Nicaragua	(2004)	OCB	OCB
Poland	(2001)	CB	CB
Saudi Arabia	1995	CB	CB
South Africa	1990	CB	CB
Spain	2003	CB	CB
Turkey	2001	MinFin/CB	OCB
Uganda	2004	CB	CB
United Kingdom	1997	CB	OCB, U

CB = In central bank
Minfin = Ministry of finance or treasury
OCB = Outside central bank
U = Unified

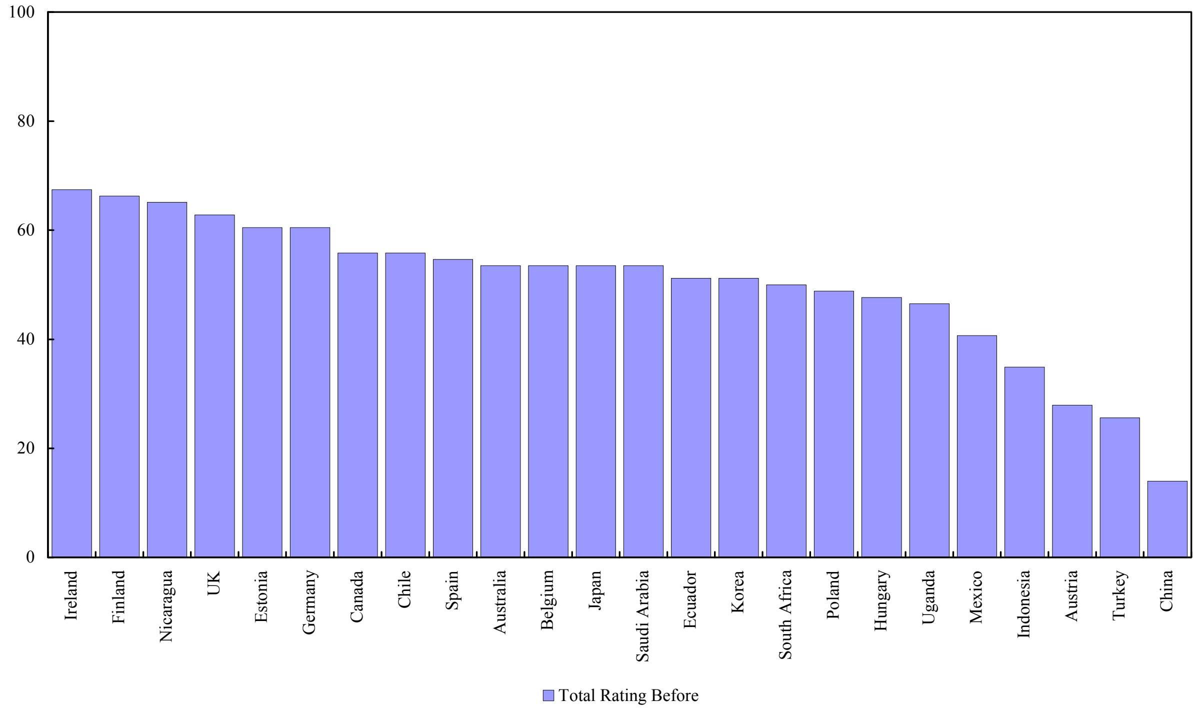
Appendix II. Criteria for the Index on Independence and Accountability for Financial Sector Supervisors

Criteria/Ratings	-2	0	1	2
Independence (15)				
1. Institutional Independence				
Has the agency a legal basis (law, act, …)		No		Yes
Does the law state that the institution is independent		No		Yes
Are the chairman and senior executives appointed by the government after discussion in parliament		No (any other practice)		Yes
Is the decision-making body a board or the president (a single person)		President only		Collegial decision making
Who has legal immunity for actions done in good faith?		No one in the agency	Senior management only	All staff
2. Regulatory Independence				
Can the agency autonomously issue legally binding prudential regulations for the sector?		No	No, but it can issue non binding guidelines etc	Yes
3. Supervisory Independence				
Has the agency the (sole) right to issue licenses?		No right	After consultation with government or other agency	Yes
Has the agency the (sole) right to withdraw licenses?		No right	After consultation with government or other agency	Yes
Has the agency the sole right to impose sanctions on supervised institutions ?		No		Yes
Has the agency the right to enforce sanctions?		No		Yes
4. Budgetary Independence				
How is the agency funded?		From government budget only	Mixed formula involving government budget	From fees, through central bank budget, or mix of the two, but no government funds
Need the agency submit the budget to the government for approval (incl. for approval of fee structure)		Yes	(Partial – for instance fee structure,…)	No
Has the agency the authority to define		No		Yes

salaries and salary structure of staff				
Has the agency the authority to autonomously hire staff		No		Yes
Has the agency the authority to define the internal organizational structure?		No		Yes

Criteria/Ratings	-1	0	1	2
Accountability				
1. Mandate				
Is the agency's mandate defined in the enabling legislation?		No		Yes
If multiple mandates, are the objectives prioritized?		No		Yes
Are agency functions defined to reach objectives/mandate?		No		Yes
2. Accountability toward legislature				
Is there an obligation in the law to present annual report		No		Yes
Does the law provide for possibility of regular hearings before committees (quarterly, …)		No		Yes
Is accountability to legislature delegated to finance minister (i.e. not the chair of the agency presents the report to parliament but the minister of finance).		Yes		No
Are parliamentarians sitting on policy board of agency	Yes			No
3. Accountability to executive branch				
Is there an obligation in the law to present annual report		No		Yes
Does the law provide for a possibility of regular briefing meetings with minister of finance (quarterly, …)		No		Yes
Does the law provide for the possibility for ad hoc hearings		No		Yes
Is there a government official on the agency policy board	Yes			No
Does the law/act give the minister of finance oversight power?	Yes			No
4. Accountability toward judiciary				
Does the law provide for legal (administrative) oversight?		No	Yes, but to minister	Yes, to an independent agency
Have supervised entities the right to appeal supervisory decision to courts?		No		Yes
Are there distinct judicial processes to handle these appeals?		No		Yes
Are there specialized judges to handle these appeals?		No		Yes
Are there penalties for faulty supervision?		No		Yes
5. Budgetary accountability				
Is there a process whereby the agency presents and discusses its budget ex post?		No		Yes

6. Transparency				
Is there disclosure of policies and of decisions? (website?)		No		Yes
Has the agency issued a mission statement?		No		Yes
Is the annual report available to the general public		No		Yes
Is there possibility for inquiries by general public? (email, ombudsman?)		No		Yes
Is there a consumer grievance board		No		Yes
7. Other				
Has the law defined clear criteria for dismissal of the president of the agency?		No, there is nothing in the law	There is something but not clear	Yes
Is there a formal ex ante consultation process with the industry about new regulations?		No		Yes
Is there a formal consultation process with the public at large about new regulations		No		Yes
Is there an internal audit process?		No		Yes
Is there an external audit process?		No		Yes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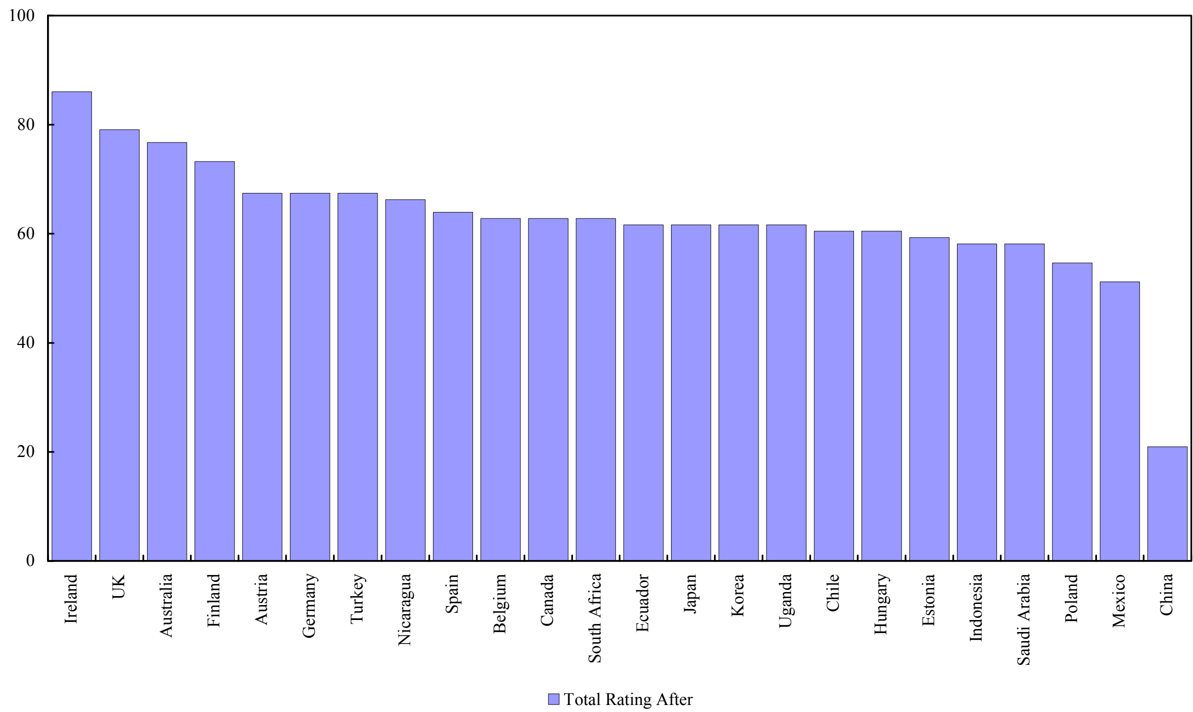
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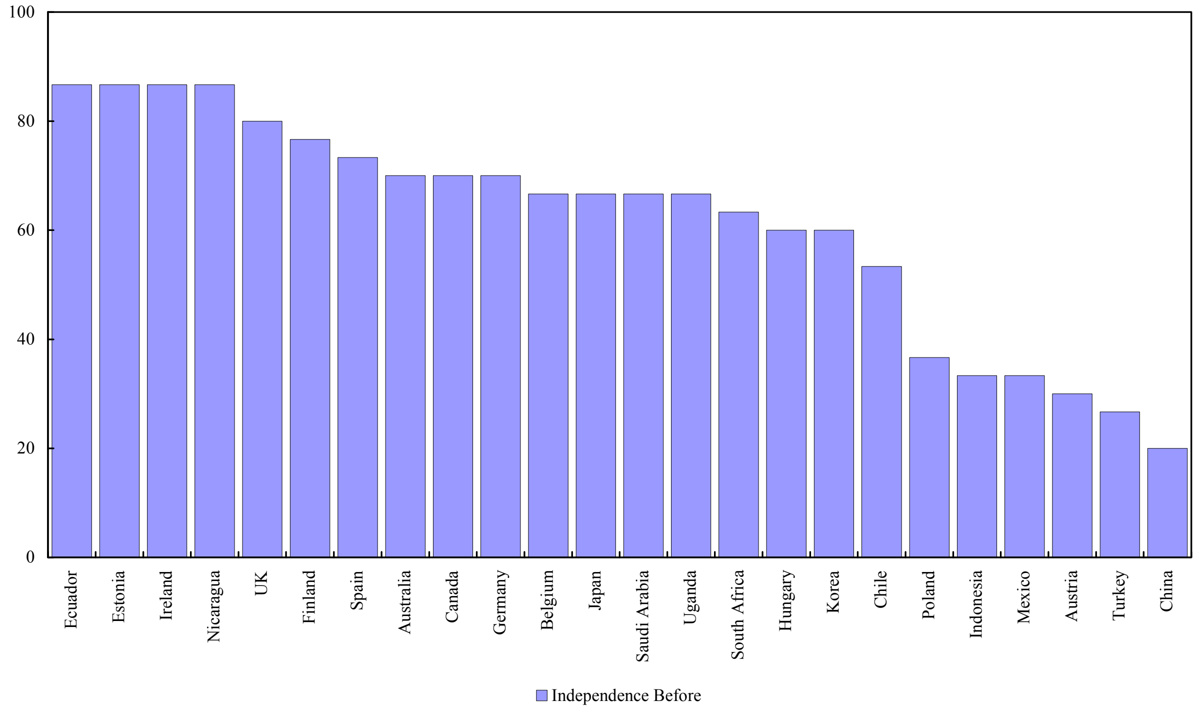
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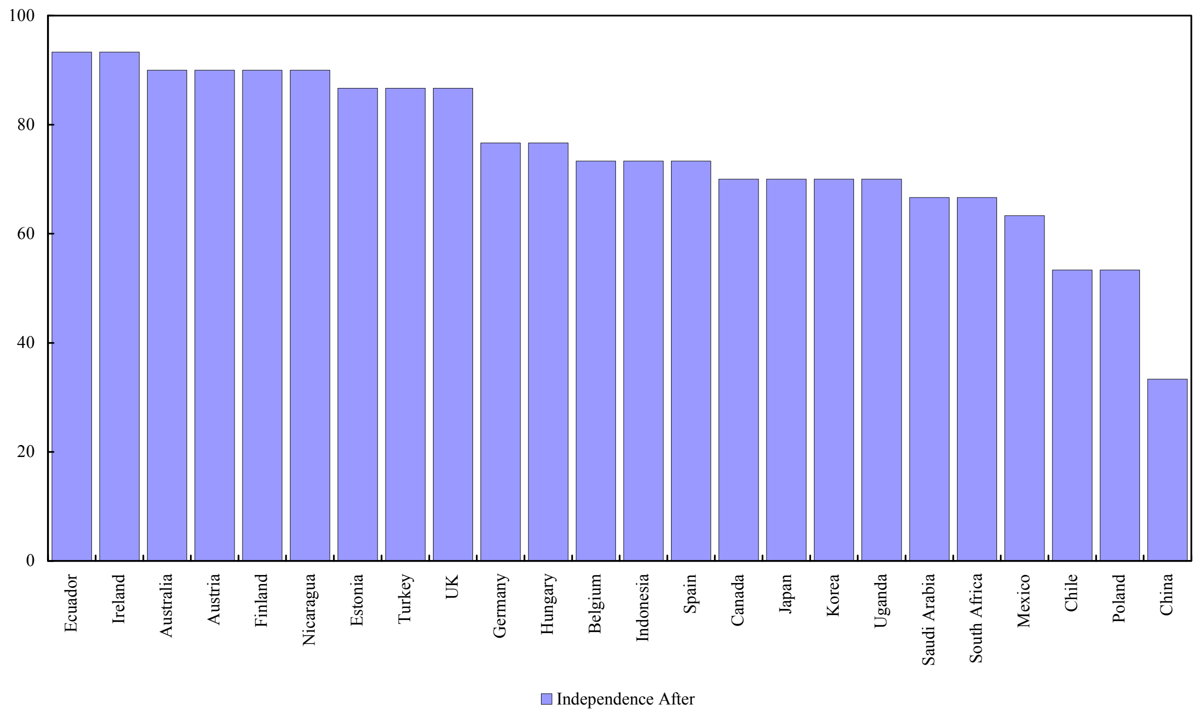
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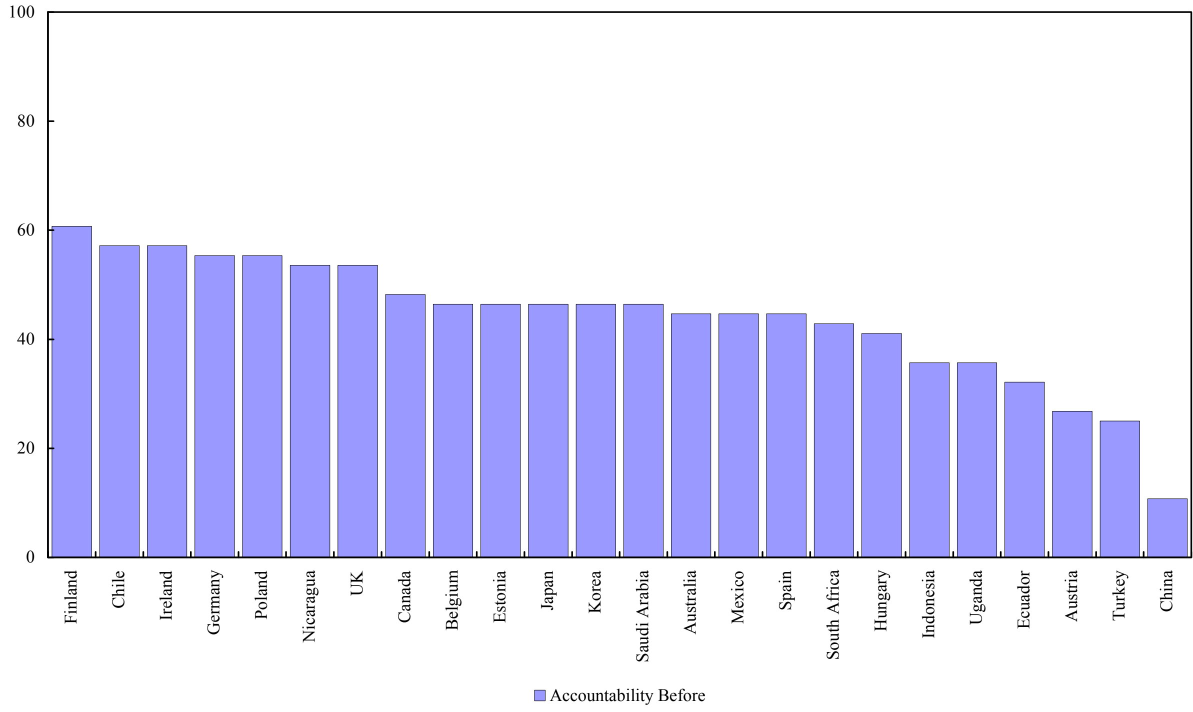
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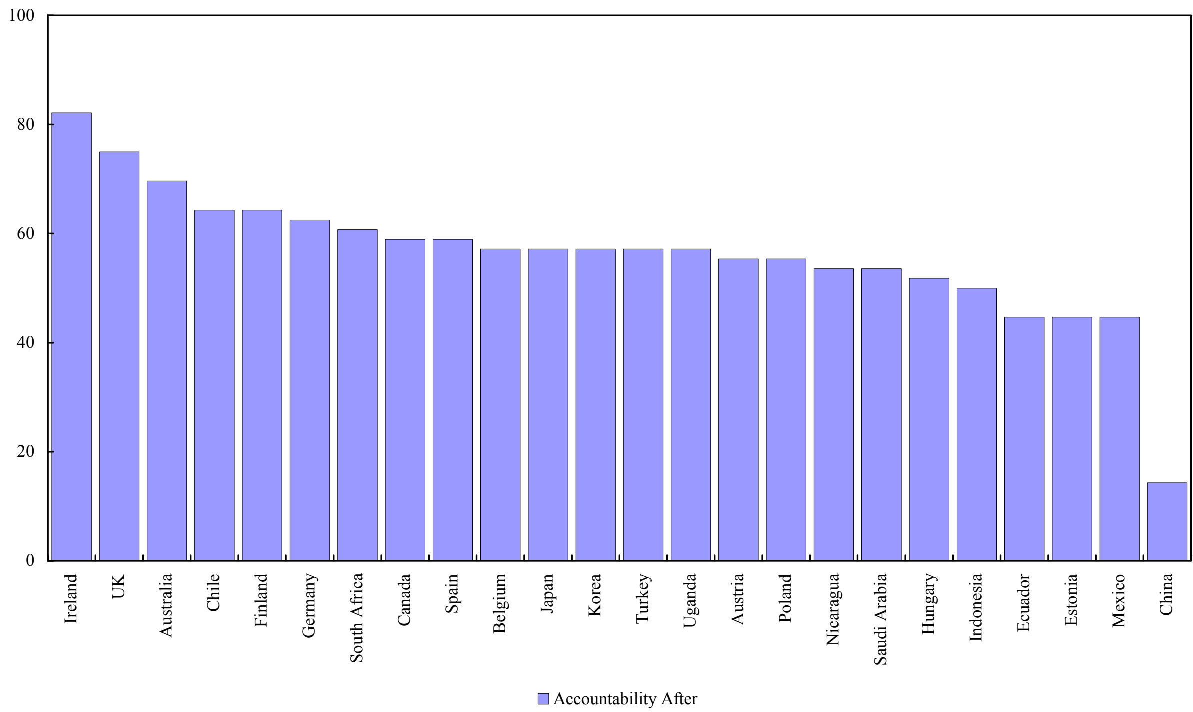
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