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ISSUES IN TRANSPARENCY AND ACCOUNTABILITY

TECHNICAL NOTE

MARCH 2013

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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GLOSSARY

EBA	European Banking Authority
ECB	European Central Bank
ESA	European Supervisory Authority
EIOPA	European Insurance and Occupational Pension Authority
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
FSAP	Financial Sector Assessment Program
IMF	International Monetary Fund
PRA	Prudential Regulatory Authority
ROSC	Report on Standards and Codes
SSM	Single Supervisory Mechanism

I. OVERVIEW[1]

1. **The prospective introduction of the single supervisory mechanism (SSM) and the experience to date with the European Supervisory Authorities (ESAs) raise some important transparency and accountability issues.** So far as the SSM is concerned, the key issues are how this may affect the appropriate transparency arrangements for monetary policy and what arrangements should be put in place for the SSM. For the ESAs, the issue is how transparency, accountability and governance arrangements might be strengthened, based on the experience since their establishment in 2011.

2. **The IMF Code of Good Practices on Transparency in Monetary and Financial Policies[2] identifies four broad areas in which countries should aim to promote a high degree of transparency with regard to both monetary and financial policies:**

- The roles, responsibilities, and objectives of the institutions involved.
- The processes for formulating and reporting policy decisions.
- The public availability of information concerning the institutions.
- Accountability arrangements and assurances of the integrity of the institutions and their personnel.

3. **A standard IMF assessment of compliance with the code, published as a Detailed Assessment Report and summarized in a Report on Standards and Codes (ROSC), provides snapshot of the extent of compliance with the code at the time of the assessment, but this would not be a very useful exercise at the current juncture in Europe.** First, by and large, the levels of transparency and accountability in the areas identified in the code are high; indeed, in many cases practices at the European level help in defining best practice. Consequently, an in-depth analysis of current practices would find relatively few areas in which standards may be notably below best practice. Second, a snapshot of current practice will quickly become obsolete, as adoption of the banking union, and reviews of the various ESAs, lead to changes in institutional arrangements and practices regarding financial policies in particular.

4. **This note takes a more selective and forward-looking approach to the issues of transparency and accountability of monetary and financial policies at the European supranational level.** In this regard, there are two main areas in which issues arise, either currently or in prospect. The first concerns the appropriate transparency and accountability

[1] Prepared by Scott Roger (EUO).

[2] See http://www.imf.org/external/np/mae/mft/index.htm.

arrangements for monetary and supervisory policies undertaken by the European Central Bank (ECB) when it takes responsibility for supranational banking supervision for the euro area and possibly other countries. The second concerns the transparency and accountability arrangements for the four ESAs established in 2011, and whether they should be modified in the comprehensive review of the ESAs scheduled for 2013.

5. **A nmber of measures are recommended to promote the credibility of monetary and supervisory policies when the ECB assumes supervisory responsibilities:**

- the ECB should begin to publish timely minutes of meetings to decide on monetary policy settings;
- the ECB should begin to publish more medium-term detail on its macroeconomic projections and alternative scenarios;
- the Supervisory Board of the SSM should develop and publish a set of guidelines that it will follow in formulating policy recommendations;
- the Supervisory Board should also publish minutes of its policy meetings;
- the ECB should consider establishing an external panel of experts to provide an independent oversight of the SSM. The panel should publish regular reports as well as provide direct feedback to the Supervisory Board; and
- the ECB should clarify and make transparent the working relationships between the macroprudential and microprudential areas of its mandate, and its relationship with the ESRB.

6. **Additionally, some measures are recommended to enhance the transparency and effective accountability of the ESAs:**

- transparency would be increased by reassessing the mandates of the ESAs with a view to reducing overlaps with others ESAs and the ESRB and the ECB;
- effective accountability and autonomy of the ESAs could be enhanced by strengthening the decision-making responsibility of ESA management, and introducing more Europe-wide representation on the Boards of Supervisors; and
- policy transparency and efficiency would be enhanced by modifying ESA funding arrangements to give them greater responsibility and autonomy in staff and budget management.

II. Transparency and Accountability Issues for ECB Monetary and Financial Policies

7. **The ECB's transparency and accountability arrangements for monetary policy have traditionally met a high standard.** The ECB's mandate is set out clearly in European Union (EU) legislation. The ECB provides considerable information on its governance and decision-making structures. It reports clearly and promptly on its regularly monetary policy decisions, complementing these with detailed monetary policy reports, on a quarterly basis, published research on monetary policy issues, as well as speeches and other forms of public outreach by senior staff. The ECB also provides considerable information on its financial position, data and data requirements, and operations, and maintains a high quality internet website. High ethical standards are required, and members of the ECB Council are subject to a careful external approval procedure.

8. **Nonetheless, it is apparent that the public perception of the ECB's policy objectives and the challenges of monetary policy communications have come under strain over the course of the financial crisis.** These problems are by no means unique to the ECB, but may be more challenging because of the particular features of the European financial crisis. More specifically, the range of measures taken to address fragmentation of the monetary transmission mechanism, and to help alleviate sovereign debt crises, have led to ongoing concerns and criticism that the ECB is pursuing multiple objectives, potentially at the expense of the price stability objective.

9. **Questions about the ECB's commitment to the price stability objective, and the potential trade-offs with other objectives, are certain to increase as the ECB becomes host to the SSM in 2013.**[3] On current plans, a Supervisory Board within the ECB, largely composed of participating national level supervisors, will have responsibility for formulating supervision policy, but final policy decisions will be made by the ECB Governing Council, which also decides on monetary policy. Many measures can and will surely be taken to keep the formulation of monetary and supervision policies as separate as possible, but a complete separation is not possible under one roof with only one final decision-making body. There are many central banks which have both monetary policy and banking supervision under the same roof. Typically, there is a defined degree of information sharing between the monetary policy and supervisory sides of the bank, but policy decisions are made by separate policy committees.[4] For example, the forthcoming re-assumption of supervisory policy at the Bank of England is planned to involve the creation of a Prudential Regulatory Authority (PRA) as a separate entity within the bank, with independent decision-making authority, but

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[3] This note takes the ECB assumption of bank supervisory responsibilities as given. It does not consider the question of whether, over the longer term, those responsibilities should be undertaken by a separate institution.

[4] Although there is also overlap in the membership of the committees.

accountable to the court of the bank and to Parliament.[5] The ECB does not appear to have the legal authority to delegate such decision-making.

10. **Both the challenges posed by the financial crisis in Europe, and the ECB's forthcoming assumption of responsibility for supranational banking supervision pose reputational risks to the ECB's policy credibility.** Uncertainty surrounding the formulation of both monetary and supervisory policies will also affect financial market pricing and volatility. Even small increases in risk premia on a euro area level would have cumulative large costs. This suggests that the ECB should consider additional steps or measures to enhance the transparency of monetary policy, and to ensure that its formulation of supervisory policies meets high standards of transparency.

III. MONETARY POLICY

11. **For monetary policy, perhaps the key requirement is to be more transparent about the inevitable trade-offs involved in policy decisions, as well as about the uncertainties associated in evaluating the trade-offs.** In this regard, two kinds of measures could be considered. The first is to begin providing timely minutes of Council meetings on monetary policy decisions.[6] These could provide a more effective presentation than in the Monetary Policy Report of the key trade-offs seen by the Council and the associated risk assessments involved in coming to policy decisions. Minutes of this discussion would present the array of views and properly reflect the range of uncertainties involved, as well as differences in assessments. Reporting need not identify the views of particular individuals, although this should be considered. Publishing the minutes of Council decisions on monetary policy would have two critical benefits in terms of ECB credibility. First, it would demonstrate the extent to which monetary policy decisions are made independent of supervisory policy considerations. Second, it would facilitate presenting the range of views of Council members and how consensus was reached in a clearer and perhaps less confrontational way than currently occurs through the press.

12. **A second measure which could help clarify where policy trade-offs occur and how they may be resolved in a manner consistent with price stability, is being more explicit in the publication of ECB projections for key variables.** The main downsides of publication of projections appear to be that some observers may mistake these for unconditional forecasts, and the publication of point forecasts can give a misleading impression of forecast accuracy. However, the experience of central banks that do publish

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[5] See Bank of England and FSA, (May 2011) "The Bank of England, Prudential Regulation Authority: Our approach to banking supervision," http://www.fsa.gov.uk/pubs/speeches/boe_pra.pdf.

[6] Article 10.4 of the ESCB Statute provides that "The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberations public." The Governing Council therefore has the authority to publish minutes of meetings.

projections suggests that these concerns may be overblown. The benefit of publishing projections, especially with alternative scenarios, is that they can be very useful in clarifying both the intertemporal trade-offs or consistencies of different policy concerns, as well as the consequences of alternative policy choices for key variables. Of course, such projections have to be used with care. They are first and foremost vehicles for helping to clarify the policy issues and risks faced by policymakers, as well as how the ECB staff understands key elements of monetary and financial transmission and interaction. As such, the presentation of projections needs to be kept simple and focused on the central issues, and not become bogged down in details which may be misleading and give a false sense of precision.

IV. Prudential Supervision in the Banking Union

13. **The ECB will need to establish a comprehensive framework for transparency and accountability for the SSM.** The IMF Code on Transparency provides a good starting point for identifying the types of measures and information that should be provided, and the ECB should draw on best practices within Europe to establish its own regime of transparency.

14. **A particular challenge is that the ECB's conduct of supervision will be subject to limited accountability to an independent or outside authority, beyond the ECB's general obligation to report to the European Parliament and the Eurogroup.**[7] This is especially awkward in so far as ECB decisions on supervision could well have important budgetary implications for SSM participants. Although there is no very neat solution to this, various measures can be taken to enhance transparency and strengthen accountability. To enhance accountability, the ECB could make regular presentations dedicated to supervisory matters to the European Parliament, and also, on occasion, to national parliaments. To increase transparency (as well as policy consistency), the Supervisory Board could set out as clearly as possible the principles and kinds of indicators or information it would generally use in coming to policy recommendations in different areas and publish them.[8] These guidelines would be analogous to the kinds of policy rules used in formulating monetary policy. In addition to providing a useful guide to consistent policy formulation over time, they also serve as useful benchmarks for policy evaluation. In this role, the guidelines would help the Supervisory Board in communicating the standard considerations entering its judgments and distinguishing these from the special considerations that inevitably need to be taken into account.

[7] At the ECOFIN meeting in December 2012, measures were agreed, based on Commission proposals (13683/12). These spell out the ECB's proposed reporting obligations regarding its supervisory responsibilities. While clarifying reporting requirements for supervisory activities of the ECB, the measures do not overcome the limited accountability that is inherent in the Governing Council's decision-making autonomy.

[8] The guidelines would need to be based on the supervisory rulebook being developed by the EBA, but could be more specific to the particular needs of the ECB.

15. **The ECB should publish regular reports on its supervisory work.** At a minimum, this should include regular (perhaps semi-annual) reports on the evolution of risks and vulnerabilities in the financial system under its supervision, and of its actions to monitor and address those risks and vulnerabilities. The SSM could also consider publishing minutes of the meetings of the SSM Supervisory Board, subject to confidentiality restrictions. The minutes of meetings of the Bank of England's Financial Policy Committee (FPC) provide an example of what might be produced.[9] Press notices of official decisions should also be published.

16. **An additional measure which could be considered is to establish a panel of external experts to provide periodic reviews of the ECB's performance and practices with regard to the SSM function.**[10] These experts would need to be independent both of the ECB and of participating national supervisors. They could include former supervisors, ex-bankers, and academics. The group could publish independent reports on the performance of the SSM, as well as provide expert feedback and suggestions as to how to improve the functioning of the SSM. This could be especially helpful in the early phases of the SSM's operations.

17. **The ECB will also need to clarify the organization and other relationships between its macro-prudential or financial stability activities and its micro-prudential or supervisory activities.** At this point, it is not quite clear where macroprudential policy will fit—whether as part of the SSM function, or as a element distinct from monetary and micro-prudential supervision, as at the Bank of England or the U.S. Federal Reserve. Whatever institutional arrangements are selected, however, the operational links between the macroprudential and microprudential functions will need to be made as transparent as possible, since they involve using an overlapping set of policy instruments. In this connection, it would be helpful to agree on a clear distinction in macro-prudential responsibilities between the ECB and the ESRB, which has an EU-wide mandate and as such may have to offer recommendations on all areas of ECB activity (see technical note on macroprudential policy).

V. Governance and Accountability Issues for the European Supervisory Authorities

18. **To strengthen the quality and consistency of financial supervision and regulation on a pan-European basis, three ESAs were established in 2011.**[11] These comprise the

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[9] See http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2012/record1209.pdf.

[10] This would go beyond the proposed annual reporting requirements of the ECB on supervision to the European Parliament, the Council, the Commission and the Eurogroup.

[11] On the recommendation of the de Larosière Report (2009)

European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). In addition, the EU also established the European Systemic Risk Board (ESRB).

19. **As supranational institutions, their positions are unusual as compared with national-level regulatory and supervisory bodies, particularly with regard to their mandates and governance and, consequently, accountability arrangements.** Although there appears to be a broad recognition that the ESAs have achieved a great deal since their establishment, some aspects of their design and operation inhibit transparency and effective accountability.

20. **The mandates of the ESAs are broad and imprecise, making transparency and accountability difficult.** Each has responsibilities in the area of sectoral regulation, promoting convergence in supervision, promotion of market and financial product transparency, consumer protection, and providing advice to other EU institutions. The ESAs, especially the EBA, have financial stability roles in their mandates, while ESMA also has direct supervision responsibilities. The breadth and imprecision of these mandates creates some overlaps between the mandates of the ESAs, as well as potentially between the EBA and the proposed SSM. The Joint Committee bringing together the ESAs and the ESRB provides a very useful venue for coordinating activities and minimizing overlaps. Nonetheless, having multiple objectives inevitably requires trade-offs to be made between them when they conflict. Moreover, with limited budgets, difficult choices have to be made in prioritizing objectives. Although the ESAs are generally quite transparent about stating their work programs and decisions, it is very difficult for them to be clear about how decisions were reached and what trade-offs were involved.

21. **The planned review of the ESAs in 2013 offers an opportunity to sharpen the focus of their mandates, facilitating greater transparency and accountability.** The mandate of the EBA in particular should be reassessed with a view to reducing overlaps with the ESRB and ECB with respect to financial stability assessment, including stress testing (see accompanying note on stress testing). For the other ESAs, especially as they move into more supervisory roles, it will be important to ensure that their powers vis-à-vis national level supervisors are clear, and that their respective responsibilities are well delineated. Crucially, it will be essential that the ESAs are able to act as truly supranational agencies, with direct and easy access to information and data from entities that they supervise, rather than having to work through national authorities.

22. **Governance arrangements for the ESAs should also be reviewed, with the aim of strengthening operational independence and effective accountability.** The current governance arrangements for the each of the ESAs include a Board of Supervisors made up of representatives from EU member state institutions, responsible for policy decisions; and a management board responsible for the operation of the ESA.

23. **The ESAs have formal accountability towards the Commission and the European Parliament and Council, but it is less clear that there is good effective accountability.** Essentially this is because it is difficult to make a large group like the Boards of Supervisors accountable in any very meaningful sense. This is especially the case when the participants are actually representatives of their respective institutions rather than participants in their own right.[12] As a consequence, there is little other than peer pressure within the boards to have members act as executives of supranational institutions rather than as representatives of national interests. To help overcome this problem, it might be helpful for published minutes of the ESAs to be more explicit regarding differences of view between participants, as well as between ESA staff and the Board of supervisors.

24. **Modifying the composition of ESA Boards of Supervisors, as well as voting arrangements, should also be considered to strengthen the supranational orientation of decision-making.** At a minimum, the ESA's chair should have a vote on an ex officio basis. Additionally, consideration could be given to adding some voting members nominated on a European rather than national basis, and have these members appointed for a relatively lengthy period so as to maximize their autonomy. Such a change would also help prevent the creation of coalitions, etc. that might block action or favor some countries over others. Further, ESA staff could be given responsibility for preparing proposed decisions on issues coming before the Boards, in order to help focus discussion on a European perspective.

25. **Governance reforms should also be aimed at increasing the responsibility and accountability of management boards.** This would also help to overcome the domination of national interests in decisions of the Boards of Supervisors. It would also facilitate more rapid decision-making than is generally possible in such sizeable groups. Delegation of decision-making responsibility, and corresponding accountability, towards management boards may be more appropriate in some areas than in others. For example, in areas where a high degree of consensus is desirable, it may be sensible for the Board of Supervisors to retain responsibility. However, in other areas, such as supervision, where an agreed set of rules is to be applied, and where speedy action is needed, it may be more appropriate for the management board to have full responsibility and be accountable to the Board of Supervisors. With this sort of shift in the role of the management board, the effective accountability of the institutions would be more clearly focused on a small set of decision makers and executives. This type of arrangement would also be more transparent in the sense that these institutions, which are meant to be largely autonomous supranational institutions, would have a higher degree of autonomy in practice.

26. **Funding arrangements for the ESAs should also be reconsidered.** The financial arrangements of institutions are not normally a transparency issue, except in so far as the

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[12] Board members are meant to act in the overall interest of Europe, but that injunction is inconsistent with the fact that they are each nominated by the respective national authority.

financial arrangements and position should be made public. However, in the case of the ESAs, it is evident that their budgetary positions and scope to manage their resources are so constrained that their ability to carry out important parts of their mandates is compromised. This amounts to a lack of transparency. In effect, external budget and staffing constraints are transferring decisions on policy priorities to the Commission from the ESAs in a non-transparent manner, inconsistent with the original mandates given to the institutions. To remedy this problem, the ESAs need to be given significantly greater responsibility for managing their own resources and budgets, with appropriate accountability required by the management of the ESAs.