

# Central Bank Governance: Governing the Fourth Estate

*Keynote Address at the IMF-Hawkamah  
Central Bank Forum*

**Dr. Nasser Saidi**  
**13 December 2016**

**NASSER SAIDI**

— & ASSOCIATES —

# Agenda

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- ✓ **GFC has led to regime change in role of Central Banks**
- ✓ **CBs and Financial Stability**
- ✓ **Pillars of CB Governance: Independence, Accountability, Transparency & Implementation Principles**
- ✓ **Evidence & Indicators of CB Governance**
- ✓ **CB governance: some takeaways**

# GFC has led to regime change in role of CBs

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- GFC & GR have radically changed the size, composition and risk characteristics of central bank balance sheets and range of instruments used in OMO and LOLR operations
- GFC has shown that CBs must also consider the maintenance of financial stability in addition to targeting inflation. Price stability and financial stability now viewed as part of same public good.
- With two objectives, the Tinbergen principle requires at least two sets of instruments. This consideration had led to the creation of both 'micro and macro-prudential instruments'. A clear assignment of policy instruments – short-term interest rate to monetary stability, prudential tools to financial stability – is not always feasible
- Financial cycles last longer than standard business cycle and interact strongly with the real economy. Require a policy of leaning against the wind as well as cleaning up after it.

# Monetary & Financial Stability objectives: changing policy toolboxes & institutions

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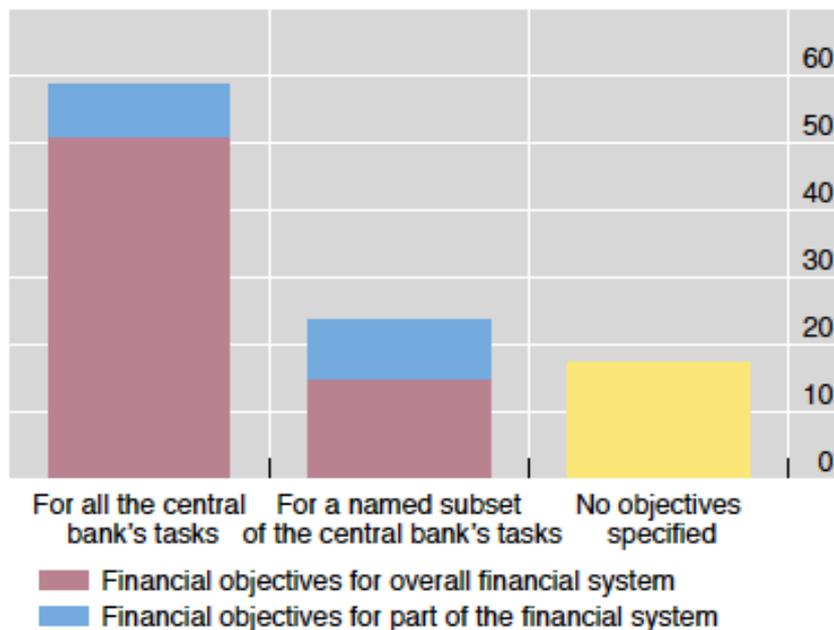
- Unconventional monetary policy generates increased financial risks: QE, ZIRP, bail-outs, quasi-fiscal operations
- Financial stability: Micro and macro prudential supervision, resolution, and financial integrity/consumer protection
- Responsibility for financial stability is shared: integrating financial stability considerations into monetary policy, and vice versa, presents institutional challenges.
- Enormous discretionary power to intervene in financial markets through QE and UMP. Types of assets CBs buy & sell is more akin to fiscal policy choices, with wide socio-economic consequences, e.g. pensions, savings, retirement, mortgages & housing etc.

# What is Financial Stability?

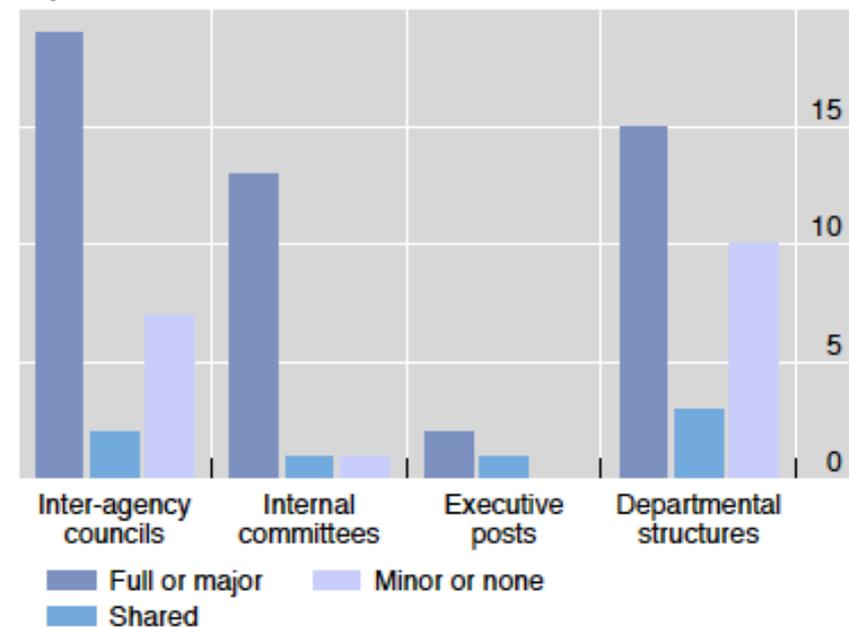
Defining “financial stability” with sufficient clarity to guide actions and create a structure for accountability is difficult. Ingves Report (2011) finds 5 different types of definition for “financial stability”

## Financial stability objectives in central bank laws; number of organisational changes related to financial stability observed at central banks

Percentage of central bank laws that mention “stability” or a close synonym<sup>1</sup>



Absolute number of changes since 2005, across surveyed institutions by type and involvement in banking supervision<sup>2</sup>



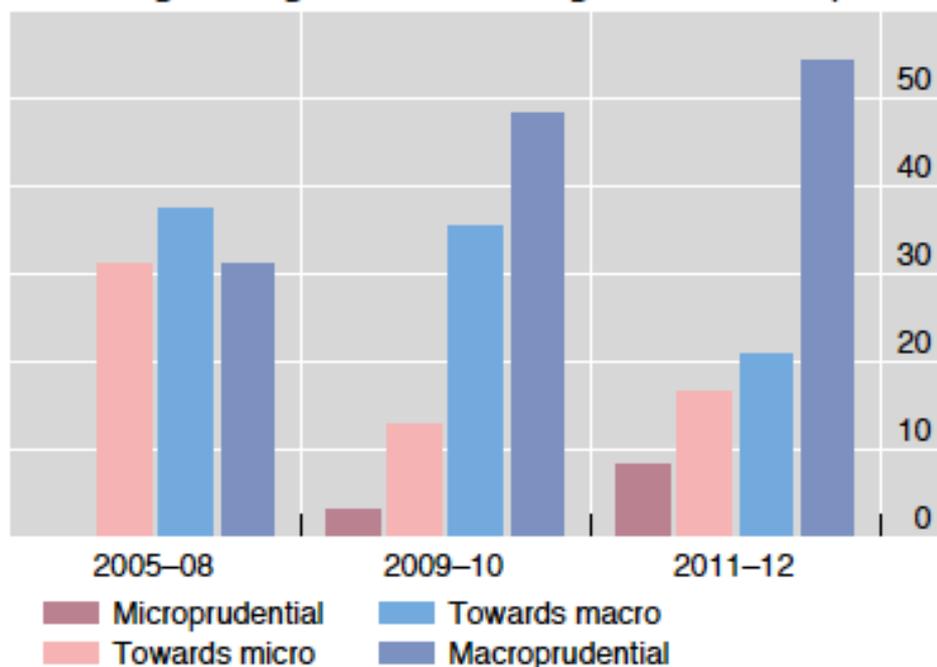
<sup>1</sup> Based on a review of 114 central bank laws and statutes.

<sup>2</sup> Based on a survey of 40 central banks and monetary authorities.

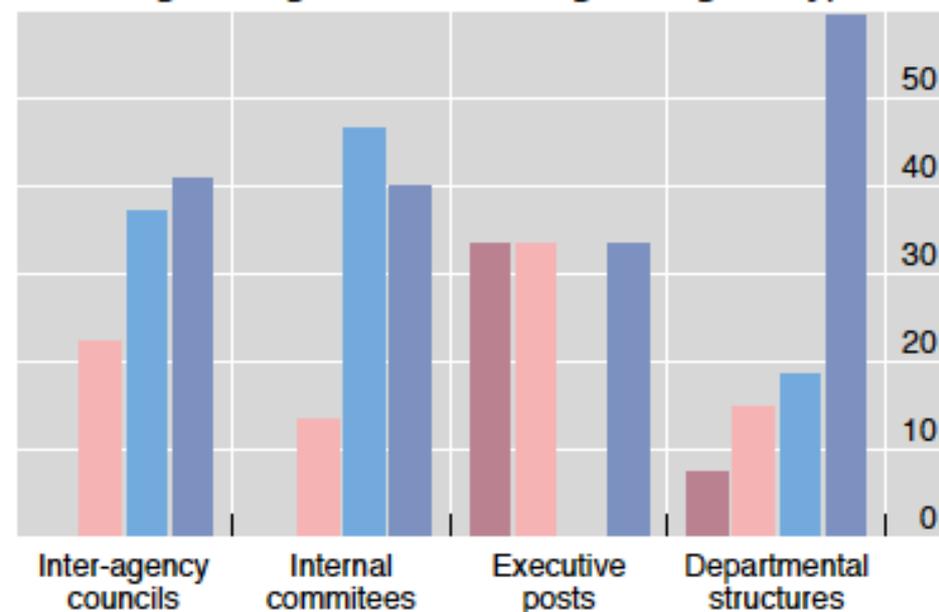
# Institutional & Organisational Changes related to Financial Stability

- Based on a 2012 survey of 40 countries, institutional & organisational changes related to financial stability were commonplace over seven years up to 2012.
- Most of these institutional and organisational changes involved bringing macroprudential considerations to the fore

Percentage of organisational change in each time period



Percentage of organisational change of a given type



Based on a survey of 40 central banks and monetary authorities.

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Source: "Financial stability objectives and arrangements –what's new?", BIS Papers No.76

# Definitions of financial stability

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- **ECB:** “Financial stability can be defined as a condition in which the financial system— comprising of financial intermediaries, markets and market infrastructures—is capable of withstanding shocks and the unraveling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities”
- **Bundesbank:** “The financial system’s ability to perform its key macroeconomic functions well, even in stress situations and during periods of structural adjustment”.
- **BoJ:** ““Financial system stability” refers to a state in which the financial system functions properly, and participants, such as firms and individuals, have confidence in the system”

# CBs play significant roles in macro-prudential policy

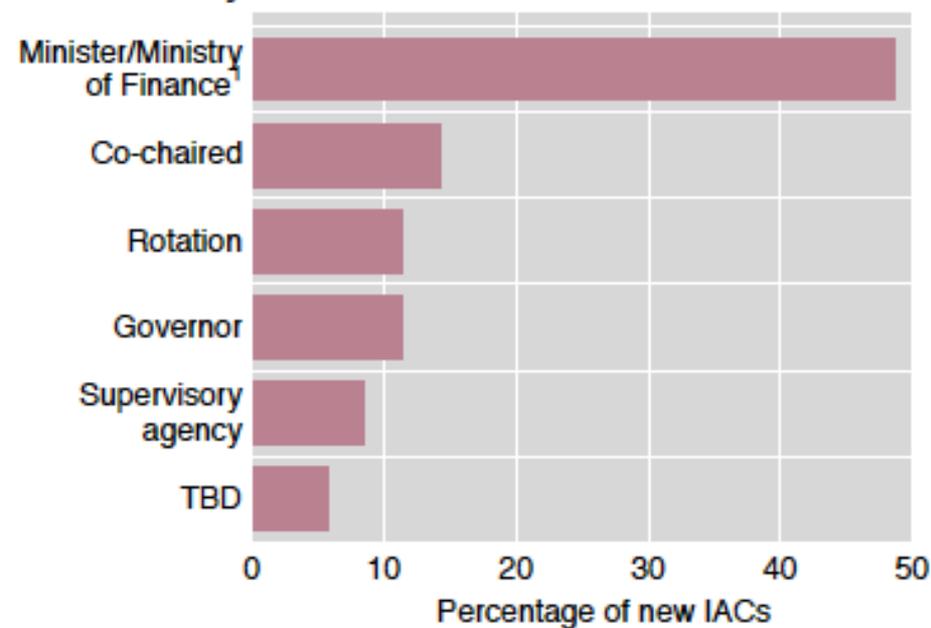
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- **Formal institutional arrangement varies:** sometimes responsibility is directly assigned to the CB; on other occasions it is assigned to an inter-agency council (IAC), of which the CB is a member or sometimes the chair
    - Malaysia, Singapore, Thailand: CB is the main agency responsible
    - Sweden: Financial Services Authority has the responsibility
  - **Inter-Agency Councils:** the European Systemic Risk Board is chaired by ECB; Bank of England's Financial Policy Committee is chaired by its Governor
  - For majority of IACs – around eight out of 10 cases – the Minister of Finance or a similar figure is the chair, but CB is often a member with key responsibilities
- => Giving some agencies clear responsibility for financial stability – along with the necessary accountability – will help guard against repeating the inattention to instability risks and buildup of systemic risks

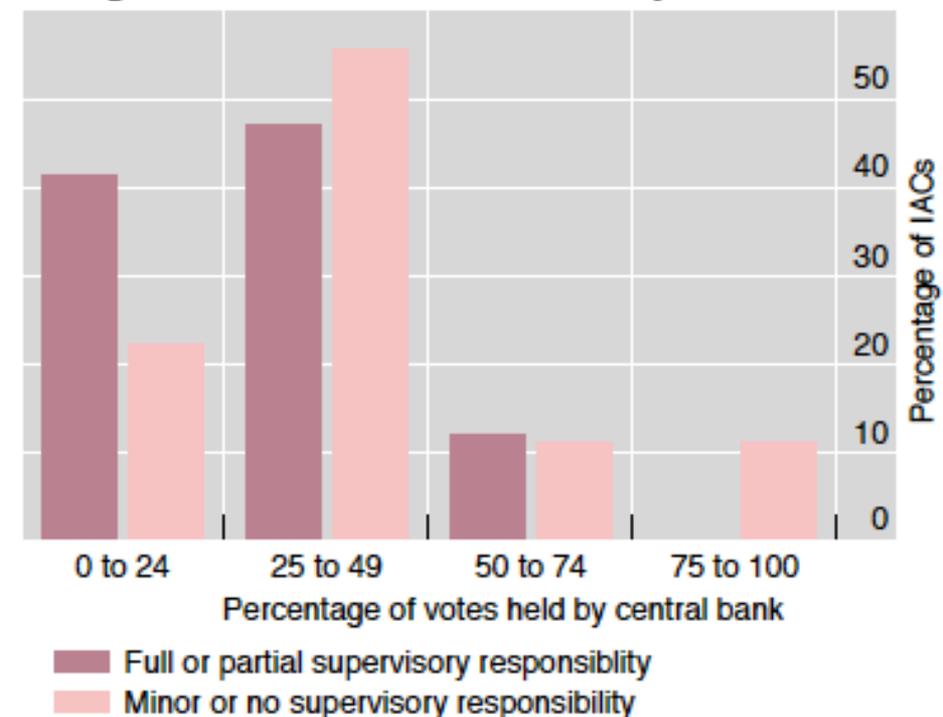
# Chairmanship & CB participation in IACs

- More than two thirds of central banks in the BIS survey (2012) sample reported being involved in at least one new (or substantially changed) IAC since 2005
- Most IACs were established to share information and to conduct a coordinated monitoring of financial conditions. Fewer were also being responsible for crisis management

Chair of newly established IACs



Strength of central bank voice on newly established IACs



Based on a survey of 40 central banks and monetary authorities.

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Source: "Financial stability objectives and arrangements – what's new?", BIS Papers No.76

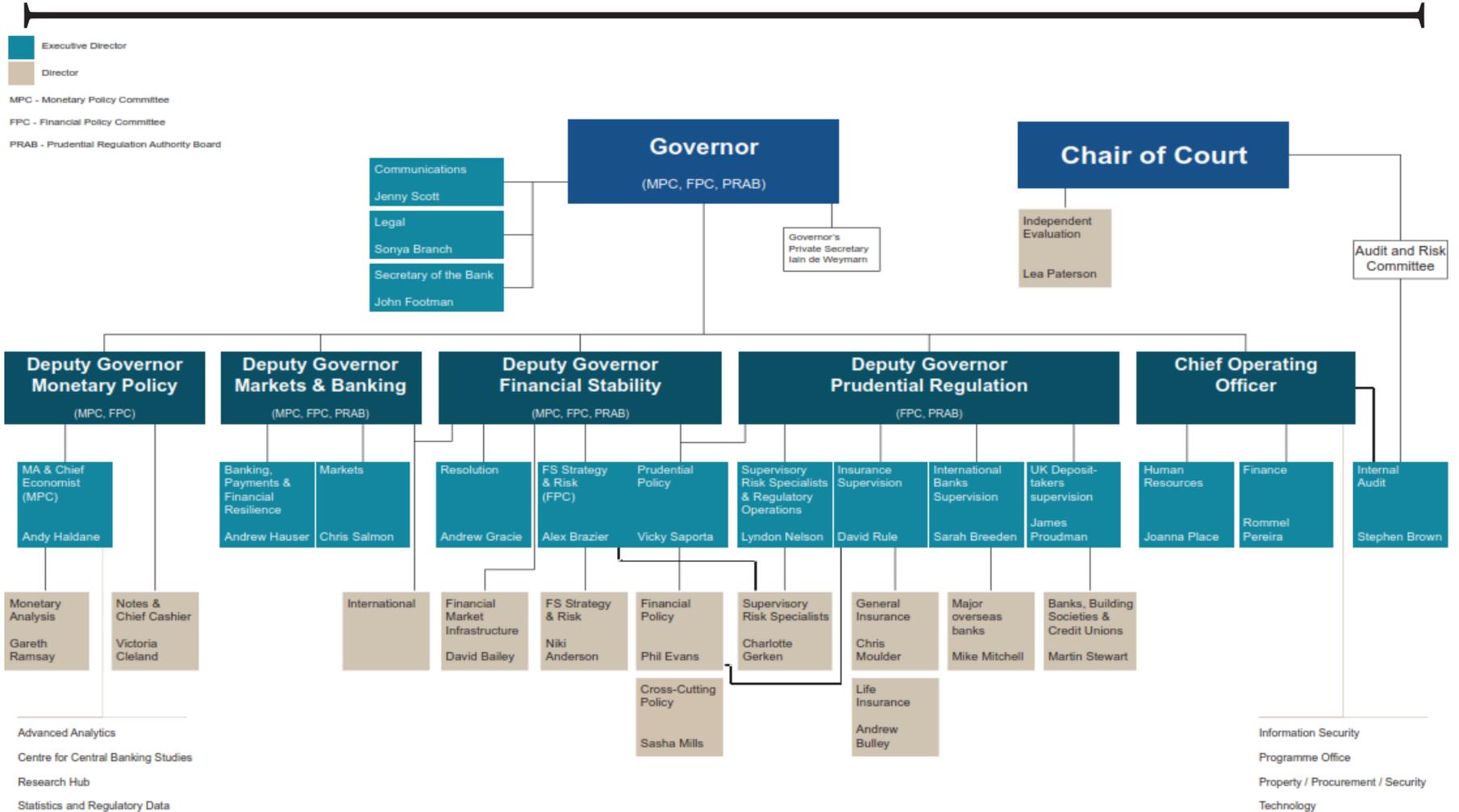
# CB's many roles... how many boards?

## Selected types of central bank boards, and their frequency

Board function specified in the law	Per cent of central banks		Median number of board members	Per cent of boards	
	One board of this type	More than one board of this type		Multiple functions	Governor as chair
Oversight	66	2	10	21	39
Monetary policy	64	0	8	83	97
Other policy	43	9	7	82	89
Management	66	4	7	60	97
Advisory	17	2	11	20	30

Note: Data are drawn from a survey of the central banks in the Central Bank Governance Network. The 12 national central banks of the Eurosystem which are in the Network are not counted as having monetary policy boards, given the centralised nature of decision-making in the euro area; nor are those 12 central banks counted as having a formal advisory role on monetary policy.

# BoE organisation chart (2016)

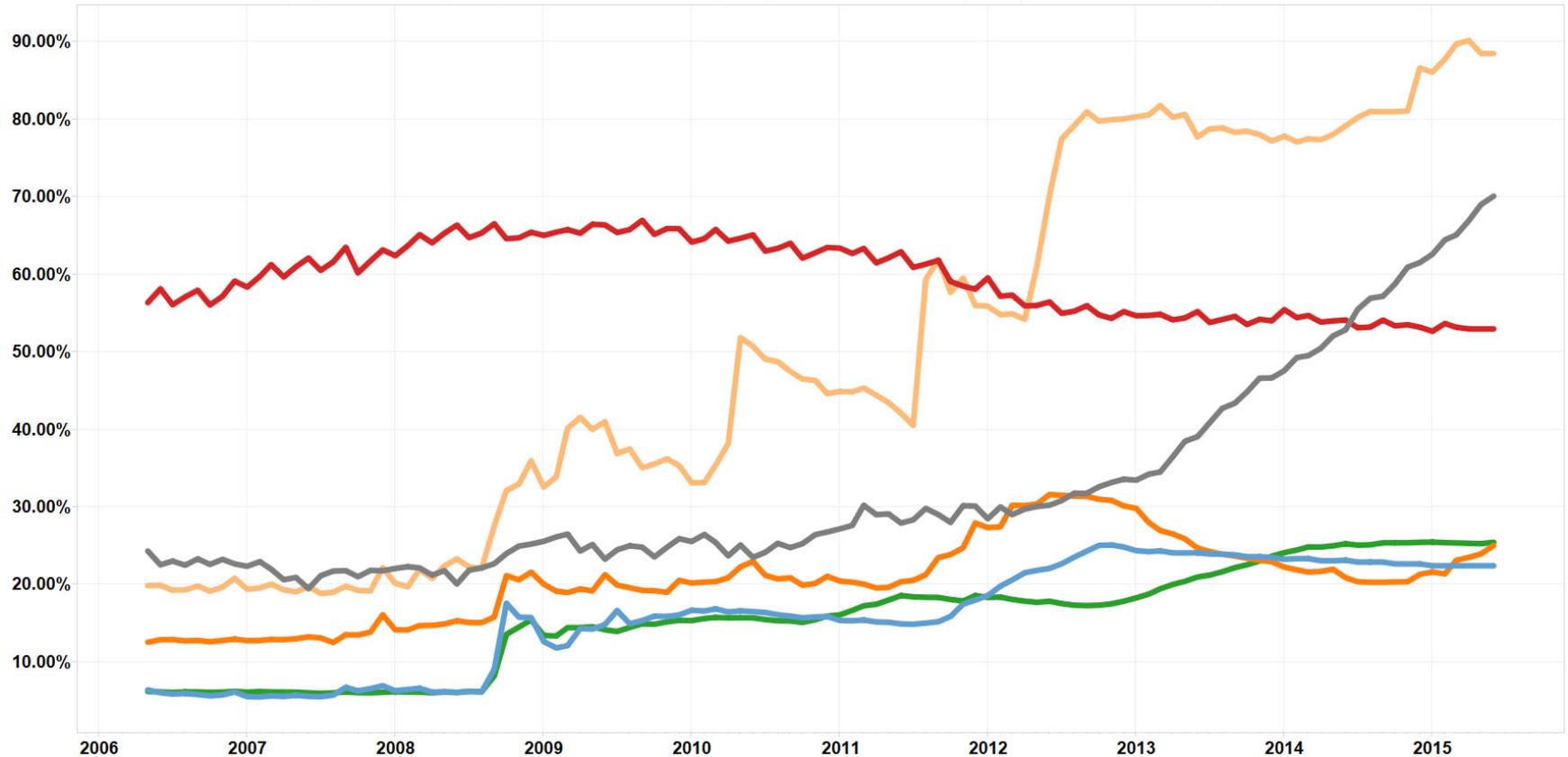


# Central Bank Balance Sheets to GDP



Central Bank Balance Sheet/GDP Ratios:

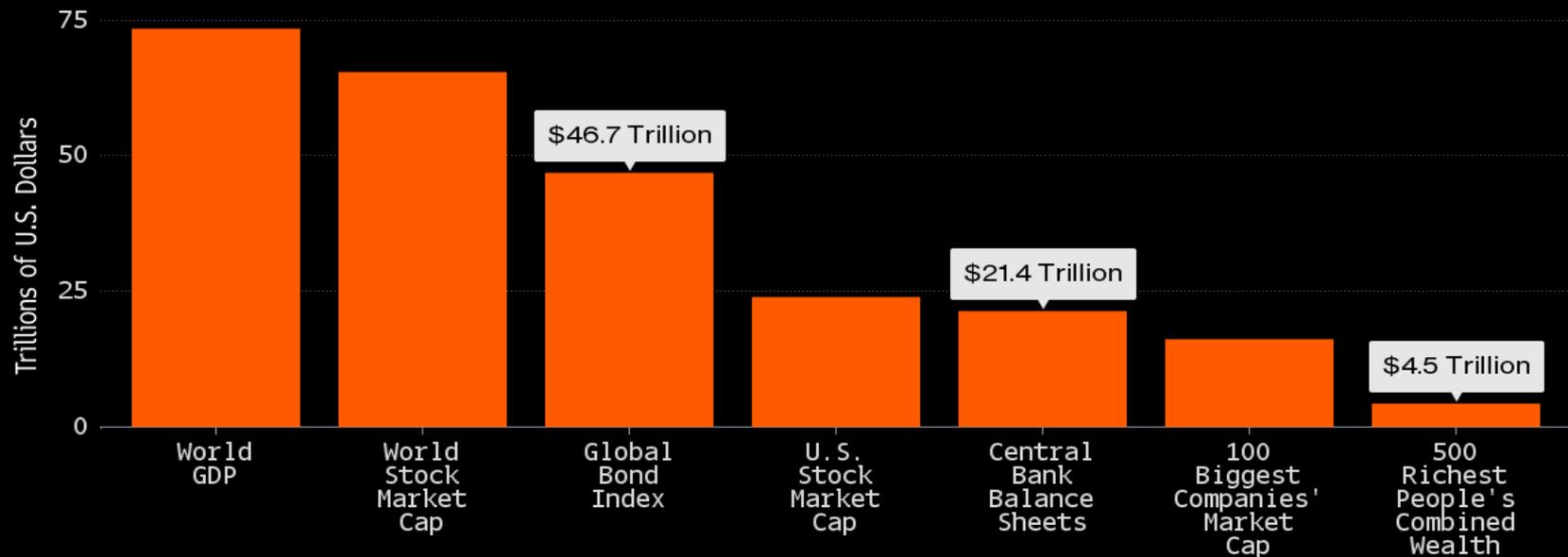
Bank of Japan, Bank of England, Swiss National Bank, People's Bank of China, European Central Bank, Federal Reserve



# Combined BS of 10 biggest CBs

## Putting \$21 Trillion in Perspective

How the combined balance sheets of the 10 biggest central banks stack up\*

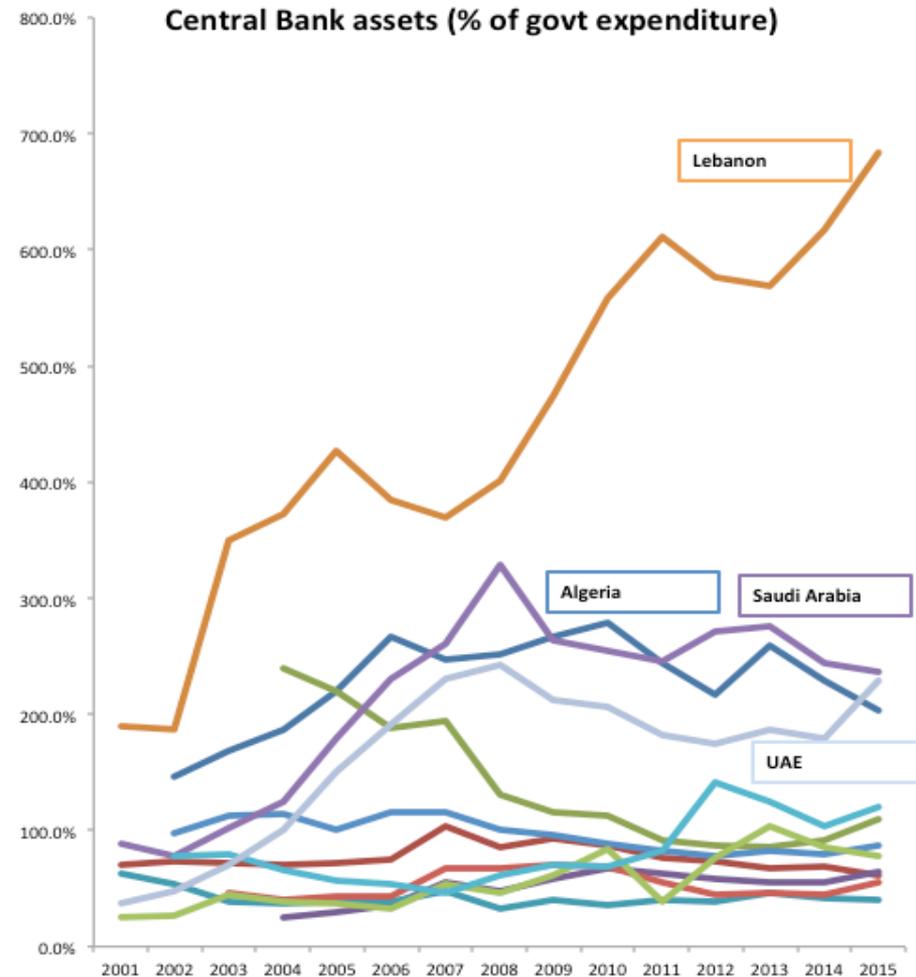
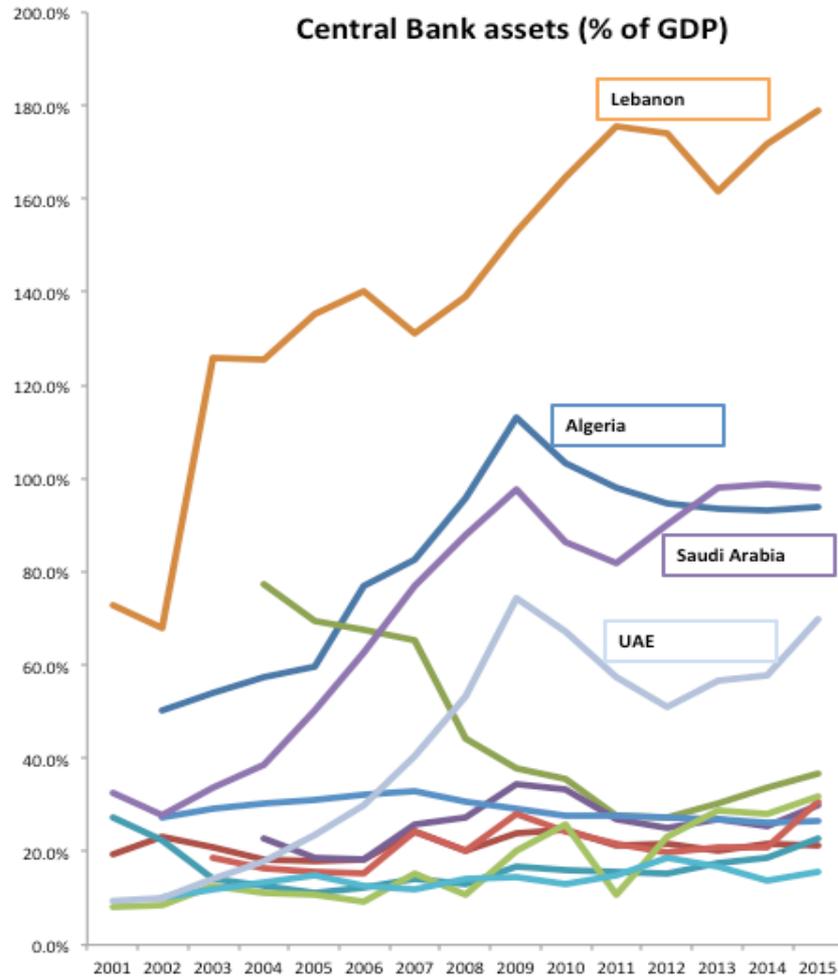


Source: Bloomberg

\*Richest people's combined wealth based on Bloomberg Billionaires Index; bonds sum uses Bloomberg Barclays Global Aggregate Index's market value

Bloomberg

# Central Bank assets in the MENA region



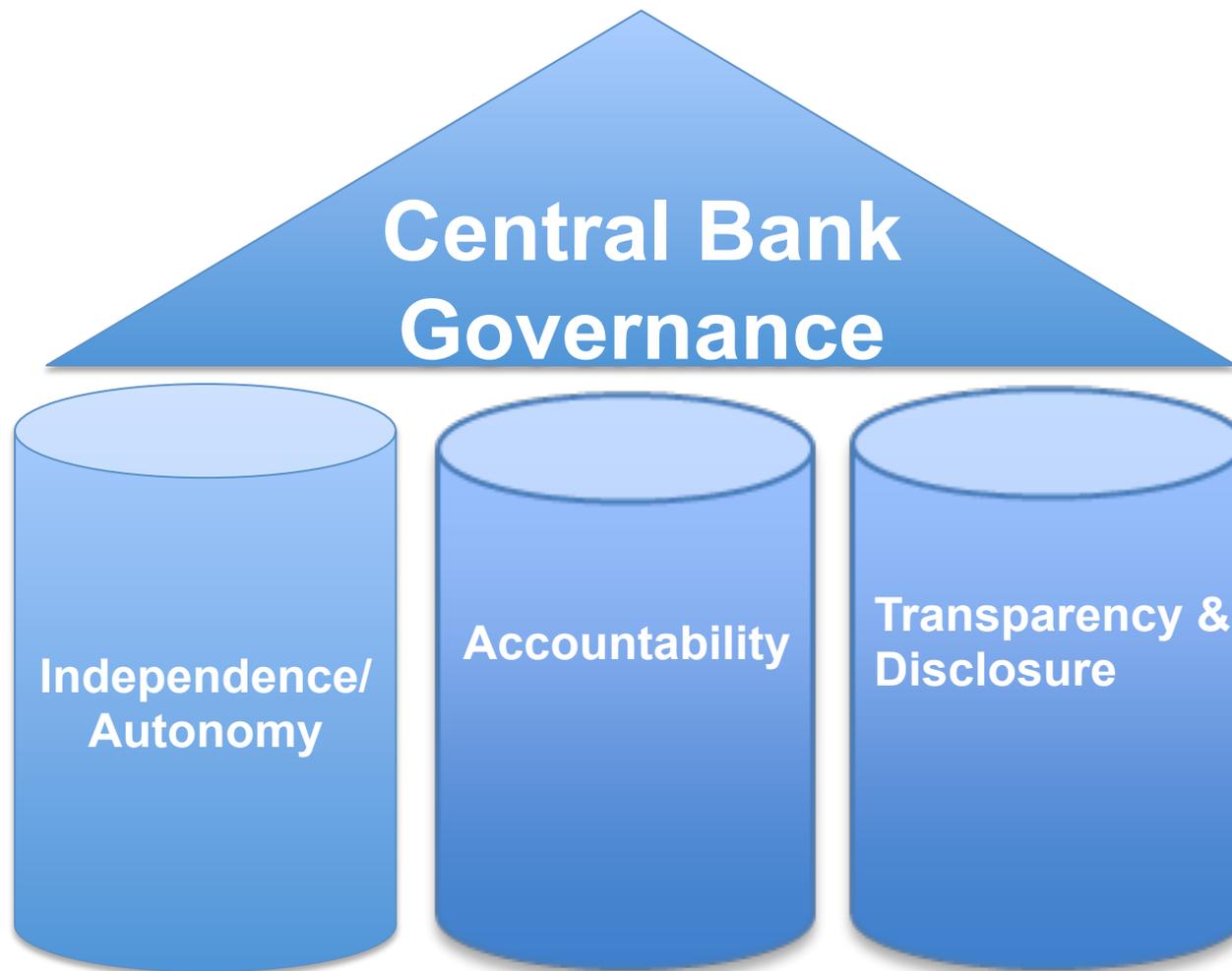
# Governing the 'Fourth Estate'

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- Wider discretionary powers raise issue of governance of CB as Fourth Estate alongside the Legislative, Executive and Judiciary
- CBs run risk of becoming “responsible for everything but accountable for nothing”
- “How, in a democratic society, do you design an institution that has considerable authority & enormous discretionary power to do what it needs to do, including sufficient independence, but also is accountable and constrained in the use of its authority?”

# Should the Three Pillars of CB Governance be reviewed?

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# CB CG characteristics

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1. Independence/autonomy
2. Responsibility
3. Accountability
4. Fairness
5. Transparency & Disclosure
6. Discipline
7. Socio-Economic responsibility

# Seven Characteristics of CB Governance

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**Independence:** Independence is the extent to which mechanisms have been put in place to minimize or avoid potential conflicts of interest that may exist, such as dominance by a strong Governor, Treasury or Minister of Finance. These mechanisms range from the composition of the board, to appointments, to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences.

**Accountability:** Individuals or committees in the CB, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These provide stakeholders with the means to query and assess the actions of the board and its committees. The board should be able to justify its policies and actions to its stakeholders.

**Transparency & Disclosure:** Transparency is the ease with which an outsider is able to make meaningful analysis of a CB's policies and actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid, accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not stakeholders obtain a true picture of what is happening inside the bank. The board should disclose information in a manner that enables stakeholders to make an informed analysis of the CB's performance, and sustainability

# Seven Characteristics of CB Governance

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**Responsibility:** The Board should assume responsibility for the assets, policies and actions of the CB and be willing to take corrective actions to keep the bank on a strategic path that is ethical and sustainable. With regard to management, responsibility pertains to behavior that allows for corrective action and for penalizing mismanagement. Responsible management would, when necessary, put in place what it would take to set the CB on the right path.

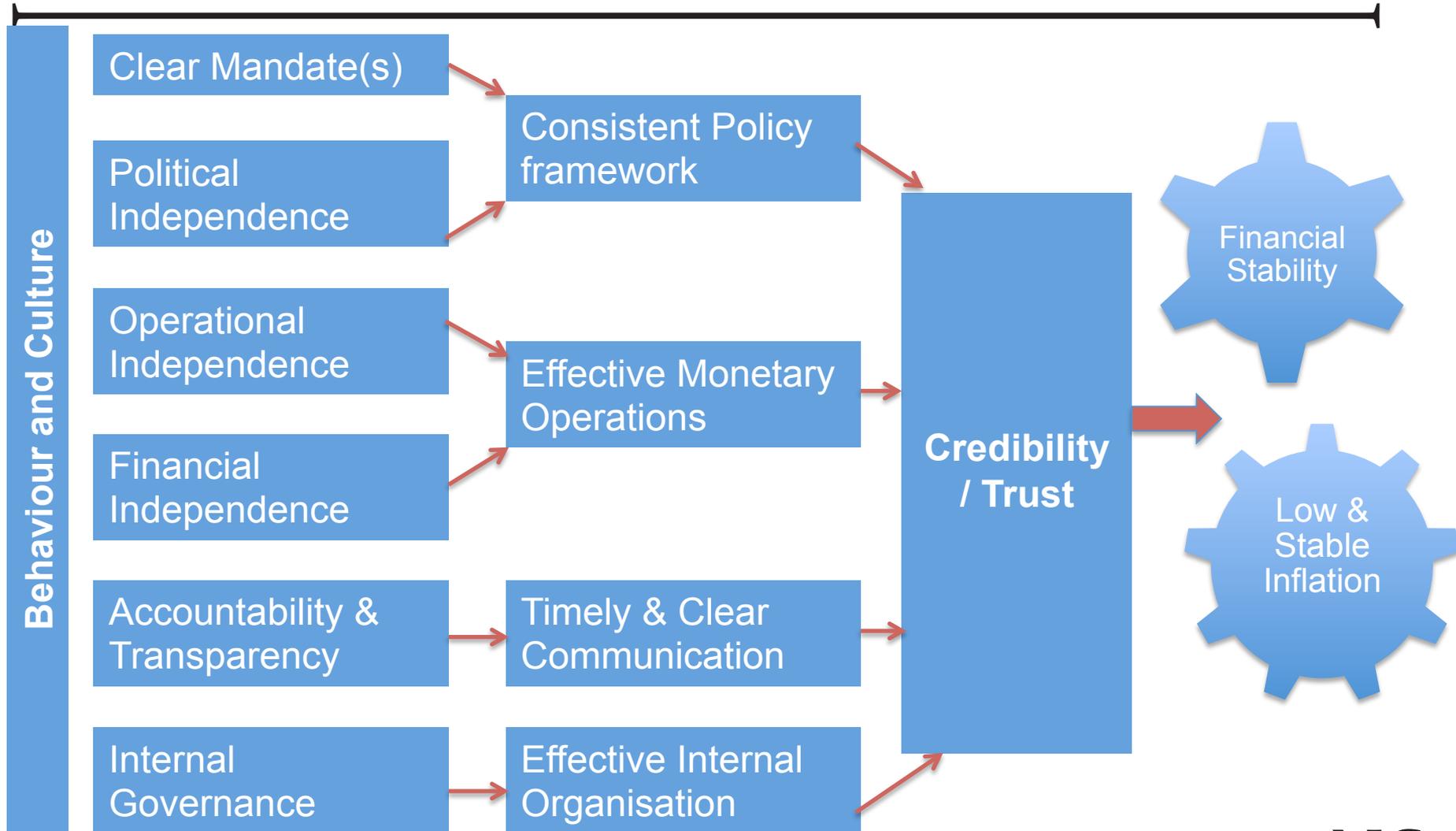
**Discipline:** Corporate discipline is a commitment by a CB's board & senior management to adhere to behavior that is universally recognized and accepted to be ethical, correct and proper. This encompasses a CB's awareness of, and commitment to the underlying principles of good governance, particularly at senior management level.

**Fairness:** The systems that exist within the CB must be balanced in taking into account all those that have an interest in the CB and its future. The rights of various groups have to be acknowledged and respected. The board should ensure that it gives fair consideration to the legitimate interests and expectations of all stakeholders of the CB

**Socio-Economic responsibility:** A well-managed CB will be aware of, and respond to, socio-economic issues, placing a high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues. A CB is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.

Source: IMF, OECD, King Code III, IV

# Central Banks' Governance underlies credibility and trust



# CB Internal Governance & Non-Financial Risk Management



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# CB External Governance

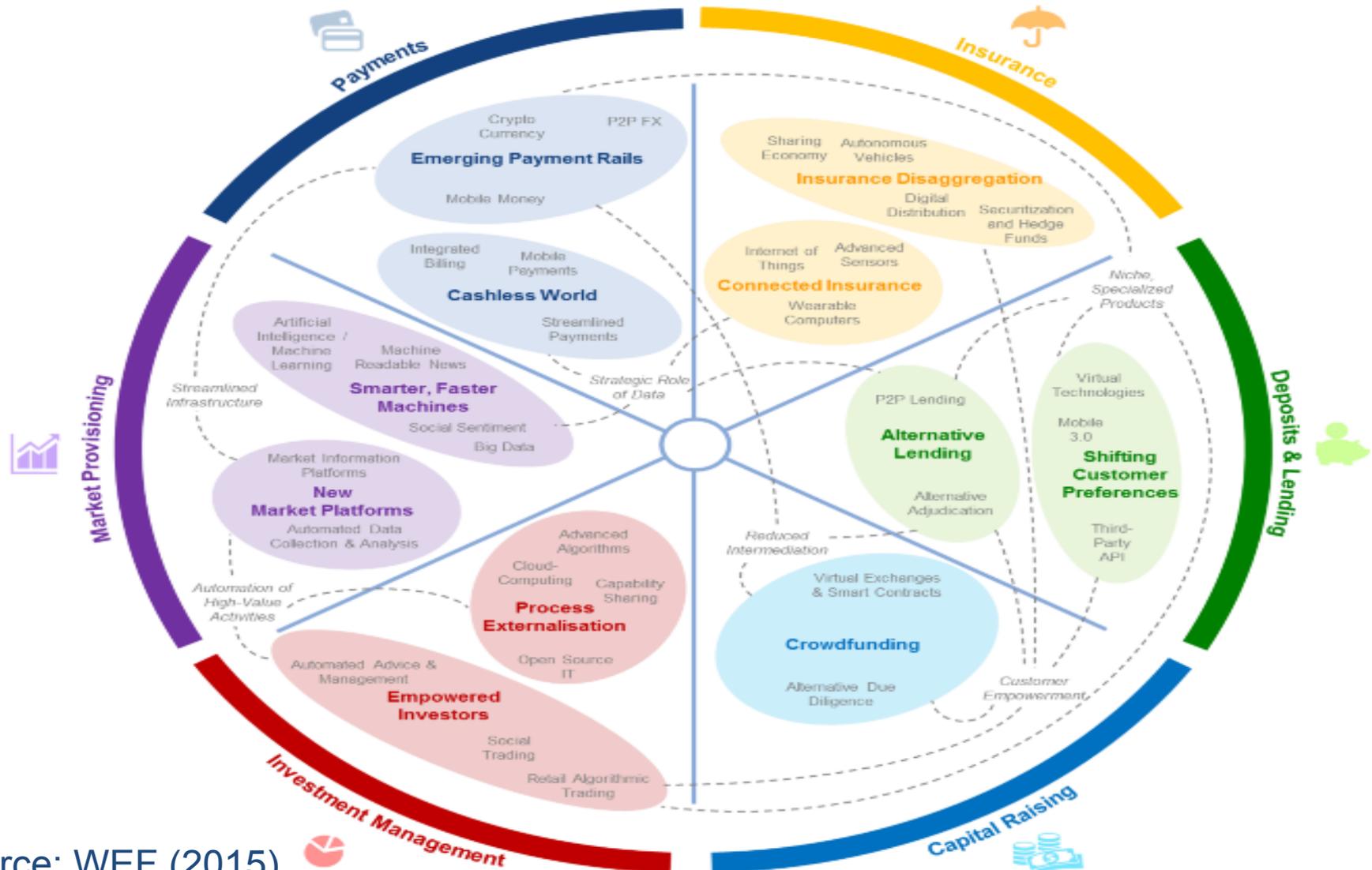
## Public/Institutional

- Government
- Parliament
- Laws/regulations
- Codes/Standards
- IFIs (BIS, IMF, WB, FATF)
- Financial Sector
- Markets:
  - Domestic
  - International

## Reputational Agents

- Self Regulating bodies
- Civic society
- Financial media
- Credit rating
- Accountants
- Lawyers
- Research

# Disruption in Financial Services will redefine monetary & financial policy & regulation



Source: WEF (2015)

# Some Implications for CB Boards

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- GFC, disruption in financial services and growing complexity of banking & finance require reform of structure of CB Governing Bodies
- Wider mandate of financial stability requires greater inter-authority cooperation and set-up of supervisory boards
- CB boards need to increasingly focus on External Governance & Reputational Risks
- CB Boards need to become more diverse, with a clear separation between executive and non-exec roles & responsibilities
- There is no 'one size fits all' in designing a consistent governance structure

# CB Independence components

## Personnel independence

- ✓ Term of office of CEO
- ✓ Who appoints the CEO
- ✓ Provisions for dismissal of CEO
- ✓ CEO allowed to hold another gov't office

## Policy formulation

- ✓ Who formulates monetary policy?
- ✓ Gov't directives & resolution of conflicts

## Financial Independence

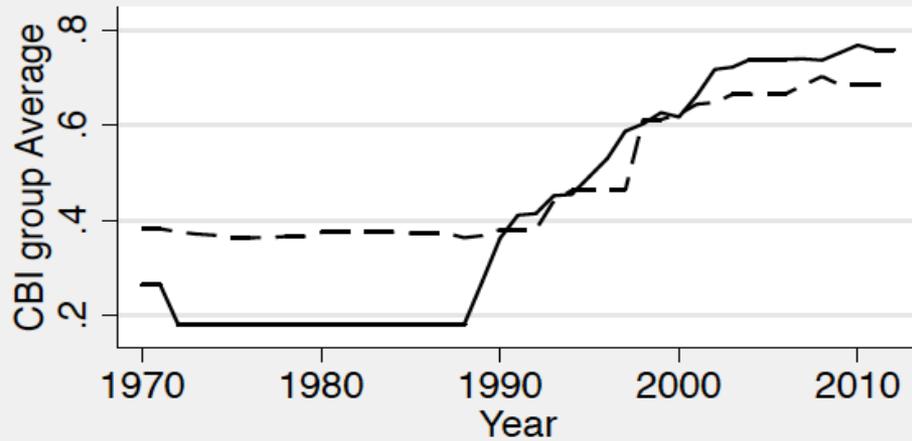
- ✓ CB given active role in formulation of government budget?
- ✓ Limitations on advances, securitized lending
- ✓ Who decides control of terms of lending to government?
- ✓ Beneficiaries of CB lending, types of limits, maturity of loans, restrictions on interest rates
- ✓ Prohibitions on CB lending in primary market to government

## Central Bank objectives

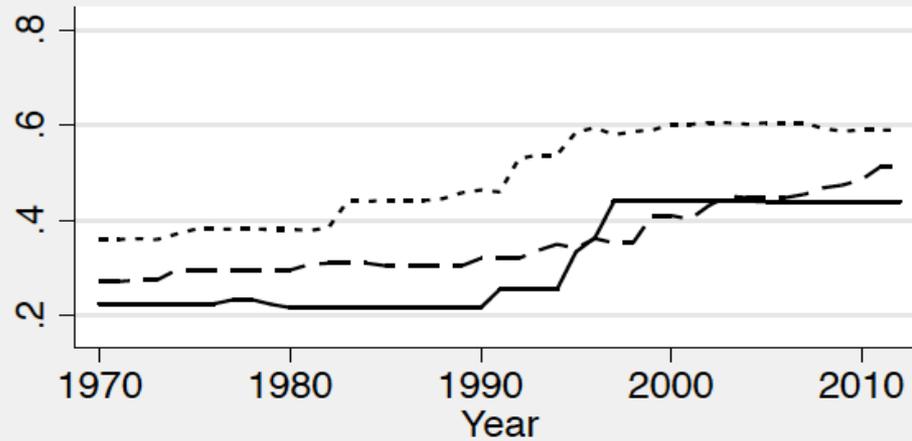
- ✓ Price stability is the only or major goal, and in case of conflict with government, CB has final authority
- ✓ Price stability is the only goal
- ✓ Price stability along with other objectives that do not seem to conflict with the former - Price stability along with other objectives of potentially conflicting goals (e.g., full employment)
- ✓ Central Bank charter does not contain any objective
- ✓ Some goals appear in the charter but price stability is not one of them

Source: Ana Garriga (2016) *Central Bank Independence in the World*

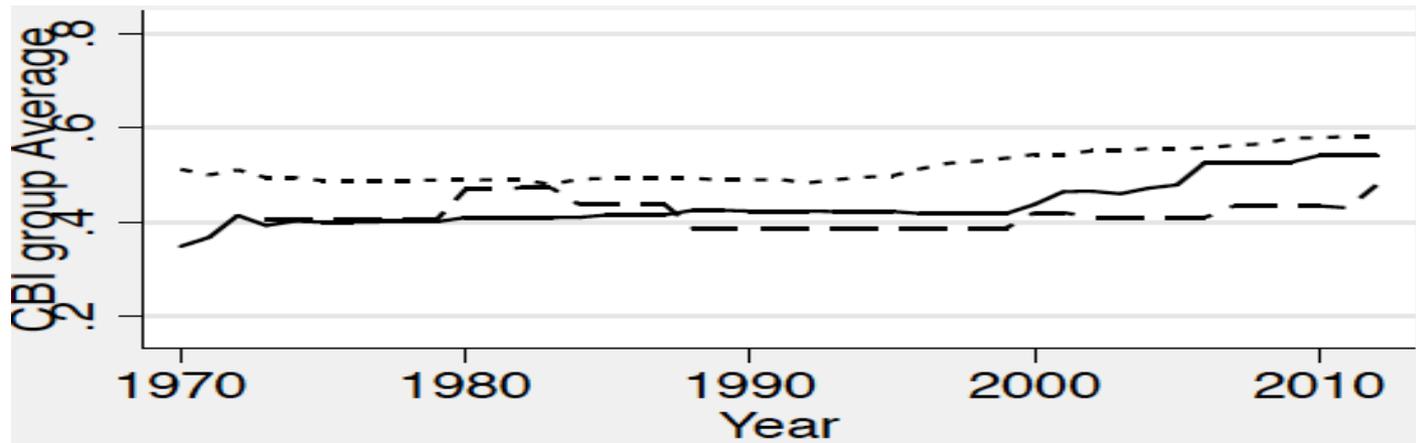
# MENA CBI low vs. rest of the world



— E. Europe and post Soviet  
 - - - W. Europe and N. America

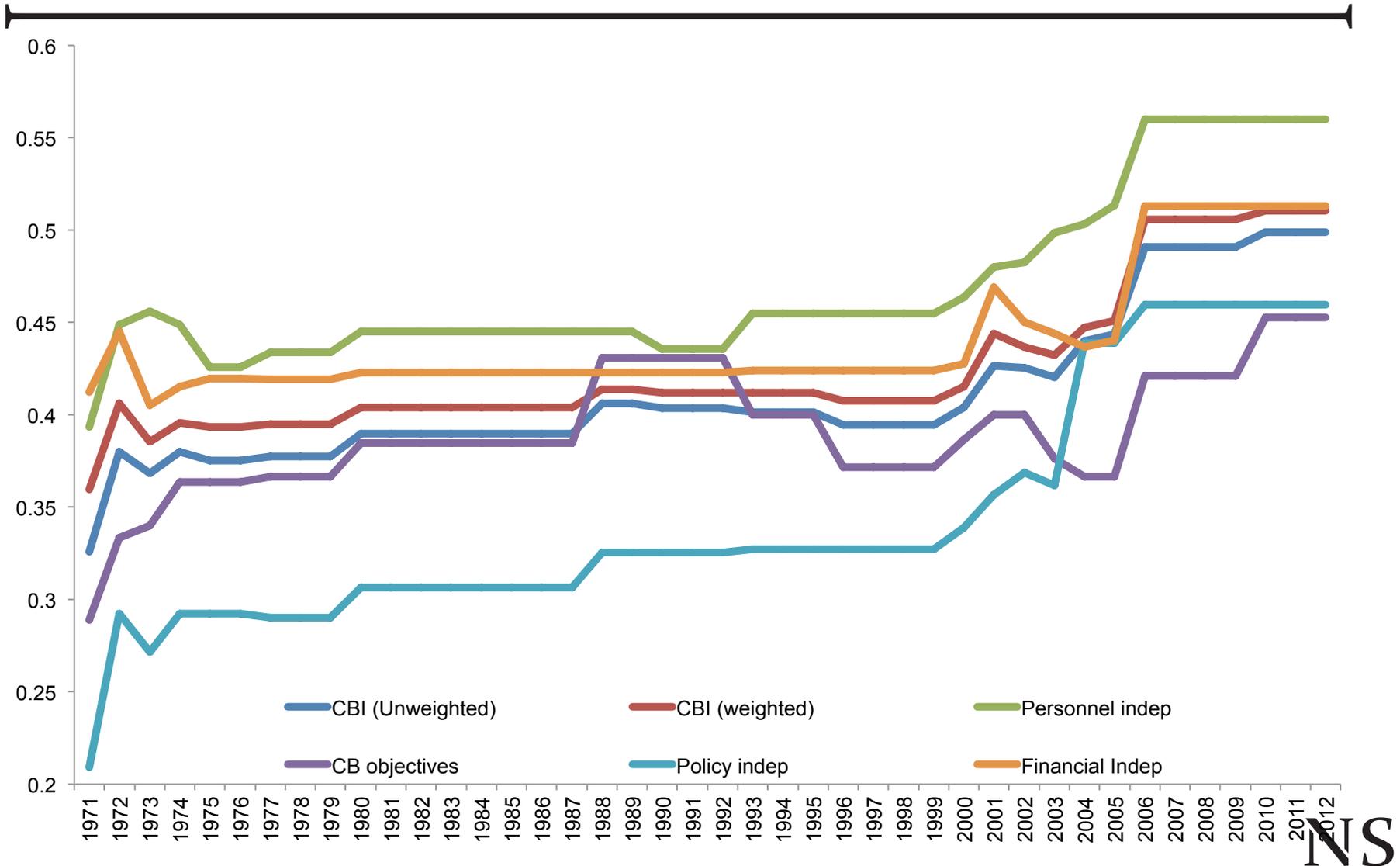


— East Asia  
 - - - S&SE. Asia  
 ..... Latin Am. & Caribbean



— N. Africa & Middle East  
 - - - The Pacific  
 ..... Sub-Saharan Africa

# CBI & its components: MENA average



Source: NS&A calculations based on Garriga (2016): Central Bank Independence in the World

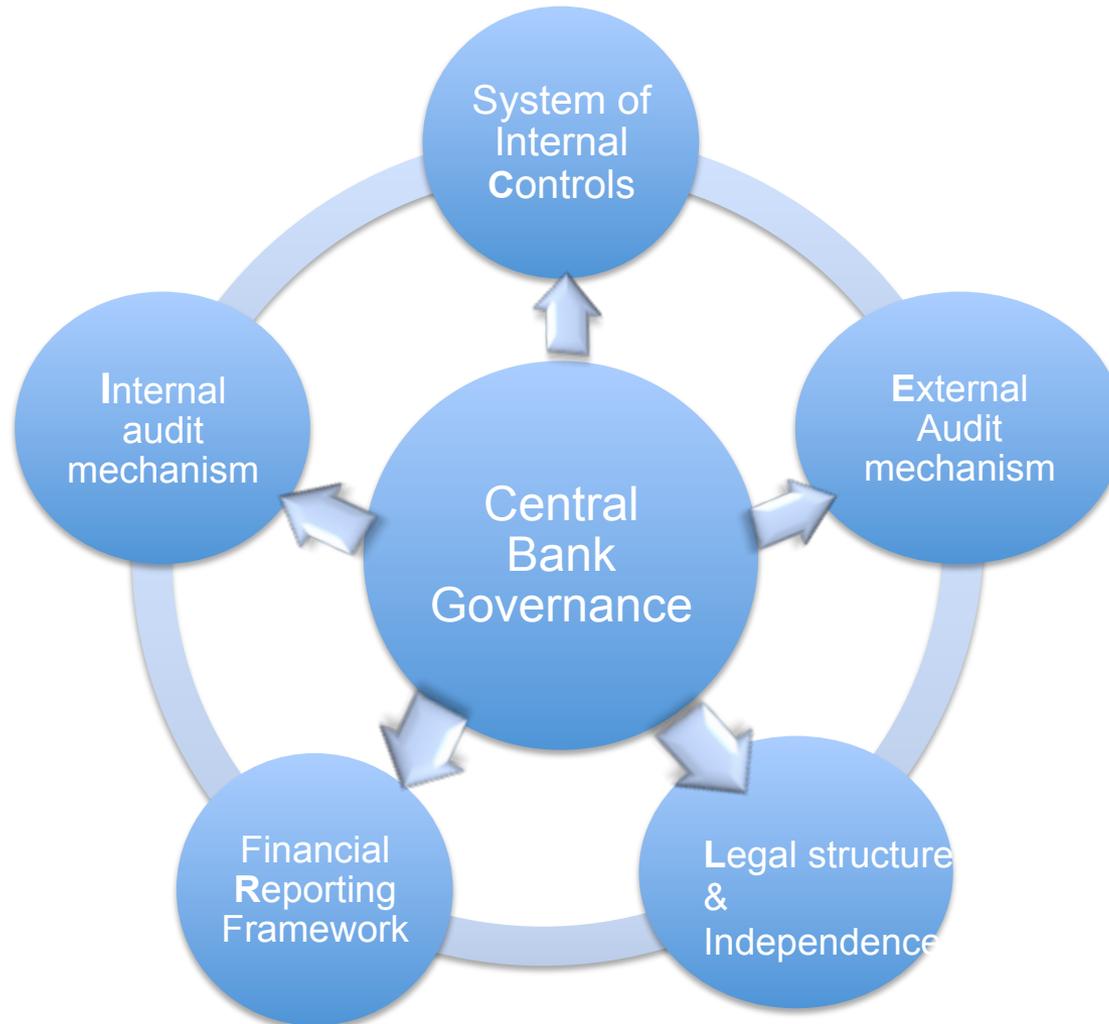
# Central bank accountability & transparency arrangements for select MENA countries

Statements	Time period	By whom	To whom	Published
<b>SAUDI ARABIA</b>				
Statements	Half-monthly and annual	Central Bank	Government	Official Gazette
Statement of its affairs, showing the quantity of issued notes & coins	Every fortnight	Central Bank		Official Gazette
General statement with annual report	End of the year	Central Bank		Official Gazette
<b>UAE</b>				
Reports covering the monetary and banking situation	Quarterly	Central Bank	Minister	
Statement of the Bank's assets and liabilities	Monthly	Central Bank	Minister	Official Gazette
Copy of the final accounts	End of the year	Central Bank	President of the State, Minister	Official Gazette
Report on the Bank's activities and summary of monetary, banking, financial and economic developments	End of the year	Central Bank	President of the State, Minister	
<b>EGYPT</b>				
Statement on financial position	End of the week	Central Bank	Board of Directors	Egyptian Journal

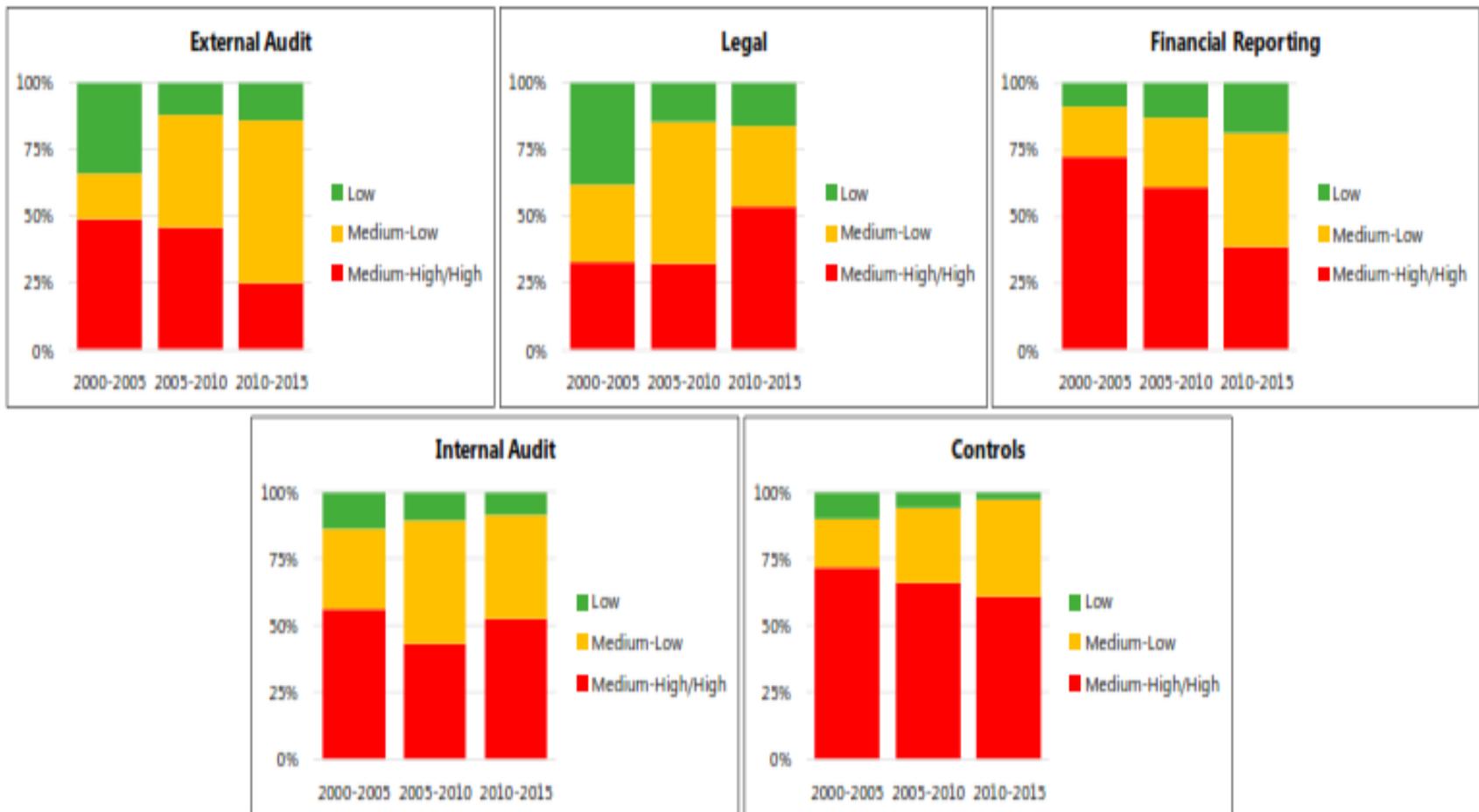
Statements	Time period	By whom	To whom	Published
<b>EGYPT</b>				
Financial statements	End of the year	Governor	President of the Republic, Prime Minister, and Speakers of the People's Assembly and the Shura Council	
Report on the Bank's financial position and outcome of its activities	End of the year	Central Bank	President of the Republic, Prime Minister, and Speakers of the People's Assembly and the Shura Council	
Report with analysis of monetary, credit and banking developments, and external debt balances	Every 3 months	Governor	President of the Republic	
Procedures applied in implementing monetary policy & its decisions related to organizational regulatory procedures		Central Bank		Egyptian Journal
<b>TURKEY</b>				
Report on operations and monetary policy	Every April and October	Governor	Council of Ministers	
Information regarding operations	Twice a year	Central Bank	Planning and Budget Commission of the Grand National Assembly	
Balance sheet and income statement with annual report.	End of the year	Central Bank	Prime Ministry	Official Gazette
Monetary policy decisions		Monetary Policy Committee		Official Gazette
Reports concerning monetary policy targets and implementations	Periods, scope & disclosure to be determined by the Bank.	Central Bank	Public	
Bulletin with brief statement of accounts	Weekly	Central Bank		Official Gazette & forwarded to foreign central banks and the institutions which are deemed appropriate

# IMF ELRIC Framework

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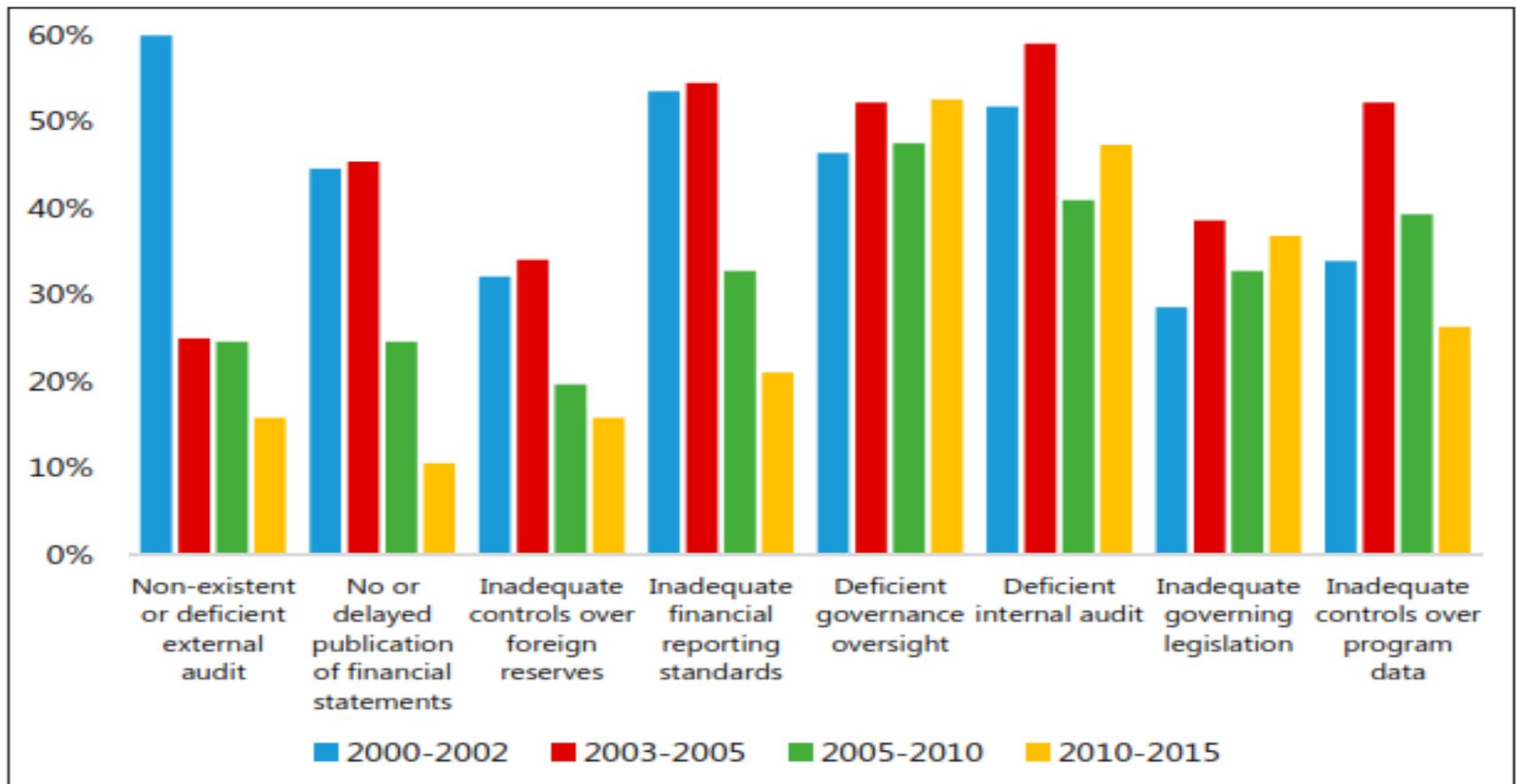


# Safeguards Findings & Risk Ratings across ELRIC framework, 2000-2015



Source: FINSA database.

# Key Vulnerabilities Identified at CBs, ELRIC framework 2000-2015



Source: FINSA database.

# Central Bank Governance: some takeaways

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- GFC & GR have resulted in CBs becoming the 4<sup>th</sup> Estate: must strengthen governance, transparency & accountability
- Financial services disruptions will require new models for monetary & financial policy and regulation to deal with innovation: e.g. digital currencies
- Develop & Adopt a CB Governance Code (BIS, IMF, OECD)
- Adopt IMF's ELCIR framework & reporting as part of regular monitoring: Article IV, FSAPs
- Wider CB mandate including financial stability requires inter-agency councils and well-defined mandates

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# Thank you

Dr. Nasser Saidi  
nsaidi@nassersaidi.com

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