Financial Stability Institute | BIS

FSI Briefs

No 14

The accountability regime of banking supervisors: with great power comes great responsibility

Sasin Kirakul, Jeffery Yong and Raihan Zamil

June 2021

FSI Briefs are written by staff members of the Financial Stability Institute (FSI) of the Bank for International Settlements (BIS), sometimes in cooperation with other experts. They are short notes on regulatory and supervisory subjects of topical interest and are technical in character. The views expressed in them are those of their authors and not necessarily the views of the BIS or the Basel-based standard setting bodies.

Authorised by the Chair of the FSI, Fernando Restoy.

This publication is available on the BIS website (www.bis.org). To contact the BIS Media and Public Relations team, please email press@bis.org. You can sign up for email alerts at www.bis.org/emailalerts.htm.

© *Bank for International Settlements 2021. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

ISSN 2708-1117 (online)
ISBN 978-92-9259-479-4 (online)

The accountability regime of banking supervisors: with great power comes great responsibility[1]

Highlights

- *Following the Great Financial Crisis, many supervisors have been tasked with a multitude of new objectives layered atop the core safety and soundness (S&S) mandate, which is difficult to define. Some of these new remits are broad and driven by governmental priorities, clouding the demarcation between prudential and political spheres.*
- *As supervisory remits multiply and converge with political interests, the potential for conflicts between S&S and other mandates grow. Actions taken by supervisors to fulfil their expanded role affect broader segments of society. This calls for a robust accountability regime to assess supervisors' performance. In practice, such mechanisms are difficult to implement due to challenges in prioritising, defining, measuring, and overseeing multiple supervisory mandates.*
- *Legislative bodies can strengthen the accountability of supervisors by prioritising the S&S mandate and setting clear objectives that supervisors can report on. The establishment of independent oversight bodies to assess supervisors' performance can further enhance accountability.*
- *Banking authorities can also foster accountability by publishing statements on their interpretation of S&S and other remits and how they plan to fulfil them. Self-assessments – backed by a range of well designed metrics that consider outcomes – can help stakeholders better evaluate how they deliver the S&S and other remits.*
- *Robust accountability regimes need to be balanced with mechanisms to shield supervisors' from undue political or industry interference and to preserve their operational independence.*

1. Introduction

A core mandate of all banking authorities is to foster the safety and soundness (S&S) of banks and banking systems. Delivering on this mandate is difficult, as prudential risks and considerations that may affect a firm's S&S continue to evolve and expand. This is due to many factors, including lessons from the 2007-09 Great Financial Crisis (GFC); banking scandals that called into question a firm's culture and behaviour; technological innovations; and societal demands to focus on climate risks in the provision of financial services.

Despite these challenges, the mandates of many banking authorities have multiplied far beyond their core S&S remit. In a recent publication (Kirakul et al (2021)), we find that banking authorities in 27 surveyed jurisdictions report up to 13 additional objectives beyond S&S. Some of these additional objectives are key priority areas of national governments, clouding the demarcation between prudential and political spheres.

The increased complexity in delivering the S&S mandate together with expanded objectives of banking authorities underscore the critical role that supervisors – who are unelected officials – play in

[1] Jeffery Yong (Jeffery.Yong@bis.org) and Raihan Zamil (Raihan.Zamil@bis.org), Bank for International Settlements and Sasin Kirakul, Bank of Thailand (sasink@bot.or.th). We are grateful to Rodrigo Coelho and Glenn Tasky for helpful comments and Dung Tran for administrative support.

shaping the contours of the financial system, with profound implications for banks, consumers and businesses. In order to discharge their core mandates effectively, supervisors need to be free from undue political influence. To preserve their independence and to reinforce public support, authorities need to be held accountable for their actions (Tucker (2018)). For this reason, the *Core Principles for Effective Banking Supervision* (BCPs) require banking supervisors to publish their objectives and to be held accountable through a transparent process in relation to those objectives.[2]

This is easier said than done. A strong accountability framework requires clearly defined objectives that are measurable. The S&S remit is hard to define and does not lend itself to a standard means of assessment. The challenges may be even greater for other supervisory objectives, some of which are "promotional" and "developmental" (P&D) in nature,[3] and may, at times, conflict with the S&S mandate. In this context, some P&D objectives are championed by governments, placing pressure on supervisors to deliver on mandates that may create tensions with the S&S remit. This, in turn, accentuates the importance of developing accountability mechanisms that respect the sanctity of supervisors' operational independence, while still holding them responsible for fulfilling their mandates.

This brief examines the accountability regimes of banking supervisors, focusing on how selected jurisdictions assess whether banking authorities fulfil their core S&S remit among other objectives. Section 2 takes stock of the types of stakeholders to which a supervisory authority is accountable and outlines the accompanying accountability channels. Section 3 summarises the performance reporting mechanisms of selected banking authorities, while Section 4 discusses the indicators used to determine "success" in delivering the S&S and other supervisory mandates. Section 5 concludes.

2. Accountability mechanisms

Effective accountability mechanisms rely on having clear mandates as vague or implicit objectives are hard to measure and execute. Kirakul et al (2021) described how the lack of clarity on what safety and soundness means has led to different interpretations in domestic legislation across surveyed jurisdictions, for example "protection of depositor interests", "maintaining banking system stability" and "strengthen the banking system". While several banking authorities have attempted to expand their definition of "safety and soundness" going beyond what is specified in applicable legislation,[4] these explanatory elements remain broad and qualitative. This highlights the inherent difficulties in specifying measurable objectives that are needed to support robust accountability frameworks for the S&S and other supervisory mandates.

The surveyed banking authorities are typically accountable to the executive and legislative branches of the government, the judiciary, supervised firms and, ultimately, to the general public. Table 1 below shows examples of accountability mechanisms targeted at each stakeholder.

[2] See BCBS (2012), core principle 2 for further information.

[3] Some P&D objectives include, but are not limited to the following: fostering fintech and innovation; developing the banking sector; and promoting competition, financial inclusion and the local jurisdiction as an international financial centre.

[4] See Kirakul et al (2021), table 2.

Examples of accountability mechanisms towards different stakeholders — Table 1

Stakeholders	Example of accountability mechanisms
Executive branch	Regular updates to relevant ministers or cross-agency committees
Legislative body	National audit frameworks that assess financial integrity and compliance with legislation, annual/regular reports, regular and ad-hoc hearings with relevant committees, response to questions from elected officials, in-depth investigations based on public inquiries
Judicial	Transparent redress procedures to challenge decisions by banking authority
Supervised entities	Transparent public consultation process before finalisation of any new regulatory/supervisory rules or guidance
Public	Annual/regular reports, freedom to request non-confidential information

Source: FSI survey.

Among the various stakeholders, the most important accountability arrangements are towards the legislative body and general public. In representative democracies, the legislature is usually the body with the widest range of tools to oversee the work of banking authorities. As for society at large, they need to understand and provide buy-in for actions taken by banking authorities that may affect their lives and livelihoods, which provides legitimacy to supervisory decisions.

In addition to examples of accountability mechanisms in Table 1, a trend is emerging among banking authorities to undertake cost benefit analyses (and sometimes even broader impact assessments) of their regulatory requirements, before and after implementation. This can also facilitate accountability by ascertaining the extent to which regulatory requirements are achieving the intended objectives.

Consultation of annual budgets with key stakeholders could also support accountability, provided there are no conflicts of interest. Some of the surveyed authorities have to seek approval from either the executive and/or legislative branch of government and, less, commonly, consult supervised institutions on their budget. While such budgetary discipline can improve accountability, care should be taken to avoid undue government or industry interference in the affairs of the supervisor. Consulting the industry, in particular, can expose supervisors to operational interference and conflicts of interest, which could undermine their autonomy and credibility.[5]

While it is important for supervisors to have a range of accountability mechanisms to ascertain that they are discharging their responsibilities appropriately, the effectiveness of accountability frameworks may ultimately hinge on the legislature's ability to perform its oversight function. In this context, some legislative bodies may not necessarily have sufficient bandwidth to scrutinise the affairs of banking supervisors, given their broader responsibilities and the technical know-how required to assess supervisors' complex and expanding mandates. For this reason, some jurisdictions have or are in the process of establishing independent oversight bodies to oversee banking authorities (Box 1).

[5] BCP 2 contains a number of essential criteria to promote independence, including funding structures of banking supervisors that do not undermine their autonomy. Other safeguards that promote independence include minimum term limits for the heads of a supervisory authority and the conditions under which they can be removed from office. See BCBS (2012) for details.

Box 1

Banking supervisory oversight bodies in the United States and Australia

To supplement governance structures of banking authorities, certain jurisdictions have established independent oversight bodies to oversee the effectiveness of banking supervisors in discharging their functions and/or in fulfilling their mandates as specified in their legislation. Such bodies can provide additional reassurance that banking authorities are fulfilling their mandates as intended.

In the United States, an Inspector General is a public official responsible for conducting independent oversight of a federal agency. Each of the three federal banking authorities – the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (the Board) and the Office of the Comptroller of the Currency (OCC)① – has an independent Office of Inspector General (OIG)② that conducts audits, evaluations, investigations and other reviews of their programmes and operations. Reports published by the OIGs, for example on crisis preparedness of the FDIC, cybersecurity supervision of large financial institutions by the Board and the oversight of incentive-based compensation structures at Wells Fargo by the OCC can bolster accountability and enhance the quality of supervision. In addition, the OIG is required by legislation to conduct and publish reviews of all bank failures that result in a material loss to the deposit insurance fund (defined as losses in excess of US$ 50 million)③. Such reviews aim to identify the cause of and the role supervision played in the failure and lessons learnt. Moreover, the US Government Accountability Office that reports to US Congress provides an additional layer of accountability oversight. For example, it published④ recommendations for the FDIC to reduce regulatory capture risks by reviewing the agency's policies that support transparency and accountability in bank examination processes.

In Australia, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has recommended the establishment of a new authority (the Financial Regulator Assessment Authority) to assess the effectiveness of the prudential and conduct regulators in discharging their functions and meeting their statutory objectives. In the legislation,⑤ the function of the new authority includes assessing the effectiveness of accountability frameworks governing the banking authority.

① The OCC is an independent bureau within the US Treasury Department. There is a dedicated OIG for all Treasury departments and bureaus, including the OCC. ② See OIG: FAQs (federalreserve.gov). ③ To access material loss review reports of the FDIC, see: OIG Reports of Bank Failures | Federal Deposit Insurance Corporation Office of Inspector General (fdicoig.gov). ④ See United States Government Accountability Office (2020). ⑤ See Australian Government (2021).

3. Performance reporting

Performance reporting that describes the extent to which supervisory authorities deliver on their objectives can enhance transparency and promote accountability. Better understanding of supervisors' fulfilment of their assigned objectives allows stakeholders to play a greater role in holding the authorities to account.

Meaningful performance evaluation and reporting relies on clear objectives[6] and effective translation of high-level mandates into an implementable and trackable plan. To provide more clarity, some supervisors issue public statements[7] elaborating on their interpretation of the assigned objectives. Drawing from the objectives, supervisors develop strategic goals and plans with concrete milestones. Among practices observed, some identify performance metrics and set targets against which supervisory efforts can be measured.

[6] As required in BCP 1, supervisory mandates should be set out in legislation and publicly disclosed. See BCBS (2012) for details.

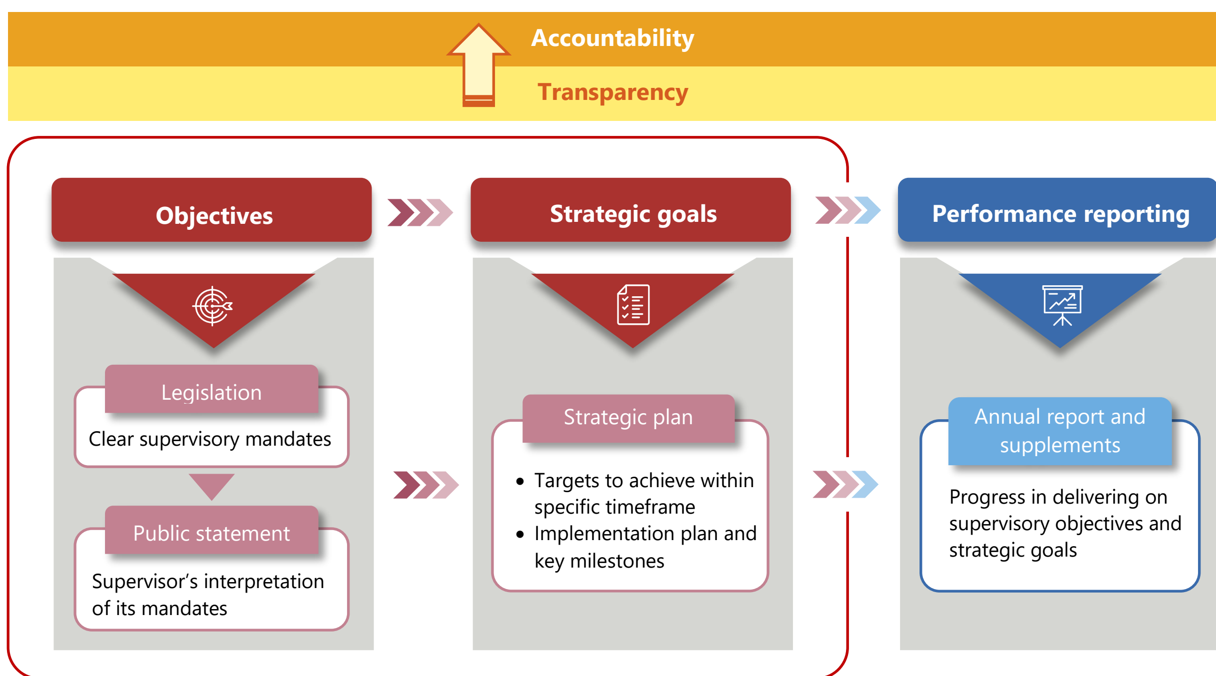
[7] See Australian Prudential Regulation Authority (2019) and French Prudential Supervision and Resolution Authority (2017).

Supervisors' performance in delivering on their core S&S and other objectives and strategic goals are usually reported to the public as part of their annual reports, a key channel of accountability. Examples of typical information disclosed in annual reports that demonstrate accountability of supervisors include:

- reporting of the past year's progress in achieving stated objectives and supervisory activities conducted that contributed to strategic goals;
- the overall state of the banking system during the period, accompanied by key figures such as performance ratios of the banking sector;
- the use of financial and human resources; and
- a forward-looking annual work plan.

Notwithstanding the common elements included in annual reports, the granularity of performance results presented differs between authorities. Some authorities report more detailed measurement metrics (mainly related to S&S) and compare actual outcomes against quantifiable targets. These more in-depth assessments are sometimes included in a separate document, as a supplement to annual reports.[8] Figure 1 illustrates the interactions among objectives, strategic goals and performance reporting, that collectively may help enhance transparency and accountability.

Illustration of an accountability framework | Figure 1



Source: FSI.

In some cases, the government provides guidance by setting out expectations on how supervisors should carry out their responsibilities.[9] This helps align supervisory objectives with the government's policy priorities and guides supervisors in forming strategic goals. There are also instances where the government requires supervisors to produce an additional performance report on a specific non-S&S objective.[10] This

[8] See eg APRA (2021) and Office of the Superintendent of Financial Institutions (OSFI) (2020).

[9] See eg Australian Treasury (2018).

[10] See eg Bank of England (2020).

may be done to hold supervisors to account for broader policy objectives that are perceived to support growth of the financial system and the economy.

4. Performance measurement

Unlike the main price stability objective of monetary policy, which is relatively easy to quantify and compare against a central bank's stated objectives, the core S&S mandate of banking authorities is vague. There is no international consensus on what constitutes "safe and sound", making it difficult to measure supervisory effectiveness in fulfilling this mandate. These challenges are reflected in a Basel Committee on Banking Supervision (BCBS) "Report on the impact and accountability of banking supervision" (BCBS (2015)).

The BCBS report specifies that supervisors use various quantitative and qualitative indicators rather than a single benchmark to assess supervisory effectiveness. It also provides an overview of indicators used in different jurisdictions – including their pros and cons – which may be based on supervisory resources (input), supervisory activities (throughput), output from supervisory activities and outcomes based on ultimate objectives. Above all, the report illustrates the obstacles involved in, and the need to take a holistic approach to, constructing relevant metrics for assessing supervisors' performance.

This section explores indicators that are disclosed in selected supervisors' published reports in relation to S&S and other objectives. It is possible that a wider range of metrics is used for internal monitoring and reporting purposes, but may not be reported publicly due to confidentiality reasons.

Safety and soundness

To demonstrate how supervisory actions contribute to the S&S objective, supervisors generally report their supervisory activities such as examinations and number and type of enforcement actions undertaken over a specified period. Although far less common, some authorities also disclose and report enforcement actions taken against individual banks,[11] which may be helpful in fostering public confidence in the ability and will of banking authorities to fulfil their S&S mandate. While activities-based indicators may demonstrate actions that contribute to an objective, they do not measure the quality of the activities performed nor the progress made towards achieving an ultimate objective.

Some authorities also publish more outcomes oriented indicators, such as those related to the soundness of banks. Although outcomes-based indicators are more relevant in assessing supervisory effectiveness in fulfilling an objective, proving causality remains a challenge as the outcomes measured may be affected by various factors and not necessarily a result of supervisory actions. Table 2 shows examples of quantitative indicators used in performance reporting by some authorities. Various mixes of indicators used by different authorities illustrate the difficulties in choosing appropriate metrics that serve as reliable proxies for assessing supervisors' effectiveness in fulfilling the S&S mandate.

[11] See eg OCC (2021).

Examples of reported performance indicators	Table 2
Activities-based indicators	Output/outcomes-based indicators
Supervisory activities • Number of examinations conducted or completion rate of prudential inspections • Number of supervisory engagements and interventions (eg number of meetings, consultations, intervention letters and measures or enforcement actions taken) • Specific enforcement actions taken against individual banks	Soundness of banks and the banking system • Percentage of banks that meet or exceed minimum quantitative prudential standards (eg capital ratios) • Percentage of banks with specified risk-rating (eg low or moderate risk-rating) • Number of banks for which the supervisory rating (risk-level) has increased by specified levels within an indicated timeframe • Rehabilitated problem banks as a percentage of problem banks from one year ago • Percentage of banks' compliance with sound governance and risk management practices requirements • Incidence of failure and loss*

*For example, APRA uses a performing entity ratio (percentage of institutions that meet their commitments in a given year – the higher the percentage, the lower the incidence of failure) and money protection ratio (value of liabilities to beneficiaries in institutions less any prudential losses to beneficiaries in a given year, divided by the total value of liabilities to beneficiaries – the higher the percentage, the lower the incidence of loss). For more information, see APRA (2020).

Sources: various public documents.

In addition to activities and outcomes-based indicators, several banking authorities report their level of compliance with relevant international standards, such as external assessments of the Basel core principles; the BCBS' regulatory consistency assessment programme; and thematic peer reviews of the Financial Stability Board. Some also report progress made in addressing recommendations from such assessments. This allows oversight bodies and the public to benchmark regulatory and supervisory frameworks against internationally accepted standards and make comparisons across jurisdictions.

Lastly, some authorities also assess supervisors' engagement with regulated firms to ensure that they do not place excessive regulatory burden on entities in pursuing their S&S objective. For example, APRA assesses itself against the Regulator Performance Framework, which includes evaluating whether it unnecessarily impedes the efficient operation of regulated entities and whether its actions are proportionate to the risk being managed.[12] Industry surveys may also be used to gauge supervisors' capability in regards to transparency and timeliness of decisions and communications with the industry on regulations and guidance.[13] When industry feedback is considered in evaluating aspects of supervisors' performance, it is crucial to ensure that supervisory efforts in delivering their S&S remit are not deterred.

Additional objectives

As difficult as it may be to measure supervisors' performance in delivering the S&S objective, it is far more challenging to credibly measure their performance against each additional objective. An added complexity is that some of these other objectives may conflict with or detract resources from the core S&S objective;

[12] The Regulator Performance Framework, comprising six key performance indicators (KPIs), is designed to assess the regulator's performance when interacting with business, the community and individuals while carrying out its functions. One of the KPIs is that regulators do not unnecessarily impede the efficient operation of regulated entities. To deliver on this KPI, regulators need to demonstrate understanding of the operating environment of the industry, take actions to minimise the potential for unintended negative impacts of regulatory activities and implement improvement strategies to reduce the costs of compliance. For more information, see Australian Government (2014).

[13] In Canada, the Office of the Superintendent of Financial Institutions (OSFI) uses a financial institution's survey to determine whether decisions on regulatory approvals are transparent and timely, and whether OSFI's expectations are communicated effectively in guidance to stakeholders. For details, see OSFI (2020).

therefore, performance indicators for other objectives need to be well conceived, such that they facilitate optimal implementation without undermining the S&S remit.

Reporting of how supervisors meet additional mandates is usually descriptive and mainly activities-based. Table 3 shows what some supervisors report with regards to certain additional objectives.

Examples of reporting on selected additional objectives — Table 3

Objective	Reporting
Crisis management and resolution	• Efforts in enhancing crisis preparedness and building resolution capability (eg new standards on resolution, designing and improving resolution strategies, number of resolution plans developed and strengthening recovery planning) • Number of administrative liquidation procedures managed
AML/CFT	• Number of related supervisory guidance and guidelines published • Completion rate of AML/CFT inspection • Enforcement actions taken or orders issued against institutions to remedy deficiencies in ML/FT prevention
Consumer protection	• Number of consumer complaints and product interventions (eg restrict distribution) • Completion rate of examination in areas of market conduct and business practices
Financial sector development	• Initiatives to foster financial sector growth, eg measures to support different business areas (typically fintech and innovation) and skills development programme for professionals in the industry
Competition	• Statistics on new authorisations • Percentage of licensing applications completed within established timeframes • Assessing implications of policies on competition, eg barriers to entry and expansion and barriers to exit
Climate change	• Measures to promote understanding and encourage the management of climate and environmental risks in the banking sector • Measures to promote sustainable banking and green finance
Promoting jurisdiction as a financial centre	• Key progress in strengthening the jurisdiction's status as a hub for various financial services and centre for new developments • Role in regional and international committees

Sources: various public documents.

5. Concluding remarks

Legislative bodies have delegated broad powers to banking authorities to deliver the S&S remit. This mandate is difficult to define and has expanded, as prudential risks evolve and multiply. Following the GFC, some banking authorities have been given other objectives beyond S&S, some of which are driven by governmental priorities that may conflict with prudential objectives. Assigning too many broad – and conflicting – objectives to a banking authority risks diluting its legitimacy, as the actions taken to fulfil those objectives are "behind the scenes" but can nevertheless profoundly impact society. As supervisory responsibilities expand, there is a greater need for more accountability. However, developing a robust accountability regime for multiple supervisory mandates that are difficult to define and hard to measure – while respecting supervisors' operational independence – is complex. In this context, one may consider the proverb in the Spiderman comic book series: "With great power comes great responsibility".

For the legislatures that bestow such powers, it means prioritising the S&S mandate in relation to other supervisory objectives and developing clear(er) objectives for all supervisory mandates. This, in turn, sets the context for assessing supervisors' performance. Well defined objectives should be supported by institutional structures that facilitate effective oversight. While institutional arrangements vary across countries, two mechanisms that merit consideration include: (i) the establishment of a dedicated, independent oversight body, with sufficient expertise to evaluate how well supervisors fulfil their mandates; and (ii) the use of regular, independent assessments on the quality of key supervisory functions that help deliver the S&S mandate. Such mechanisms can complement and provide context to other inputs used to assess supervisors' performance – such as annual reports – particularly given that their performance metrics cannot be simplified into a single, measurable variable.

As the recipients of state power, banking authorities are accountable to various stakeholders, most notably legislative bodies and the general public. To facilitate this process, it may be helpful for authorities to publish their interpretation of S&S and other mandates and how they plan to fulfil them. Annual self-assessments – informed by a range of quantitative and qualitative metrics that incorporate outcomes – can assist oversight bodies and the public to evaluate how supervisors meet their S&S remit. Performance measurements of other supervisory objectives are still evolving. Nevertheless, considerable thought is needed to construct useful indicators that may represent how supervisors meet other objectives in a manner that does not jeopardise their ability to fulfil the core S&S function.

Lastly, accountability regimes should not be overly intrusive. A robust regime that provides for a broad range of accountability channels anchors banking authorities' legitimacy and independence. At the same time, excessive accountability to branches of government and regulated entities can undermine supervisors' independence and may diminish their ability to call the plays as they see them regardless of the players – or politics – involved.

References

Australian Government (2014): *Regulator performance framework*, October.

——— (2021): *Financial Regulator Assessment Authority Bill 2021*, May.

Australian Prudential Regulation Authority (2019): *Information Paper – APRA's objectives*, November.

——— (2020): *Annual Report 19/20*, September.

——— (2021): *APRA 2020 Year in Review*, February.

Australian Treasury (2018): *Statement of expectations – Australian Prudential Regulation Authority.*

Bank of England (2020): *Annual Competition Report 2020*, pp 47–57, June.

Basel Committee on Banking Supervision (2012): *Core principles for effective banking supervision*, September.

——— (2015): *Report on the impact and accountability of banking supervision*, July.

French Prudential Supervision and Resolution Authority (2017): *The ACPR's domestic and European responsibilities*, November.

Kirakul, S, J Yong and R Zamil (2021): "The universe of supervisory mandates – total eclipse of the core?", *FSI Insights on policy implementation*, no 30, March.

Office of Inspector General: *Reports of Bank Failures*.

Office of the Comptroller of the Currency (2021): *OCC enforcement actions and terminations*, news release, May.

Office of the Superintendent of Financial Institutions (2020): *2019–20 Departmental Results Report*, December.

Tucker, P (2019): *Unelected power: the quest for legitimacy in central banking and the regulatory state,* Princeton University Press.

United States Government Accountability Office (2020): *Bank supervision: FDIC could better address regulatory capture risks*, September.