Basel Committee
on Banking Supervision

Report on the impact and accountability of banking supervision

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1. Introduction and summary

In response to the global financial crisis, standard-setting bodies and national authorities have initiated a broad overhaul of the regulatory framework. The implementation of Basel III makes a necessary and important contribution to strengthening regulation and increasing the resilience of banks. However, regulatory reforms alone cannot assure the soundness and stability of financial institutions; they must be supported by effective supervision.

In recent years, supervisors have revised and strengthened their strategy and practice. Supervision has become more comprehensive and intrusive, taking additional dimensions of a bank's business into account. Supervisors have also taken steps to gain more insight into the impact of their activities.

Measuring the impact of supervision is a relatively new area. Jurisdictions have developed various practices to show how their activities contribute to the objective of sound and stable financial institutions and of the financial system. That said, no analysis is straightforward, because supervisors have to deal with methodological challenges and because there is no unique method or indicator that can be singled out in response to these challenges. Thus, current experience must be discussed while practices are still evolving.

Against this background, the Basel Committee on Banking Supervision (BCBS) set up a Task Force on Impact and Accountability (TFIA) in January 2014 to develop a range-of-practice study on how supervisors around the world define and evaluate the impact of their policies and actions, manage against that impact and then account for this impact to their external stakeholders.

The aim of this report is to share international experience with regard to the impact and accountability of banking supervision. This report identifies a wide variety of objectives, performance indicators and practices with respect to accountability among jurisdictions participating in the study. This review provides an opportunity to deepen our understanding of different supervisory practices, to learn from one another and to identify emerging trends or best practices on an international level with a view to further strengthening supervisory processes.

Responses to a survey developed by the task force are an important source of information for this report. The intention is not to review or assess the effectiveness of different supervisory agencies or their supervisory processes. The analysis does not refer to the international regulatory framework itself, which is within the scope of the Regulatory Consistency Assessment Programme (RCAP) or compliance with the Basel Core Principles for Effective Banking Supervision, as may be covered by the International Monetary Fund (IMF)-World Bank Financial Sector Assessment Program (FSAP). Rather, the aim is to identify and describe general practices, tools and instruments that supervisors currently use.

Structure of the report

Section 2 describes recent **trends in supervision**, including how supervisory practices have evolved and broadened since the financial crisis. As a result, impact measurement has become an even more important aspect of supervision. Thus the report is structured along the lines of a comprehensive supervisory cycle that is intended to (i) clarify supervisory objectives; (ii) evaluate the effectiveness of supervisory actions; and (iii) account to stakeholders that supervision has been effective.

Section 3 describes the **objectives of supervision**. The report shows that all jurisdictions have strategic objectives aimed at promoting the safety and soundness of banks and the banking system. In detail, a great variety exists in the specification of objectives along different dimensions (presented in Tables 1 and 2). The report also describes the different practices that supervisors have developed to translate general objectives into supervisory actions, and to disclose their objectives and expectations to relevant stakeholders. A structured framework to translate strategic objectives into supervisory priorities and actions offers guidance on the supervisory process and supports a constructive dialogue with supervised institutions on what is expected from them.

Section 4 discusses developments in practices for **measuring impact**, which constitutes an important and evolving element in the supervisory cycle. Most supervisors have increased their efforts to gain insight into the effects of supervisory activities by developing tools and performance measures. The wide variety of indicators used are summarised in Table 3. To mitigate methodological challenges, supervisors use a broad portfolio of both measurable and qualitative indicators at different levels of the supervisory process to provide a comprehensive overview to evaluate impact. Also, jurisdictions have taken important steps with regard to the monitoring and reporting of the impact of their activities through the development of structured quality assurance mechanisms and feedback loops within the supervisory process.

Section 5 describes the different **accountability arrangements**. Most supervisors have strengthened internal and external accountability in the wake of the crisis. Internal accountability refers to the decision-making processes within the organisation, including checks and balances and a clear division of roles and responsibilities. External accountability consists of the supervisors' obligation ability to explain to external stakeholders (including the government, parliament and the general public) the impact of their activities. Various mechanisms have been implemented by jurisdictions for this purpose, including peer reviews, stakeholder analyses and external evaluations. A well designed system of accountability can support operational independence and enhance transparency, while safeguarding confidential, institution-specific information.

Section 6 sets out several **observations** that were submitted with the answers to the questionnaire and discussion in the group. These observations encompass the key elements of the supervisory cycle as a cohesive framework. This starts with a comprehensive and consistent set of objectives, which is clearly communicated to stakeholders and supervised institutions. Subsequently, the impact of supervisory activities is measured on the basis of a broad portfolio of indicators, which are regularly monitored and structurally controlled through management reports and quality assurance mechanisms. In combination with clear internal processes, this finally provides a basis for demonstrating the impact of supervision, which feeds back into the supervisory process. These observations, as described in Section 6, may provide material for further discussion.

2. Background

The international response to the financial crisis focused initially on strengthening the traditional, quantitative elements of supervision, ie increasing capital buffers and strengthening liquidity requirements. At the same time, international supervisors started a more fundamental debate on what constitutes effective supervision and how this can be implemented. This section will discuss the role of the supervisor and recent trends in supervision. Understanding these trends provides the starting point for the analysis of impact and accountability.

2.1 The supervisor's role

Financial regulation ensures financial discipline and stability. The long history of financial crises shows that many different elements within the financial system can destabilise financial institutions and markets. This instability creates externalities where the overall, social costs of market failure exceed the private costs. Financial stability is therefore a public good. National supervisory authorities have a legal mandate to supervise financial institutions and thereby protect the financial interests of the community by (i) promoting safe and sound institutions; (ii) safeguarding continuity in the provision of financial services; (iii) protecting the interests of deposit holders; and (iv) maintaining the stability of the financial system.

Several factors limit the effectiveness of regulatory reforms. Regulation and supervision can never reduce the probability of failures to zero. Banks operate in a market environment and, occasionally, situations will arise in which risks materialise and affect the soundness of institutions. Supervisors intervene to the best of their abilities to remediate issues that could potentially lead to the failure of individual financial institutions. Their ability to prevent failures also depends on external developments, the resources available, and the risk tolerance of both the supervisor and of the bodies to which the supervisor is accountable. Another complication is that the more effective regulation is in constraining behaviour, the more likely it will induce financial institutions to move their risk-taking activities into unregulated segments of the financial sector (Brunnermeier et al (2009)). In addition, the introduction of safety nets can distort market functioning and create moral hazard.

Effective supervision must complement regulation. The policies to address the main lessons of the financial crisis have been implemented and the regulatory reform agenda is now well under way. As a result, the focus in maintaining financial stability will shift more towards effective supervision. As the economic recovery progresses, new risks may emerge. It is important that supervisors are prepared to quickly and effectively identify, assess and mitigate these risks when they threaten to create vulnerabilities in the financial system.

There is no single definition of supervisory effectiveness. Regulation provides a general framework which depends on the expert discretion or judgment of supervisors. The IMF notes that good supervision is intrusive, sceptical, proactive, comprehensive, adaptive, and conclusive (Viñals and Fiechter (2010)). However, to put these elements into practice, different approaches can be applied. The recent Financial Stability Board (FSB) thematic review on supervisory frameworks and approaches for systemically important banks (SIBs)[1] concludes that assessing the effectiveness of more intense

[1] Financial Stability Board, *Thematic peer review on supervisory frameworks and approaches for SIBs*, 2015, www.financialstabilityboard.org/2015/05/fsb-publishes-peer-review-on-supervisory-frameworks-and-approaches-for-systemically-important-banks-sibs/.

supervision is still at an early stage and refers to the present report to provide a foundation for moving work in this area forward.

Box 1 – What constitutes effective supervision?

The Basel Core Principles for Effective Banking Supervision are the international standard for the supervision of banks. They are the benchmark for sound supervisory practices and are used by the IMF and the World Bank in the context of the FSAP to assess the effectiveness of banking supervision. First published in September 1997, the Basel Core Principles were revised in October 2006 and September 2012 to reflect the main lessons from the financial crisis and necessary developments in supervision.[2]

The revised Basel Core Principles have raised expectations for more effective supervision on the basis of a risk-based approach and timely supervisory actions. This is reflected in efforts to strengthen supervisory practices and risk management with greater supervisory intensity towards systemically important banks, the application of system-wide supervision and a macro perspective and increased focus on early intervention and crisis management. In addition, a new Core Principle has been added to reflect the importance of sound corporate governance, and more emphasis has been put on public disclosure and transparency of banks to promote market discipline.

For the purpose of this paper, Core Principle 1 on the powers, responsibilities and powers and Core Principle 2 on independence, accountability, resourcing and legal protection of supervisors are particularly important. The full text of these Basel Core Principles is included in Annex A.

Effective supervision is also dependent on the willingness of supervisors to act and their ability to exercise judgment, which is subjective in nature. Viñals and Fiechter (2010) have pointed out that supervisory approaches and skills will become more challenging as the rule book becomes more detailed and complex. Enforcing compliance with regulatory requirements does not necessarily mean that risks are contained, as they are not, for example, when banks have an unsustainable business model, inappropriate risk management or the underlying culture or behaviour has not changed.

The discussion of effective supervision will continue to evolve, as the concept is neither static nor easily defined. In this context, supervision is sometimes referred to as a craft (Sparrow (2012)), because it critically depends on the analytical and professional skills of supervisors. Therefore, the elements of effective supervision deserve as much attention as the regulatory reforms.

2.2 Trends in supervision

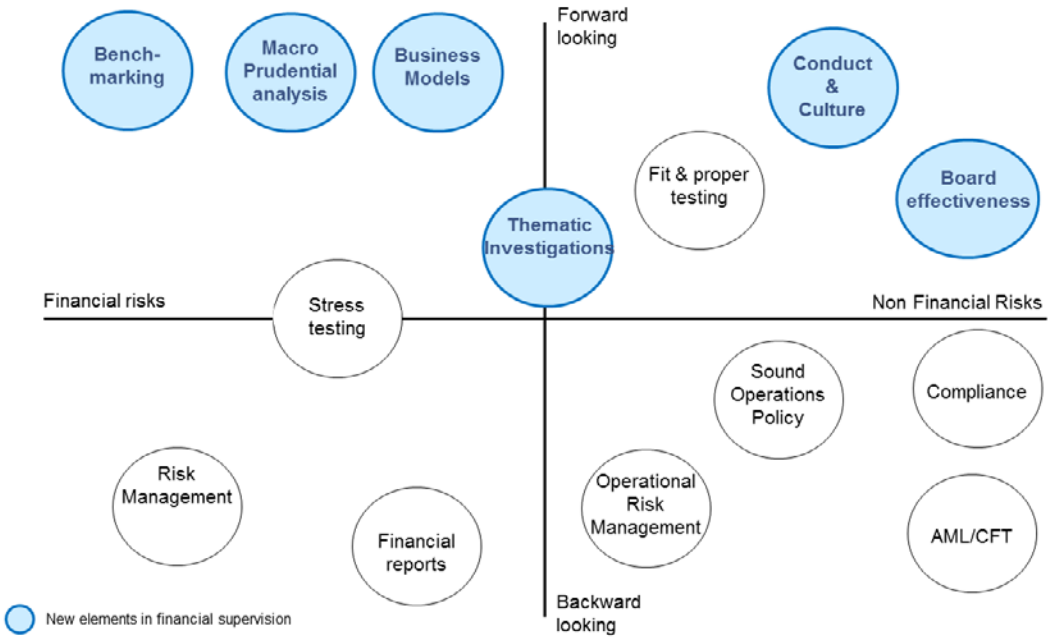
The financial crisis has had an important effect on supervisory practices. In addition to the regulatory reforms, national supervisors all over the world have revised their supervisory strategies. Figure 1 summarises some of these strategies.

Supervisors apply a more forward-looking approach with more attention to strategic and qualitative elements. The traditional, quantitative elements of capital buffers and liquidity requirements continue to play a central role in supervision and have therefore been significantly strengthened in response to the financial crisis. Capital and liquidity provide important buffers to absorb losses and ensure a bank's ability to meet its obligations. In addition, supervisors have taken a more forward-looking approach, for example by requiring bank and supervisory stress tests as well as capital and liquidity planning. At the same time, supervisors are looking increasingly at aspects of an institution that

[2] Basel Committee on Banking Supervision, *Core Principles For Effective Banking Supervision*, September 2012, www.bis.org/publ/bcbs230.htm.

might provide insights as to whether its business model and strategy are sustainable in the long term (FSA (2009)). This includes a focus on behavioural, governance and cultural aspects of financial institutions (Nuijts and de Haan (2010)). Also, supervisors are paying more attention to financial institutions' risk governance frameworks, which comprise the board, the firm-wide risk management function and the independent assessment of risk governance (FSB (2013)). These qualitative elements enable supervisors to identify possible sources of future problems at an early stage and to mitigate risks before they affect an institution's financial soundness or integrity.

Figure 1 – Trends in financial supervision



Source: A Kellermann, J de Haan and F de Vries, *Financial supervision in the 21st century*, 2013.

Supervisory practices have been renewed. Supervisors have evaluated their supervisory approaches and redesigned their toolbox for prudential supervision. In addition to institution-specific supervision, supervisors make more use of overarching approaches with cross-cutting analyses of the sector as a whole. This is reflected in the increased use of benchmarking exercises and thematic reviews. An approach of looking beyond individual institutions enables supervisors to better detect industry trends, spot potential outliers and look at risks to financial stability.

The scope of supervision has been broadened. More segments of the financial sector have been brought into the scope of regulation. For example, new regulation has been developed in some jurisdictions for hedge funds, private equity entities and credit rating agencies. Moreover, different initiatives have been developed to expand the supervisory footprint into the shadow banking sector, although in some countries this remains work in progress.

Macroprudential supervision has gained a more prominent role. An important lesson from the financial crisis was that financial institutions are more interconnected with each other and the real economy than previously thought and that the stability of the financial market as a whole is a separate element that should explicitly be taken into account (de Larosière (2009)). Central banks and supervisors have developed a separate macroprudential pillar in their supervisory processes, often reflected in the creation of new macroprudential authorities. Also, new macroprudential supervisory instruments have been developed, such as the countercyclical buffer in the Basel III framework.

Several jurisdictions have initiated organisational changes. Since the financial crisis, central banks have generally gained a more prominent position within the supervisory process (either directly or indirectly) and there has been a movement towards more cross-sectoral consolidation (ECB (2010)). A notable change in the organisation of supervision has been the shift towards European supervision with the creation of the European Supervisory Authorities and – since November 2014 – the Single Supervisory Mechanism, which brings prudential supervision in the euro area under the responsibility of the European Central Bank (ECB).

There is an ongoing debate between principle-based and rules-based supervision. Before the crisis, supervisors increasingly relied on open norms in supervision, giving institutions increased freedom to develop their own strategies to comply with regulatory rules (Black (2011)). As a result of the crisis, this approach came under scrutiny, indicating that supervision had become too "light-touch". However, it is not evident that a return to more detailed, compliance-driven approach will necessarily strengthen the effectiveness of supervision (Haldane (2012)). More importantly, supervisors seek to strike an adequate balance between the application of a uniform, rules-based approach as opposed to a more targeted approach, tailored to the specific circumstances of the individual institution.

To facilitate orderly resolution, crisis management has been strengthened. In a market environment financial institutions can fail. An effective crisis management framework allows supervisors to intervene at an early stage and to facilitate an orderly resolution of a troubled institution, thereby preserving financial stability.

2.3 The supervisory cycle

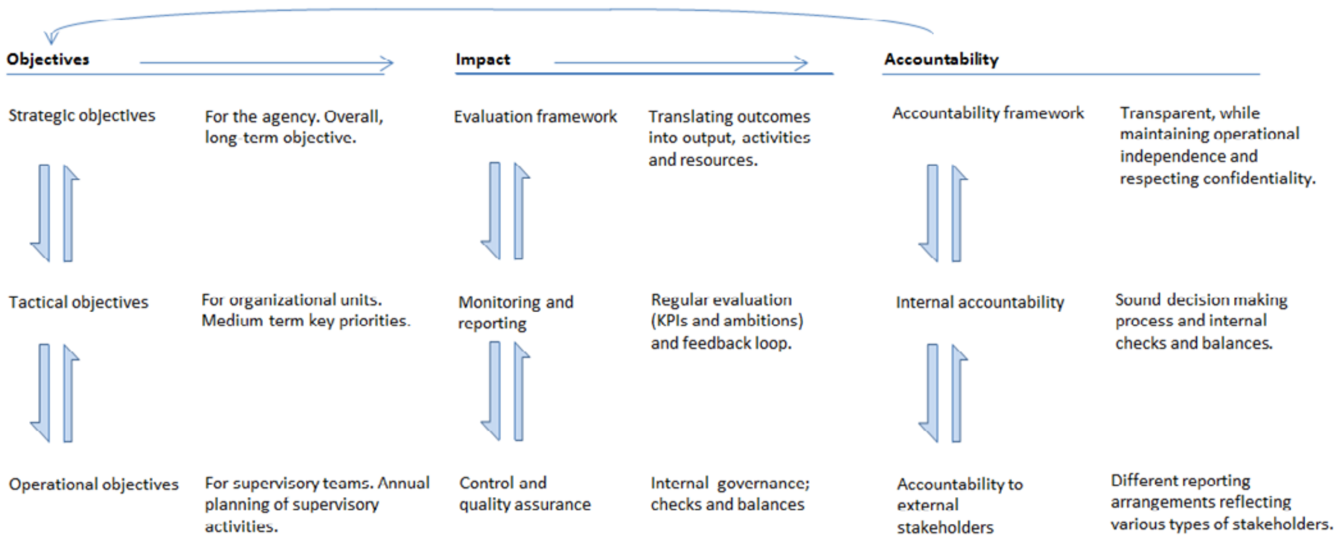
The broader scope of supervision has made the design and implementation of financial supervision more complex. Supervisory activities have expanded and the effects of supervision may be more difficult to assess. This makes it more relevant to develop a structured framework to measure the impact of supervision. It is useful to identify different tools and instruments of supervision and how they contribute to the ultimate objective of promoting the safety and soundness of banks and overall financial stability.

Impact assessment and accountability are part of a continuous evaluation process to monitor and enhance supervisory effectiveness. Given the absence of a unitary definition of effective supervision, supervisory authorities regularly evaluate their methodologies and operating frameworks to establish what works best in their jurisdictions. As financial market and supervisory practices continue to develop, supervisors are also adapting their supervisory approaches to take into account relevant developments.

Ideally, supervision is embedded in a consistent, continuous and comprehensive cycle (as presented in Figure 2 below). The key elements of a supervisory cycle – discussed in the following sections of this paper – are based on a supervisory strategy that includes:

- Clarity regarding the objectives of supervision, ("what do we want to achieve?"), translated into activities through a structured planning process.
- Evaluating impact ("how do we know if our activities contribute to meeting our objectives?").
- Accountability ("how do we demonstrate to key stakeholders that our supervision has been effective?").

Figure 2 – Example of a framework for impact and accountability



3. Objectives

This section discusses how supervisors set their objectives and how those objectives are translated into supervisory activities. The FSB report on SIB supervision (FSB (2015)) concludes that supervisory effectiveness can be more objectively assessed when authorities have in place a well defined supervisory strategy, which clearly articulates and prioritises objectives.

3.1 Clarity about the general objectives of supervision

In all jurisdictions, the safety and soundness of banks and the banking system is reflected in some form in the overall, strategic objective of supervision. The overall objective of supervision is determined by the supervisor's mandate, which is often established by law and has a strategic, long-term perspective. The Basel Core Principles for Effective Banking Supervision provide a consistent framework:

- An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups (Principle 1; Essential Criterion 1).
- The primary objective for banking supervision is to promote the safety and soundness of banks and the banking system (Principle 1, Essential Criterion 2).
- If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it (Principle 1, Essential Criterion 2).

Notwithstanding substantial commonality in the goals, the methods of supervision adopted by individual prudential supervisors differ markedly. Supervisors reported that a variety of practices are applied to fulfil the core objectives of supervision. To some extent, this can be attributed to differences in financial conditions or market structure. However, differences often are simply due to operational history or to individual preferences in jurisdictions.

Supervisory authorities determine their strategies from various perspectives. In addition to the ultimate goal of safety and soundness, strategic objectives can be targeted towards the financial system, institutions, consumers and/or the economy. The objectives – which are generally established by law or regulation and may not be within the supervisors' control – may also include the overall stability, efficiency and competitiveness of the financial system, and preventing irregularities that may endanger the safety and soundness of the banking system. For some supervisors, the main objective of financial supervision is to ensure that financial promises to individuals are met – implying that failures are mitigated or that safety net provisions are robust – while other jurisdictions may focus on an effective functioning of the financial system, aiming at orderly resolution. Other supervisors make it more explicit that a zero-failure policy is not the ultimate objective.

Overview of primary objectives

Table 1

Category	Examples
Financial system	Safety and soundness: • Ensure the sound and prudent management of the overall stability, efficiency and competitiveness of the financial system • Prevent irregularities in the banking system
	Governance and transparency: • Decision-making process to ensure good governance and transparency
Institutions	Safety and soundness: • To ensure sound and prudent management of institutions subject to supervision
	Financial analysis: • Financial parameters affecting the financial performance of banks
	Risk assessment: • Monitoring supervisory risk profile of institutions and taking preventive or corrective measures when necessary • Evaluation of the risk structure, internal control, internal audit and risk management systems of banks • Compliance with corporate governance principles
	Supervisory strategy: • Risk-based framework • Medium-term strategy • Target-based management
Consumer/public	Consumer protection: • Protect the customers, insurance policyholders, members and beneficiaries of the entities • Protection of creditors, investors and insured persons • Transparency of contractual conditions and the fairness of relations with customers • Preservation of confidence in the financial system • Prevent irregularities which endanger the safety of the assets entrusted to institutions
Economy/market	Safeguards to prevent or minimise market disruption: • Ensuring proper functioning of financial markets • Measures to counter financial imbalances, and to stabilise credit markets and financial system • Create a mechanism to guard against a financial crisis • To facilitate smooth provision of financing • To contribute to the development of the financial system • Ensure compliance with banking and financial rules and regulations
	Measure, monitor, safeguard the economy: • Prevent irregularities in the banking system that may prejudice the economy as a whole • Anti-money laundering and measures against financing terrorism

Many jurisdictions have additional objectives, often of a secondary nature. While respecting the primary objective of promoting the safety and soundness of banks, these secondary objectives include maintaining public confidence, fostering a reputable and competitive financial system and ensuring a sound and stable financial system that contributes to a healthy and successful economy. Some supervisors also include within their general objectives the protection of depositors and customers.

Overview of secondary objectives — Table 2

Category	Examples
Financial system	Safety and soundness: • Maintain public confidence in the banking industry • Foster a sound and reputable financial centre • Supervision facilitates effective competition
Institution	Risk assessment: • The objective of supervision is not to prevent banks from taking risks but make them understand the levels and types of risks they face and control them.
	Effective supervision: • Supervision facilitates effective competition
Consumer/public	Consumer protection: • Protecting the public's interest • Maintain public confidence in the banking industry • Customer/depositors protection
Economy/market	Measure, monitor, safeguard the economy: • Supervision ensures a stable financial system which contributes to a healthy and successful economy • Financial market supervision contributes to reputation and competitiveness of financial system

There is no single best practice that emerges. There are many strategic supervisory objectives with a range of definitions. Strategic objectives are generally high-level and do not necessarily give insight into the actual supervisory process. This indicates that it is the responsibility of the supervisor to further clarify its strategy and translate the general objectives into supervisory actions.

3.2 Translating general objectives into supervisory actions

Supervisors can build upon their strategic objectives to guide their activities. Supervisory authorities may have discretion to further refine their strategic objectives and typically have a certain degree of discretion to determine their supervisory strategies. To support the evaluation of supervisory impact and strengthen accountability, some supervisors have benefited from a structured process that translates the general objectives into supervisory actions. The Basel Core Principles state that

- "The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs." (Principle 9, Essential Criterion 2)

A coherent supervisory framework within the organisation can facilitate the conversion of long-term objectives into daily supervision. A coherent framework can make the objectives more actionable and thereby enhance effectiveness. A structured planning and control process can help to determine priorities. This can be done in various ways. Supervisors can operationalise supervisory objectives on a more tactical level (eg over a three to five year time frame) by defining and translating objectives into key supervisory outcomes, which in turn allow supervisors to better determine the impact of supervision. These objectives could relate to the main developments in the sector, as well as the goals and priorities established by management. These objectives could subsequently be translated into the yearly, operational planning of supervisory activities with regard to institution-specific and thematic supervision (see Figure 3 for such a framework for supervisory objective-setting).

Figure 3 – Different levels of supervisory objectives

This planning process can provide a clear link between the different levels of supervisory planning. This is essential to ensure consistency with the ultimate, strategic objectives and supervisory activities.

The process can be structured by top-down guidance, a bottom-up process or a combination of the two. Some jurisdictions have an explicit structure in place where the executive board provides direction to translate strategic, general objectives into the organisation. For example, this can be done through a (multi-year) strategic plan or through definition of long-term goals. Jurisdictions may also follow a process that starts with a bottom-up identification of different risks and vulnerabilities, which is input for further selection within the organisation and then translates into priority planning on a higher level within the organisation. Decision-making in this case is typically done at board level. These top-down and bottom-up processes need not be mutually exclusive and may be applied in combination.

Box 2 – Examples of structured planning for supervisory activities

Most supervisors develop annual supervisory plans following a risk-based approach, and in some cases include macroprudential analyses and the detection of general issues. Many jurisdictions noted that supervisory plans may change over the year depending on needs. Even for multi-year planning cycles, supervisory plans are commonly reviewed at least annually.

FINMA (Switzerland) has defined strategic goals on a multi-year horizon. These explain the approach of the supervisor to relevant developments in the financial sector and the associated challenges,[3] which are then translated into five key priorities and main activities. The strategic goals are decided by the Board of Directors, subject to approval by the Federal Council (the Swiss federal government). The strategic goals are set for a four-year period: 2013–16. Based on the strategic goals, the Board of Directors annually defines strategic priorities for the subsequent year.

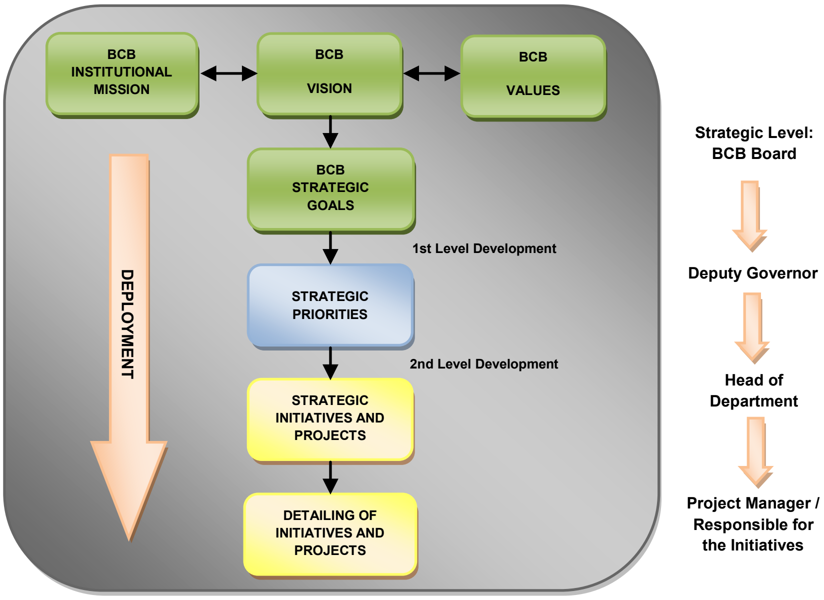
In the United Kingdom, the PRA's thematic teams and individual supervisory teams identify and report on emerging risks. The executive board identifies and prioritises the emerging risk themes, which are then discussed with the PRA Board. Also, the PRA maintains a suite of risk reports on strategic, operational and sector risks and sector analysis (horizontal scanning, financial stability and business model analysis), which feed into the risk assessment process. The PRA Risk Framework provides a structure for forming resource allocation judgments, based

[3] FINMA, *Strategic Goals 2013 to 2016*, www.finma.ch/e/finma/publikationen/Documents/strategische_ziele_finma_2013-2016-e.pdf.

on the potential impact, the risk context and available mitigating factors. On that basis PRA supervisors judge a firm's proximity to failure, which is captured in the Proactive Intervention Framework (PIF) and translated into a PIF score, with an associated supervisory programme.

The Central Bank of Brazil (BCB) has a management model aimed at connecting senior management's priorities with each department's execution of its processes. By fostering closer ties between the senior administration and technical staff, the management model allows faster decision-making and improves coordination among the departments in relation to the institutional strategic challenges. This coordination is achieved via a two-stage process:

- Level 1: the strategic objectives are established by the Board according to strategic priorities defined by the Deputy Governor of each area;
- Level 2: the strategic priorities are translated into projects or strategic initiatives at department level (see chart below).



Once a year, the strategic priorities and guidelines are reviewed and then translated into initiatives, projects and ongoing activities. These are elaborated in a Supervisory Action Plan. The priorities drive the definition of strategic actions and the allocation of available resources with targets and indicators for periodic follow-ups.

The inclusion of the following four key elements in the planning process can help ensure that the general objectives of banking supervision discussed above are met in practice:

(i) Identification of bank-specific and system-wide vulnerabilities through verification work and forward-looking analysis;

(ii) Escalation of findings to the supervisory decision-making bodies;

(iii) Enforcement of the legal and regulatory framework; and

(iv) Timely preventive and corrective actions. This includes contributing to resolution processes where other public sector bodies are also involved, such as the deposit insurance fund or the ministry of finance.

Supervisors can be more effective if they clearly communicate their objectives to their stakeholders. Notwithstanding the differences in implementation, it is particularly important that supervisors provide clarity on their objectives. The Basel Core Principles state that:

- “The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.” (Principle 2, Essential Criterion 3)

By defining upfront the effects that supervisors want to achieve, supervisors not only provide direction to the supervisory process and a clear focus towards the relevant ultimate outcomes, they also give supervised institutions clarity on what is expected from them and contribute to an effective dialogue and better prioritisation of actions. Finally, defining desired effects is a necessary precondition for any analysis of impact and accountability. The role of transparency will be further discussed in Section 5.

Typical ways to communicate expectations include annual reports, financial stability reports, business consultations and circular letters sent to the banking industry. Supervisors reported the use of regular public announcements and explanations of regulatory and supervisory policies and approaches to make sure that expectations about supervisory objectives are known. Communication on individual institutions’ supervisory expectations is primarily done as part of the institution-specific supervisory dialogue, eg through the supervisory review and evaluation process (SREP).

Box 3 – Some illustrative examples of disclosure of objectives and supervisory expectations

The US Office of the Comptroller of the Currency (OCC) has established protocols to communicate expectations to supervised entities on a frequent and regular basis. Examination findings are provided in writing to each bank and orally to boards of directors during the supervisory cycle. In addition, the OCC uses quarterly letters, banking bulletins and semiannual risk reports to disclose relevant information to the public. In addition, the OCC has developed several initiatives to inform banks about policies, rules and emerging risks.

At the beginning of each year, the Hong Kong Monetary Authority (HKMA) holds a press conference to discuss its activities over the past year and introduce its priorities and areas of key supervisory focus for the coming year. This information is uploaded to its public website. The HKMA also briefs the Legislative Council on the full range of its work several times a year. The materials presented to the Legislative Council are available to the public through the HKMA’s and the Legislative Council’s websites.

The French Autorité de contrôle prudentiel et de résolution (ACPR) communicates its operational and policy objectives through the publication of its annual report and also presents its expectations through the ACPR website and an official register for instructions, guidelines and recommendations. The ACPR also issues a bimonthly publication aimed at banking and insurance professionals. In addition, the ACPR organises regular conferences seminars and meetings with the supervised institutions to reach out to the market.

The China Banking Regulatory Commission (CBRC) has established protocols to communicate expectations to supervised entities. The CBRC publishes its objectives, principles, measures as well as regulatory standards via its website and annual reports. It also regularly discloses major regulatory initiatives and supervisory actions through the same channels. This includes forward-looking information on strategic priorities.

The Netherlands Bank publishes its supervisory objectives on its website. It has presented its *Vision on Supervision* for the period 2014–18. On that basis, the DNB presents a yearly brochure on thematic supervision and its budget (available on the website). Institution-specific expectations are communicated directly to institutions.

The Bank of Italy makes use of several channels to communicate its supervisory expectations, addressed both towards specific institutions (supervisory dialogue) and stakeholders. It publishes a triennial strategic plan and an annual report, which are complemented by periodic meetings with the senior management of the most significant banking groups and by the publication of the *Guide for Supervisory Activities*, which summarises the supervisory approach (objectives, methodology and evaluation process).

Confidentiality legislation may impose limits on disclosure. Several jurisdictions point out that transparency and communication must take into account the rules governing the confidentiality of information. These are likely to set limits on how far supervisors in many jurisdictions may disclose institution-specific supervisory information. Sensitive information may also include proprietary, institution-specific information as well as information that affects the privacy of individuals and their activities. However, this does not preclude disclosure of overarching policy goals that the supervisor pursues for certain groups of institutions or for particular risk issues. Moreover, confidentiality should not be an excuse to hide from public scrutiny.

4. Measuring impact

Supervisors monitor their activities to assess whether and how far their actions are contributing to the achievement of their objectives. This section discusses the main elements in the design of a performance measurement framework, the different practices among jurisdictions and the main emerging trends.

4.1 Methodological aspects

When evaluating effectiveness, different methodological challenges can arise. The following elements should be taken into account.

Causality

Perhaps the greatest challenge to assessing supervisory performance is to prove a clear relationship between supervisory activities ("cause") and observed outcomes ("effect"). It is not easy to establish the contribution of a supervisory action to the financial position and behaviour of a financial institution. There is a lack of reliable counterfactual information or a control group to compare results with other exogenous factors such as the economic cycle and market developments. A financial system can be performing strongly with few or no failures and without losses being incurred by protected beneficiaries. However, this does not necessarily mean that this is the result of effective supervision. The opposite is also true: financial failures and losses borne by taxpayers do not necessarily mean that prudential oversight has been inadequate. It is often difficult to isolate the impact of supervisory interventions.

In addition, risk-based supervision means that supervision is focused on areas and institutions where the risks are most imminent, which creates a selection bias whereby those institutions under the strictest supervision may be those that perform least favourably.

Time horizon

Time aspects can be difficult to take into account when measuring supervisory impact. An effective regime of prudential supervision seeks to promote financial stability over the long term. Through regular prudential oversight, supervisors seek to identify potential weaknesses in risk management, governance or resilience at an early stage and take corrective action. Over many years, these programmes serve to build financial sector resilience by encouraging firms to build a culture of sound prudential management that enables them to withstand economic shocks, as well as changing market conditions. The outcomes of supervisory interventions are not always immediately apparent, as it can often take considerable time for these outcomes to materialise.

In the short term, supervisory measures may come at a cost to a firm's immediate financial position. For example, a credit review may reveal that an institution must take additional losses on its positions, which may have a negative impact on its financial performance and result in short-term financial costs. Over the longer term, however, this intervention may serve to reduce the probability or impact of the firm's failure.

Unintended consequences

A performance measurement framework based on quantitative elements can be susceptible to behaviour that is driven by a focus on those specific indicators (ie "what gets measured, gets done"). Focusing on a certain performance metric could create perverse incentives by focusing supervisory attention on that specific indicator, while diverting attention from activities that are less easily measured, but would contribute more effectively to preserving overall financial stability. For example, an indicator based on the number of supervisory interventions may increase the number of formal measures that are taken, but may not necessarily address the underlying risks. On the other side of the spectrum, performance indicators that focus on the desired outcome of financial stability (eg "no new losses or winding down an institution") could also have counterproductive effects. For example, if a supervisor takes necessary corrective action, some performance metrics may suggest that supervision has been ineffective.

Confidentiality

Several supervisors have indicated that confidentiality requirements can make it difficult for them to demonstrate the effectiveness of supervision. Much banking supervision work is, by design, conducted "behind the scenes". In most jurisdictions, supervisors may only publish information on individual institutions to the extent necessary for the performance of their statutory tasks. This makes it difficult to communicate about specific interventions that might have demonstrated the effectiveness of supervision. Also, it is difficult to report on specific prudential interventions when a financial catastrophe has been averted (such as timely uncovering of fraudulent or improper practices). Public disclosure might reveal previous problems, potentially impairing financial stability by causing negative prudential consequences for the institution involved. In these cases, supervisors typically report generically on the effects achieved, even if reporting specifically what has been achieved by their actions might cast the effectiveness of their supervisory action in a more positive light.

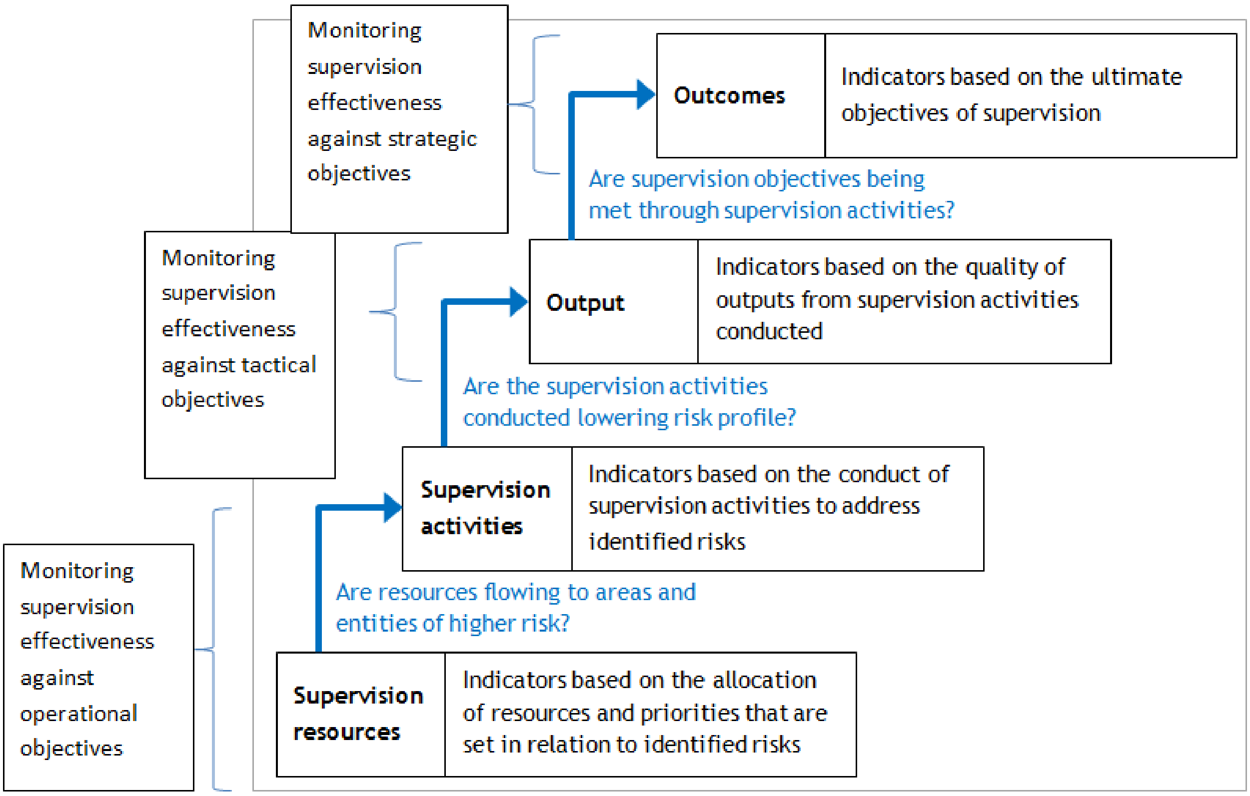
4.2 Coherent framework

There is no single tool or set of tools for measuring supervisory effectiveness. Many countries have begun to develop tools and performance measures to monitor the implementation and impact of supervision. National jurisdictions utilise a range of indicators such as operational measures covering resourcing, risk prioritisation and supervisory activities as well as outcome-based measures for changes to entity risk profiles and the prudential condition of the financial system and entities within it.

One of the sound practices that seems to emerge from the survey is to use a broad portfolio of indicators to assess the effectiveness of prudential supervision. A wide range of quantitative and qualitative indicators, rather than any single performance indicator, better enables supervisors to evaluate their effectiveness and incorporate different perspectives into the assessment. A sample framework is provided in Figure 4. Taken together, these performance measures can present a comprehensive and cohesive picture. A broad approach is also applied in most supervisory rating systems (for example, the CAMELS rating system),[4] which provide an overarching assessment of the financial position of a firm and its risk management. Outside the financial sector, a comparable approach can be observed with the use of a balanced score card to evaluate complex objectives. A broad framework can also be used to assist supervisors in coordinating their supervision planning processes. It could be employed to address thematic or system-wide issues as well as idiosyncratic risk issues identified within individual institutions. Another advantage of applying multiple metrics is that a portfolio of indicators is less sensitive to outliers than a single parameter.

[4] The CAMELS rating system typically consists of an overall composite rating for the institution, as well as individual component ratings for **c**apital adequacy, **a**sset quality **m**anagement, **e**arnings, **l**iquidity and **s**ensitivity to market risk.

Figure 4 – Example of an overall framework with a broad portfolio of performance indicators



Ideally, the indicators in a portfolio are aligned and cascade into a cohesive picture of how supervisory action has led to the desired prudential outcomes. Such an approach would link the application of supervisory resources to supervisory action planning to specific targeted goals to overall prudential impact.

Further steps can be taken to focus on long-term outcomes. Most supervisors use indicators related to inputs and activities, because they are readily observable and available. Indicators that focus on output or the overall achievement of supervisors' outcomes with regard to the strategic objectives are less frequently observed. These indicators may better assess the ultimate effectiveness of supervisory action against the overarching strategic objectives, but it is not clear which indicators are the best predictors of effectiveness. Also, few supervisors are capable of assessing how indicators have transitioned over time as a result of supervisory actions and whether changes in firms' financial condition result in greater safety and soundness. Jurisdictions structurally monitor the financial condition of institutions, but in many cases it is not clear if and how this data are used to assess supervisory effectiveness.

4.3 Indicators

Supervisors use a wide variety of indicators to evaluate the impact of their supervisory actions that can be classified into different categories of the supervisory process. These indicators are based on (a) supervisory resources (input); (b) supervisory activities (throughput); (c) output from supervisory activities; and (d) outcomes, based on the ultimate objectives of supervision. These indicators can consistently be applied within the framework, described in Figure 4 above. Potential indicators are summarised in Table 3 below.

Indicative overview of indicators that are used in different jurisdictions Table 3

Performance indicators	Do you use these? (Yes/no)	Examples of metrics used	Rationale/benefits	Potential downsides
Market data such as credit ratings, stock price of firm, CDS spreads	Around half the jurisdictions surveyed used market data as an indicator of supervisory effectiveness	• Credit ratings • Stock price • CDS spreads • Vix index • Funding rates	• Understanding of the riskiness of institutions as perceived by the market. • Simple • Comparable	• Difficult to establish link with supervisory actions. • Market data alone are not a good measure of supervisory impact. • Concerns over role of rating agencies
Supervisory requirements such as solvency or liquidity ratios	Nearly all jurisdictions use supervisory requirements. In some cases specific targets were set. Jurisdictions that have not established quantitative performance indicators use this data as part of their risk framework	• Capital ratios • Liquidity ratios • Leverage • Loan growth • Non-performing loans	• Objective, consistent, easy to understand • Trends show a build-up of risk • Can review on an individual firm and system level	• Ratios in isolation can be misleading. Might miss hidden risks such as off-balance sheet assets • Ratios do not take into account the quality of governance in a firm • Prudential ratios not only driven by supervisory actions • Lagging indicators
Indicators related to number of bankruptcies or the amount of losses by these defaults	Around half of the jurisdictions surveyed used data on the number of bankruptcies as performance indicators. Some do not use this indicator due to a lack of data	• Number of failed institutions including asset size • Losses from failure • Orderly vs disorderly failure	• Failures are easily observable • Failures often indicate areas where supervision can be improved	• Reason for bankruptcy might be outside of supervisor's control • Bankruptcies are too infrequent to measure • Relates mostly to smaller institutions • Backward-looking indicator. It can be difficult to identify trends
Throughput time for supervisory activities, such as procedures, applications, assessments and stress tests	Around three-quarters of jurisdictions surveyed used indicators related to supervisory activities	• Monitoring whether assessments (eg Pillar 2, CAMELS, qualitative assessments) are carried out in full and to agreed timeframes • Volume (resources) of supervision over a time period (in staff or expenses)	• Stakeholders have certainty on timelines • Simple to use and supervisors can directly affect and address these indicators • Timely response from supervisors after visits and timely actions from institutions	• Measures compliance with a process. • Supervisory actions could be rushed impacting thoroughness • Supervisors might deprioritise more important work that is not measured. • Depends on complexity of the institution and quality of its risk management. • Measures efficiency rather than impact
Indicators related to (public) confidence in the financial sector or in the financial supervisor	Around a third of jurisdictions use indicators related to (public) confidence in the financial sector or in the financial supervisor for an assessment of supervisory effectiveness	• The number of complaints to the banking ombudsman • Business and public surveys, eg performed by an audit or consulting firm • Trends in customer deposits	• Surveys are easy to access and makes supervisory bodies accountable • External validation of performance • May be useful during times of financial instability	• Impact is difficult to measure from public confidence metrics, because supervisory actions are not reported • Metric can vary due to measurement errors and could be misleading • Difficult to highlight the impact of external factors, such as the media

Indicators that measure the migration between pre-defined supervisory regimes or risk scores (within a risk-based framework)	The vast majority of jurisdictions surveyed uses indicators that measure the migration between pre-defined supervisory regimes or risk scores as a measure of supervisory objectives. Those countries that do not use this indicator did not provide reasons for not using these metrics	• Percentage of problem banks where failure was averted • Long run trends of supervisory ratings/ risk scores of banks monitored and reported • Comparison of risk score with results of institutions	• Reveals a build-up of possible risks • Guides supervisory attention and resource allocation • Useful basis for aggregate analyses • Clear metric. and easy to monitor • Performance can be assessed against key performance indicators	• Lagging indicator • Rating migration might not be due to supervisory actions • Disincentive for regulators to downgrade a rating or risk score. • Risk scores are subjective in nature and differ between countries and need peer review and validation • Capacity to monitor and maintain the data • Ensure that supervisor understands rationale for risk score migration
Indicators based on the outcome of external or international peer reviews	Around two thirds of the jurisdictions surveyed used external or peer reviews as an indicator of supervisory effectiveness. Often these were based on international reviews. However it was not always clear how the results from eg FSAPs were turned into indicators to assess supervisory impact.	• Compliance BCBS core principles in eg FSAPs/FSAP updates, FSB peer reviews and Art IV reviews • Risk assessment undertaken by host supervisors on branches of banks • International stress tests • External audit assessment • RCAPs (measures compliance with Basel framework)	• IMF and Basel reviews provide useful benchmarks against international standards • Helps to validate the impact of supervision • International expertise • Reviews serve as signals and provide important recommendations. • Enhances transparency and accountability	• Reviewers sometimes have objectives that differ from those of the supervisory authority • Results only as good as the review • Difficult to highlight the impact of external factors such as economic trends or rumours • Reviews often done over a short period of time and at a high level
Indicators based on stakeholder surveys	Around half of the jurisdictions surveyed used stakeholder surveys as an indicator. It was not always clear how the results are translated into quantitative indicators	• Questionnaire completed by institutions following on site review • Perception survey or supervisor undertaken by external consultants • Surveys completed by different stakeholder groups	• Reflects an independent view of the regulator's reputation • Indicators can reveal areas of concern and for potential improvement for the regulator	• Can be highly dependent on effective wording of questions • Can be biased towards response sample • Stakeholder input is tainted by vested interests. Results have to be considered within context who the stakeholders are • Subjective responses
Other measures (qualitative or quantitative)	Jurisdictions reported a wide variety of other measures that are used to measure supervisory impact	• Progress on supervisory projects • Regulatory failure pre-report to the supervisory board (internal document) • Results on specific subjects (eg loan-to-income caps) • Results on institutions • Complaints data	• Supervisor's impact is made visible which strengthens confidence	• Depending on the nature, supervisory activities can be made public • Public announcements must not be made for the sake of publicity and can be (considered) partial

Below, we break down these indicators in Table 3 into the four categories according to the framework presented in Figure 4.

(a) Supervisory resources

Indicators in this category are based on supervisory input. To a large extent, all countries use a similar approach to determine operational priorities and allocate resources. Supervision is risk-based. This means that the riskiness of an entity and the potential impact of a failure on the financial system determine the amount and intensity of supervisory activity. Some countries also include other factors in this analysis (such as performance indicators, historical data, reputation, complexity, geography, budget).

In most instances, the analysis is an input into a planning document (for example a supervisory action plan) mapping out the risks and associated activities. Further feedback is gathered from all levels in the organisation, from the supervision teams to the highest management level. The plan is reviewed at least once a year (sometimes quarterly), with the results fed back into the plan.

Some indicators used in this category include:

- thematic issues/industry risks
- riskiness of entity
- size of entity
- complexity
- budget
- number of staff

(b) Supervisory activities

These indicators relate to the throughput of the supervisory process. They are focused on the supervisory activities and consist of the whole range of available tools and instruments that supervisors have to identify and mitigate risks. The activities would normally follow from the risks that have been identified and reflect the operational planning and the choices that have been made in the allocation of resources, where it is considered to be most effective.

Some indicators used in this category include:

- number of risk profiles prepared
- percentage of activities completed compared with plan
- timeliness of closing of supervisory issues and actions
- progress of corrective actions undertaken by banks
- throughput time for activities
- number of onsite reports and visits
- number of meetings with banks regarding supervision
- timeliness of examination reports

(c) Output

These indicators are based on the quality of output from supervisory activities. Many countries have in place indicators for tracking how institutions have responded to the findings that come out of various prudential reviews. Many supervisors also monitor the migration of entities between pre-defined supervisory categories or risk scores to assess the impact of their supervisory activities. These risk scores are used to help in planning and scheduling future supervisory activities and often include a feedback loop designed to assess the impact of supervisory actions on the risk score.

Some indicators used in this category include:

- number of entities in a heightened risk status (for example higher probability of failure percentage of supervisory rating downgrades and migration of risk scores

- matrix of overall risk scores
- consolidated index of risk and controls
- impact of adjustments and recommendations from supervision
- index of repeated infringements after a legal proceeding
- stakeholder surveys
- internal audit and national audit office
- external party reviews (World Bank, IMF, EBA, Basel Committee)

(d) Outcomes

These indicators are based on the ultimate objectives of supervision. This is the most relevant category, but also the most difficult to analyse and manage as a measure of effectiveness (see discussion about causality in Section 4.1). Supervisors have various measures in place to monitor the financial condition of the institutions that they supervise. Nearly all supervisors make use of market indicators (such as ratings, share price or CDS spreads) and supervisory parameters (such as capital ratios, liquidity ratios or asset quality) for risk assessment and monitoring purposes, but do not necessarily link these indicators to supervisory effectiveness. These data are analysed with broader economic movements and developments in financial markets to give context to the changes in values.

Some indicators used in this category include:

- bank credit ratings
- bank failure numbers
- capital and liquidity ratios
- movement in proximity to failure scores
- movement in quarterly risk scores
- loan loss reserves
- credit risk (bad loans, defaulted loans)
- confidence index on financial system
- estimated recoveries on failed institutions (percentage recovered)

4.4 Monitoring and reporting

A structured process for monitoring the impact of supervisory activities can support a performance measurement framework. A supervisory strategy is most likely to be successful when supervisory activities are consistently monitored. A structured approach can contribute to supervisory effectiveness, for example, by clearly defining goals and desired outcomes of supervisory actions at the outset, along with regular checkpoints embedded within the supervision business line. Such monitoring is resource intensive and therefore deserves careful consideration as an integral part of the supervisory process.

Box 4 – Management by objectives

FINMA (Switzerland) has set up a management by objectives process. Based on FINMA's strategic goals, the board of directors defines priorities. Based on these priorities, the executive board defines its annual goals. Depending on their nature, the implementation of each annual goal is pursued either through a project sponsored by the executive board or through the line management of the responsible division. In the latter case, the annual goal is included in the management by objectives process of the respective division head. The division head will further break down the goals into individual objectives for his direct reports. The section and group heads will do the same on their level. This process translates into the definition of personal objectives for each employee by his or her line manager and mid-year and end-of-year performance evaluations, including personal development needs.

The achievement of the objectives is assessed regularly in a formal annual process. On a strategic level, the executive board updates the board of directors twice a year. In case the objectives are not expected to be achieved, the executive board can take corrective measures.

An array of quantitative indicators provides a useful basis for measuring overall performance. Where possible, performance indicators are developed in a SMART way (ie specific, measurable, attainable, relevant and time-bound). Sparrow (2008) argues that supervisors can better prove the plausibility of a causal relationship by reducing the level of abstraction at which effects are measured. Supervisors may be able to better demonstrate overall effectiveness through a series of successful results at a more measurable level to provide a plausible and compelling picture. This process can be complemented with clear ambition levels against which to compare supervisory performance. These can come from past performance, from the performance of peers or from a professional or industry standard such as the IMF-World Bank FSAP. Benchmarking might particularly be a useful tool when a specific pattern is unusual.

To provide a full picture, these quantitative indicators can be complemented with qualitative indicators. Because of the methodological aspects discussed earlier, performance measurement based solely on quantitative indicators does not necessarily provide a complete picture. It does provide a constructive basis for discussion, but findings have to be verified and supported by qualitative evidence. To this aim, many supervisors have developed additional qualitative tools to assess supervisory effectiveness.

Box 5 – Supportive qualitative evidence

In order to consider a causal relationship, the UK applies a "reasonable man test", whereby a reasonable individual could conclude that, on balance, there is likely to be a causal link between actions and outcomes. Supervisors can further increase plausibility by developing a logical "contribution story" that credibly explains how supervisory activities have resulted in observed outcomes. Supervisors can thus provide reasonable evidence about the contribution of their supervisory interventions.

Also some supervisors have indicated that they qualitatively assess the impact of recommendations by supervisors through routine supervision, or onsite and offsite monitoring. In addition, supervisors may perform individual "deep dives" on specific issues, which provide indicative evidence of the impact on supervision. Finally, some jurisdictions make use of stakeholder surveys to assess supervisory effectiveness. These are based on questionnaires or interviews with supervised entities – often on an anonymous or confidential basis – which provide relevant feedback about the impact of supervision.

Frequent reporting facilitates regular discussions about progress and provides a feedback loop into the supervisory process. Senior executives of supervisory agencies can effectively monitor whether supervisors meet their operational, tactical and strategic objectives when they receive regular management information reports on all the different performance indicators in the overall framework. The report could for example indicate whether supervisory resources are adequately allocated, if supervisory activities are on track, whether supervisory outputs and prudential outcomes are being reached, and how these prudential outcomes are leading to a reduction in the impact or probability of failure of firms and ultimately improving the safety and soundness of the financial system. This reporting process can be supported by a formal escalation ladder to determine the timing and planning of corrective action. Most of the surveyed countries provide reports on supervisory activities (MIS, dashboards, key performance indicator reports). Some of these reports are automated with key figures, such as the number of risk profiles prepared, meetings with entities, onsite reports and timely examination report issuance. Others are a package on the risk profile and performance of the financial system as a whole, with commentary on any significant movements.

Box 6 – Structured data set

To support the process of performance measurement, supervisors can benefit from a good data set by which they register and monitor the follow-up and results of their supervisory actions.

For example, the OCC and Federal Reserve (United States) have "matters requiring attention" (MRAs) processes, which identify required actions by institutions that are tracked separately in the OCC's and Federal Reserve's information systems. The Federal Reserve also utilises "matters requiring immediate attention" (MRIAs) for the most pressing issues. If institutions do not resolve MRAs or MRIAs in a timely or effective manner, the US agencies will take corrective measures. Aggregated MRA and MRIA data are reported to senior management. Outcomes can be measured by timeliness of resolution, increases/decreases in the number of closed, repeated, and outstanding MRAs/MRIAs and management ratings.

At the ACPR (France), the Financial Affairs Department collects and monitors on a quarterly basis the performance results, which are divided into 17 key performance indicators divided into four strategic areas.

Korea's Financial Supervisory Service (FSS) monitors the effects of supervision before and after policy implementation by operating an internal supervisory database as well as an information exchange system set up between the FSS and financial institutions. To evaluate the effectiveness of individual supervisory programmes, the FSS uses statistical impact analysis and survey methods reflecting market data on both an ex ante and ex post basis.

The Bank of Italy has two informative tools respectively for analysts (SIGMA) and senior management (SMART). The former contains a dosser on supervised entities, including SREP outcomes and supervisory measures taken and actions planned for the next year. The latter is a dashboard that presents synthetic offsite and onsite supervisory data, as well as timely market and qualitative information.

4.5 Control and quality assurance

Impact assessment can be supported by an internal quality assurance process as a means of challenging the findings and intended outcomes of supervisory plans. Checks and balances within the supervisory process provide a critical review of activities and thereby enhance effectiveness. In accordance with what is expected from banks in their risk management, many supervisors apply a three-lines-of-defence model to assess their own processes to monitor performance and effectiveness.

First, supervisors are responsible for critically evaluating their own activities within their day-to-day operations, both as an organisation and at a business unit level. For the most part, the focus of these assessments are on supervisory outcomes, although many supervisors also pay considerable attention to the efficiency of their processes, taking into account the number of supervisory activities, timeliness and resource allocation. Typically, the results of these assessments are factored into an organisational risk assessment which drives planning for future supervisory activities.

Second, the supervisory process can be supported by a control mechanism to monitor, coordinate and challenge planned operational activities. Most supervisors have such processes in place to measure and account for their activities, for example by using benchmarks or internal checks and balances within existing governance arrangements. Typically, supervisors rely on line management and existing reporting lines to assess the impact of their supervisory activities. Often this is supplemented by strategic planning and financial control functions. Some jurisdictions also incorporate supervisory self-assessments into their assessment.

Box 7 – Organisational structure of internal control

Some countries have in place formal and structured processes to monitor and assess the impact of their supervisory actions through the creation of a separate unit to assess supervisory effectiveness.

Such a separate unit can be an effective means of explicitly ensuring quality assurance within the supervisory organisation. It operates independently with responsibility for strengthening internal control, measuring performance and executing ad hoc reviews and deep dives. This unit can report to the supervisory teams and to the executive board. For these analyses to be effective, this unit typically comprises experts who are familiar with the core supervision processes.

For other jurisdictions, this review and evaluation is an implicit component of their ongoing supervisory operations within their business line, for example, through intercollegial reviews and challenge sessions.

Finally, validation is a key component in the assessment of supervisory effectiveness. Internal reviews concentrate on the qualitative aspects of the supervision activities – reviewing the timeliness of actions and relevance and quality of recommendations made, as well as checking for compliance against the documented policies and procedures. The findings from these reviews feed back into the planning process.

5. Accountability

As noted in the previous section, supervisors are placing greater emphasis on performance measurement to demonstrate how their efforts and actions contribute to financial stability. Increased understanding about the impact of supervision can also contribute to strengthening the accountability of supervisors.

5.1 A balanced system

Accountability is a generic concept which may be interpreted in different ways. According to Marshaw (2006), it encompasses at least six important elements: (i) *who* is liable; (ii) to *whom*; (iii) *what* are they liable for; (iv) *through what processes* is accountability assured; (v) by *what standards*; and (vi) *what are the potential effects* when standards have been breached?

This section explores the elements of both internal and external accountability. The former refers to internal processes and procedures that guide the supervisory process, including checks and balances and a clear division of roles and responsibilities to ensure well founded actions and decisions, while the latter refers to arrangements by which supervisors are responsible for their actions to external stakeholders.

Financial supervisors have developed various initiatives to demonstrate how their actions contribute to financial stability. Accountability gives insight into the role of supervision and the results that it can achieve, thereby contributing to the effective management of expectations. In this context, it also strengthens supervisors´ willingness to act and to deliver sound supervisory outcomes.

An independent institutional setting is important for effective supervision. Supervisors are given an independent position and are delegated a wide range of powers to regulate and supervise banks. This reflects the notion that regulatory and supervisory independence is important to financial stability for the same reasons that central bank independence is important to monetary stability (Quintyn and Taylor (2002)). It enables supervisors to carry out their activities based on their mandate and technical expertise and to withstand industry and political interference.

Supervisors need to demonstrate that they operate under good governance and according to their mandate and objectives. Financial stability is a public objective and political leaders are ultimately held responsible by the general public for a sound and stable financial sector, even when this task has been delegated to an independent authority. Accountability reinforces checks and balances and is a key element in maintaining public confidence in the banking system. Accountability of financial supervision is particularly important when decisions are made that may involve public money.

The ability to demonstrate supervisory impact enhances supervisory accountability. As indicated in Section 3, supervisors aim to be transparent in defining objectives and setting clear expectations. In the same context, transparency also provides a basis for accountability by reporting to what extent these objectives have been achieved. Similar to the implementation of monetary policy, there has been a clear trend towards more openness in the performance of banking supervision in recent years (Angeloni (2015)). All jurisdictions have taken steps to enhance transparency about their strategies, supervisory frameworks and policies, including through the publication of this information in their annual report and other regular publications. Transparency puts supervisors' actions and decisions under public scrutiny. At the same time, supervisors strive to remain independent and respect legal confidentiality requirements.

These different aspects of operational independence, accountability and transparency are not mutually exclusive; on the contrary, they interact. A strong accountability regime strengthens independence, because it provides legitimacy to the financial supervisor (Quintyn, Ramirez and Taylor

(2007)). If a supervisor is transparent, it can reinforce its authority and independent position (Iglesias-Rodriguez (2014)) by explaining its objectives and, where appropriate, its activities and decisions. A balanced system of accountability, incorporating these elements is consistent with the Basel Core Principles, which determine that

- "The operational independence, accountability and governance of the supervisor should be prescribed in legislation and publicly disclosed." (Principle 2, Essential Criterion 1)

The following two sections will describe different practices on internal governance and accountability to external stakeholders.

5.2 Internal accountability

Effective decision-making benefits from a strong internal organisation and a clear division of responsibilities. This naturally follows from the hierarchical structures within the institution. All staff members within a supervisory agency are, to varying degrees, accountable for their actions and play a role in internal accountability. It is apparent that greater responsibility is placed on senior officials within each agency to ensure the organisation remains accountable for its actions. In some jurisdictions, a formal framework of responsibilities is established through the use of protocols, authorisation matrices or delegations to assign decision-making authority. This particularly relates to measures that have formal status or consequences (eg the granting of an operating license).

Most jurisdictions have a structured process in place for decision-making that includes internal checks and balances. The internal decision-making process is typically risk-focused and provides for considerable judgment by supervisory staff. Some countries allow certain decisions to be made by middle and senior management, while other decisions must be made by higher-ranking staff within the organisation such as deputies, general secretaries or governors (not precluding questions flowing upward to management or downward to staff). Typically, significant issues or problems at larger institutions are brought to the attention of more senior supervisory staff. This follows from the hierarchical organisation structure and internal procedures, including formal escalation ladders. A number of jurisdictions noted "sign-off" procedures for approving important supervisory documents. The types of decision that are usually delegated vary across jurisdictions. Some countries also utilise committee structures for deliberating and decision-making. These committees are often organised by a certain type of risk (such as liquidity or capital) or by an institution type (such as large complex banks, or smaller banks).

Most jurisdictions maintain an internal code of conduct or code of ethics for supervision staff. Several jurisdictions noted that staff undergo a security clearance process and are required to sign a code of conduct and ethics policy covering areas such as disclosures of conflicts of interest and financial transactions as well as personal probity. In addition, countries described codes of conduct that included recusal requirements and mandatory cooling-off periods or other post-employment restrictions for staff after working at the supervisory agency. For some jurisdictions, senior officials must comply with a more stringent code of conduct in comparison to regular staff. Often, staff are required to take annual tests or refresher courses on the organisation's code of ethics. A number of jurisdictions explicitly indicated that they have confidentiality provisions that prohibit staff from disclosing confidential supervisory information such as reports of examination and proprietary bank information both during and after their employment. Such provisions are important to ensure that staff and officials do not use information they obtain as a supervisor for personal gain.

Organisations also maintain audit and/or quality assurance functions to assess whether internal processes are being appropriately followed. Nearly all jurisdictions apply some form of internal audit process, which supports internal accountability. In addition, numerous jurisdictions described their quality assurance functions, which are separate but often similar to their internal audit functions. These functions' primary outputs include audit or quality assurance reports. In general, audit and quality assurance function activities and reports are risk-based. Jurisdictions indicated that most of these reports were summaries that were completed annually, although sometimes reporting was more frequent, such as biannually, quarterly or monthly. These reports include a wide range of performance indicators to judge progress against supervisory review plans for institutions, such as follow-up activities on recommendations to banks during the examination process. Fewer jurisdictions commented on external audit activities. Nevertheless, the countries commenting on external audit noted that national audit offices, inspector general offices, or other external governmental bodies conduct periodic reviews, typically ranging from annually to every five years, which can be conducted more frequently based on the situation.

Supervisors are also subject to reviews of their regulatory framework and internal processes by external organisations. In addition to external audits, supervisory processes in nearly all countries are periodically reviewed by other external parties, such as the IMF, FSB, BCBS and the European Banking Authority (EBA). The combination of existing internal processes and checks and balances and these external reviews provide a variety of perspectives on effectiveness and help to enhance accountability.

Box 8 – Reviews by external organisations

The IMF-World Bank FSAP Program assesses risks to financial stability and often reviews compliance with international supervisory standards. In addition, the FSB peer review programme monitors the implementation progress of these recommendations.

The RCAP is a programme of the Basel Committee to monitor the timely adoption of Basel III standards, and to assess the consistency and completeness of the adopted standards including the significance of any deviations in the regulatory framework.

A tool used by the European Banking Authority (EBA) to foster consistency in supervisory outcomes is the peer review of (specific aspects of) activities of competent authorities, in line with Article 30 of the EBA regulation. The peer review work is carried out by the EBA's Review Panel, using a methodology agreed by the EBA's Board of Supervisors. The peer reviews assess in particular the adequacy of competent authorities' resources and governance arrangements, especially regarding the application of EBA regulatory measures; the degree of convergence in the application of European laws, EBA regulatory measures and supervisory practices; and the best practices developed by competent authorities. The results of a peer review can lead to identification of best practices, or to issuance of guidelines and recommendations, as appropriate.

More specifically the peer review consists of (a) a self-assessment undertaken by competent authorities; (b) a follow-up review by peers (other competent authorities) phase; leading to (c) on-site visits to competent authorities based on the outcomes of the desk-based (off-site) peer review. The three-stage peer review assessment is intended, inter alia, to provide various examples of good supervisory practices and to identify possible weaknesses in other supervisory practices.

5.3 Accountability to external stakeholders

External accountability arrangements reflect different types of stakeholders. These arrangements also reflect the institutional design of supervision, where an independent supervisor acts as an agent to which a public task has been delegated and which is responsible for demonstrating to the principal (the community) that it has acted according to its mandate. Practices in different jurisdictions may differ depending on legal requirements and supervisors' mandates. The Basel Core Principles prescribe that

- "The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives." (Principle 2, Essential Criterion 3)

External stakeholders can broadly be categorised into four major groups:

1. General public: Members of the general public are the ultimate users of bank services. Effective supervision that contributes to a well functioning and sound banking system can have a significant effect on public confidence.

2. Executive bodies (government): Some supervisors are an integral part of the government and are accountable directly to executive bodies of the government through an internal reporting process. Others operate as statutory bodies and their operations are independent from the government. In the latter case, supervisors may nevertheless consider executive bodies to be external stakeholders even if they are not legally accountable.

3. Legislative bodies (parliament): As the approving body for the relevant laws that confer the mandates and powers of supervisors, legislative bodies frequently have oversight responsibility for supervisory authorities. Supervisors are therefore typically accountable to their respective legislative bodies to ensure that the powers delegated to them are exercised appropriately and that their operations are effective and in line with their mandates and objectives.

4. Supervised institutions: Supervisors are typically not directly and formally accountable to the institutions they supervise. However, as these institutions are directly affected by rules imposed and actions taken by supervisors, it is important for supervisors to explain to institutions the rationale for the rules and actions and to foster objectivity and fairness in the supervisory process.

External accountability can be supported by effective channels through which supervisors can disseminate relevant information to allow stakeholders to make informed judgments. Publications and face-to-face interaction are the two key channels supervisors most commonly employ to disseminate information and promote accountability. Publications take a variety of forms, including but not limited to annual reports, ad hoc reports and bulletins, internal supervisory rules and policies that are made available to the public, and external party review reports. Face-to-face interaction also takes different forms for different stakeholder groups. For example, such interaction can include formal appearances or hearings before a parliament or congress, private meetings with legislative staff, speeches, press conferences, or informal media contacts. In these cases, supervisors do not just disseminate information, but also may respond on the spot to any questions and challenges raised by the audience.

There are differences in practices as to how these information channels are used by supervisors and how information is disseminated through these channels. This is not surprising given the nature of different stakeholders, and the confidentiality requirements of different jurisdictions.

Accountability towards external stakeholders — Table 4

Stakeholder	Role / Interest	Main type of Information	Purpose	Illustrative Examples
General public	Ultimate users of banking services	Publications (mass-media) with high-level information on an aggregate basis.	Promote public confidence and awareness. Inform the public how supervisors operate within their mandate and protect public interests.	Annual reports, periodic bulletins, general information on banking laws and rules, supervisory approaches and regulatory tools. Ad hoc publication of information on supervised institutions if deemed appropriate (including publication of fines).
Executive bodies (government)	May be directly responsible for delegating or delegated tasks to supervisors.	Frequent, informal information sharing on relevant developments and aggregate prudential information, as well as institution-specific information in exceptional circumstances (eg crisis).	Oversee the activities of the independent statutory body and provide discharge of its supervisory duties.	Regular reports, statements of expectations, memoranda of understanding, accountability arrangements.
Legislative bodies (parliament)	Approving body for relevant laws.	More formal interaction on a regular, structured basis. Information in aggregate form.	Statutory oversight responsibility that supervisory powers are exercised appropriately.	(Written) testimonies, public hearings, special reviews, ad hoc reports.
Supervised institutions	Directly affected by actions of supervisors.	General rules and responsibilities. Supervisory feedback on examination findings.	Ensure that supervisory processes are transparent, fair and objective and that policies are operable.	Supervisory dialogue. consultation papers, industry meetings. Formal or informal procedures to challenge supervisory action or provide feedback.

5.4 Overview of practices

The following section provides an analysis of practices adopted by surveyed supervisors for disclosing information to each of the four external stakeholder groups. Examples of specific practices are also highlighted in the analysis.

1. General public

Publications are generally viewed as the most effective means of communicating to the general public. The Task Force survey noted that publication of regular reports, such as annual reports and periodic bulletins, is the channel most commonly adopted by the surveyed supervisors. While face-to-face interaction is conducted by a few surveyed supervisors, the interaction is normally conducted through mass media.

Surveyed supervisors are generally very transparent to the general public about their mandates and objectives. While high-level in nature, this information is important in the context of accountability as it ensures that the general public is aware that supervisors are operating with mandates to protect their interests. Much of the information is high-level and in aggregate form, because most supervisors can only disclose firm-specific supervisory information due to legal confidentiality requirements and financial stability considerations.

Publications

All surveyed supervisors publish their banking laws, supervisory rules, policies and guidance to give the general public a good understanding of the supervisors' mandates and objectives as well as their supervisory frameworks and regulatory tools.

The annual report is the publication common to all supervisors. All surveyed supervisors publish annual reports, sometimes as specified by law. In addition to providing annual reports to the general public, some surveyed supervisors submit their annual reports to executive or legislative bodies, sometimes through the ministry of finance. In some cases, the report addressed to the general public differs from the one addressed to legislative/executive bodies.

In addition to high-level qualitative information, such as supervisory mandates, objectives, and plans, annual reports usually contain more detailed information on the performance and achievements of supervisors. The information may include, for example, the number of authorisations approved, examinations conducted, enforcement actions taken, details of supervisory actions initiated during the year, and information regarding major improvements in the agency's management, organisation and supervisory practices.

Annual reports often contain statistics on the positions and performance of the banking industry. Most surveyed supervisors disclose this information in aggregate form, such as the overall asset quality, liquidity levels, and capital adequacy of the banking sector.

In addition to annual reports, all surveyed supervisors publish periodic reports or bulletins that include detailed information on banking industry statistics. Most supervisors disclose their risk assessments of the banking industry through periodic publications. Many supervisors also disclose the results of various stress tests (for example, the US Federal Reserve's Comprehensive Capital Analysis and Review and the comprehensive assessment of the Single Supervisory Mechanism (SSM) for euro zone banks).

Some supervisors indicate that they may also disclose institution-specific information to the public under their legal regime or under specific circumstances. There have been some illustrative examples (the London Whale, FX manipulation, the Banca Monte dei Paschi di Siena in Italy) where supervisors have published institution-specific findings. Publication of the findings was important to make the supervisory actions accountable and to underline to the banking industry that such behaviour would not be tolerated. The information raises public awareness of the latest developments in the banking industry and the public's ability to evaluate the effectiveness of specific actions taken by supervisors.

Some surveyed supervisors have taken further steps. These include disclosing their supervisory work programmes, supervisory performance benchmarks or thresholds, although this is still not a common practice. Less than half of the surveyed supervisors disclose information on their performance against specific objectives, key performance indicators or thresholds. Examples include supervisory performance against pre-defined benchmarks or pledged service standards. Apart from the publication of reports prepared by supervisory agencies, many surveyed supervisors consider that the publication of peer review and assessment reports prepared by international organisations, such as the FSAP reports by the IMF, are important channels for the general public to better understand how well supervisors in their jurisdictions have performed compared with other supervisors in terms of adherence to international regulatory and supervisory standards and principles.

Face-to-face interaction

Some surveyed supervisors organise periodic meetings and briefing sessions for the media to deliver messages to the public. Information is shared with the media after regular releases of major reports in relation to the banking and financial systems, or announcements of results of important banking system assessment exercises. The information disseminated through this channel includes analysis of the current conditions of and challenges faced by the banking sector, major supervisory initiatives/actions taken by supervisors and their supervisory priorities. Such arrangements provide a basis for external stakeholders to evaluate the performance of supervisors, and enables supervisors to respond to queries raised by the media or the public.

2. Executive bodies

There are different ways to organise accountability to executive bodies. Depending on their organisation and structure, some supervisors are an integral part of executive bodies, while others operate more independently from executive bodies. Regardless of different institutional arrangements, executive bodies usually (but not always) have direct oversight responsibility over supervisors. Therefore, in almost all surveyed jurisdictions, executive bodies have access to a very comprehensive set of supervisory information, including aggregate prudential indicators of the banking industry, supervisory performance and achievements and in some cases supervisory performance measured against specific benchmarks or thresholds.

Some surveyed supervisors also allow executive bodies to have access to institution-specific information under specific circumstances. This includes key financial indicators and specific supervisory measures and actions taken against individual institutions, which are not normally made available to the public. Executive bodies' access to such institution-specific information can be particularly important in maintaining the soundness and orderly functioning of the financial system, particularly during crisis situations.

Publications

To enhance accountability to executive bodies, a number of surveyed supervisors have entered into formal accountability arrangements. Statements of expectations/intent or memoranda of understanding with executive bodies have been used to set out institutional details. Such agreements highlight executive bodies' expectations about the roles and responsibilities of supervisors, and how the supervisors will meet the executive bodies' expectations. These administration agreements are often published to enhance transparency.

Apart from publicly available reports, many surveyed supervisors submit regular reports to executive bodies. These are submitted, in particular to the Ministry of Finance, to provide updates on developments among individual institutions and of the banking industry as a whole. The information in these reports may include details such as:

- Financial indicators of the banking industry;
- Information on noteworthy events occurring at systemically important institutions;
- Extreme events at smaller institutions that are of material importance to the financial system;
- Supervisors' assessments of the industry and individual institutions; and
- Proposed supervisory responses to address risks identified.

Many surveyed supervisors also submit regular reports to executive bodies on the progress of noteworthy international supervisory discussions, or on the conclusion of cooperation agreements with foreign supervisory authorities such as memoranda of understanding. Most surveyed supervisors also submit ad hoc reports to executive bodies, such as detailed situation reports updating the executive bodies on the status of troubled institutions, and reports on the impact of newly introduced supervisory policies on the financial system.

Some surveyed supervisors are subject to external audits or external stakeholder surveys on their efficiency and submit these independent reports to executive bodies.

Face-to-face interaction

In addition to providing different publications and reports to executive bodies, all surveyed supervisors have frequent contacts with executive bodies. Contacts are mainly through the Ministry of Finance or equivalent bodies on supervisory-related matters. In some cases these contacts may be necessary for formal planning purposes, while in other cases such contacts may be more informal in nature. The contacts include regular meetings, usually on a monthly or quarterly basis, for supervisors to give an update on areas such as developments in the banking industry, risk assessment of the banking industry and related supervisory responses and major supervisory achievements. In some cases these meetings may focus more on financial stability matters rather than on institution-specific issues.

Surveyed supervisors also have ad hoc meetings with executive bodies to communicate specific matters. This may include discussion of events that could have a significant impact on individual institutions or the banking system, or to give advance notice of the impending issuance of major supervisory measures. During crisis situations, most surveyed supervisors collaborate with executive bodies to devise crisis management strategies.

3. Legislative bodies

In general, supervisors are accountable to legislative bodies. This ensures that the power delegated to them is exercised under sound governance, and that their operations are effective and in line with their mandates and objectives. Because legislative bodies (as opposed to the general public and supervised institutions) typically have statutory oversight responsibility for supervisors, the accountability channels are often more formal and structured, and adequate information is provided to them to enable them to effectively review their supervisory activities. In some cases, legislative bodies can invoke their vested powers to make formal inquiries into specific incidents.

Publications

All surveyed supervisors provide written submission of information to legislative bodies. This is organised through testimonies or hearings, or in response to ad hoc requests. Some surveyed supervisors also submit performance or self-assessment reports to legislative bodies, sometimes through the ministry of finance. Supervisory information provided to legislative bodies is normally in aggregate form. Although some legislative bodies have the statutory power to obtain confidential supervisory information from supervisors, that power seems to be invoked only in rare circumstances.

Sometimes, legislative bodies conduct special reviews of supervisory topics such as the regulatory framework governing supervisors, or specific incidents such as bank failures or alleged supervisory failures. Reports issued following such reviews are frequently made public.

Face-to-face interaction

Surveyed supervisors often have regularly scheduled face-to-face interaction with legislative bodies. The frequency of such interaction varies among jurisdictions. Most surveyed supervisors participate in regular testimonies or hearings before legislative bodies and their committees, usually on a quarterly or half-yearly basis. Testimonies to legislative bodies are usually attended by the head of the supervisory agency. In some jurisdictions, the testimonies are performed through executive bodies such as the ministry of finance.

These regular testimonies often follow a standard agenda for surveyed supervisors to update the legislative bodies on, among other things, the latest developments in the banking industry, the supervisors' risk assessment of the industry, and the corresponding supervisory priorities. Most surveyed supervisors also make ad hoc appearances before the legislative bodies to address their queries, such as on the root causes of major supervisory incidents, the justifications for major supervisory actions, and the rationale for proposing major supervisory rules or policies. Supervisors may also meet privately with legislators or their staff to provide information and respond to questions on various supervisory matters. Taking into account both regular and ad hoc testimonies, some surveyed supervisors attended more than 10 testimonies before their respective legislative bodies in a year.

4. Supervised institutions

Supervisors aim to develop supervisory processes that are transparent, fair and objective to supervised institutions. Many surveyed supervisors establish direct channels to engage the banking industry and individual institutions on matters including general developments in the industry, development of supervisory rules and policies, and specific supervisory duties and actions. There are also channels for the banking industry or individual institutions to make representations or appeals against supervisory actions or decisions.

Publications

Supervisors engage in regular contact with the industry. To avoid possible impediments when implementing supervisory policies and rules, it is common for surveyed supervisors to engage the banking industry throughout the policy development process. In doing so, supervisory objectives, assessment methodologies and other operational issues are disclosed to supervised institutions and other stakeholders.

A common practice is for supervisors to issue consultation papers. These consultations set out to the industry and public the justifications for the proposed policies and related implementation arrangements, and seek their feedback on the proposals. Most surveyed supervisors have such practices in place. These supervisors typically provide formal responses setting out whether or not industry and public feedback was accepted. In some cases, the consultation is conducted through committees consisting of representatives of the banking industry and professional trade associations. In some jurisdictions, such prior consultations are required by law while others are initiated by the supervisors. In some other cases, the results of related impact analyses would also be disclosed to the industry before issuing new supervisory rules.

Some surveyed supervisors also engage the banking industry and other relevant stakeholders at a very early stage of policy development by issuing concept papers, before any formal consultations are conducted, to introduce a new policy framework and explain the rationale behind it.

Many surveyed supervisors have established a structured process for communicating supervisory findings and the corresponding supervisory actions to the institutions concerned. For cases of non-compliance with banking law or supervisory rules, most surveyed supervisors document the details of non-compliance, the decision and rationale for taking any supervisory actions against the institutions concerned, and any arrangements whereby the institutions can respond to supervisory decisions.

Face-to-face interaction

Most supervisors meet with industry representatives or participate in industry working groups to address questions concerning proposed supervisory rules and policies. These dialogues provide an opportunity for supervisors to explain the proposed rules and supervisory expectations. Some supervisors are required to formally document these meetings in the interests of public transparency.

Subsequent to the implementation of rules/policies, some surveyed supervisors also organise industry briefings to clarify or reinforce supervisory expectations in the light of actual implementation experience.

Some surveyed supervisors also participate in regular or ad hoc meetings with banking industry associations. These meetings allow supervisors and the banking industry to exchange views on overall developments in the banking industry, major risks and challenges, and supervisory initiatives. A number of these supervisors indicate that they would take into account the industry's input from these meetings for their updating of supervisory objectives, priorities and work programmes.

In addition, some surveyed supervisors have established mechanisms to facilitate institutions to formally challenge supervisory actions taken or decisions made by supervisors, or to provide feedback on how the supervisors have met their supervisory objectives and discharged their functions.

Box 9 – Accountability within the Single Supervisory Mechanism (SSM)

The Single Supervisory Mechanism (SSM) comprises the ECB and the national competent authorities (NCAs). The ECB has responsibility for effective European supervision in the euro area, and directly supervises the "significant institutions", through joint supervisory teams (JSTs) which include both ECB and NCA staff. Supervision of the "less significant" institutions remains with the NCAs, leaving the ECB to play a coordinating role and oversee the NCAs' functioning.

The SSM regulation explicitly states that the ECB "is to act independently when carrying out its supervisory tasks". At the same time,"any shift of powers from the Member States to the Union level should be balanced by appropriate transparency and accountability requirements".

Ter Kuile et al (2015) distinguish three elements of accountability: political, administrative and legal accountability. Political accountability refers to the fact that the ECB is accountable to both the European Parliament and the Council. In accordance with the SSM regulation, the ECB must submit an annual report on the execution of its tasks. Furthermore, the chair of the Supervisory Board can be heard by the Eurogroup or by the competent committees of the European Parliament and the ECB must reply to questions. Also, the Supervisory Board chair must hold confidential discussions with Parliament, when this is required for the exercise of the Parliament's powers under the European Treaty. Finally, the ECB must provide to Parliament a comprehensive and meaningful record of the proceedings of the Supervisory Board, including an annotated list of decisions.

Administrative accountability consists of the internal organisation within the ECB of its supervisory tasks. It includes the internal processes within the ECB and the procedures for decision-making, including the role of the Supervisory Board – which does all the planning and preparatory work – and the Governing Council which adopts the draft decisions. Last, legal accountability reflects the accountability of the SSM to the courts. This is based on a mixed administration where the ECB and national competent authorities can be held accountable to the European court as well as to national courts for their respective responsibilities.

6. Observations

This report is a range-of-practice study. Sharing international experiences makes an important contribution to the continuing development of effective supervisory practices and provides an opportunity to identify emerging trends for further strengthening of supervisory processes. Based on responses to the questionnaires and discussions within the group, several observations have come up, which may provide a basis for further discussion.

1. **A comprehensive framework that clearly translates the (multi-year) strategic objective(s) into supervisory actions offers useful guidance to the supervisory process.** Consistently and coherently linking a national supervisor's overall mandate with its activities promotes the development of actionable strategic objectives, prioritises its actions and focuses on the intended outcomes. This can be organised through a top-down or a bottom-up process with close involvement at the board or senior executive level. A framework which defines and clarifies the objectives and supervisory actions ex ante also provides a strong basis for evaluating the impact of supervision ex post.

2. **Clear communication to stakeholders and supervised institutions can contribute to a more constructive dialogue.** Supervisors have become more transparent and have developed various ways to inform their stakeholders about their objectives. By showing the choices they make in their supervisory strategies and the intended effects of their actions, supervisors can make their actions more effective.

3. **Using a broad range (portfolio) of indicators that operate at different levels of the supervisory process can provide a consistent and cohesive overview of supervisory effectiveness.** There is no single indicator that uniquely captures supervisory effectiveness. Supervisors can mitigate methodological problems in measuring effectiveness if they apply a wide variety of performance metrics to assess the impact of supervision. Through constant monitoring and evaluating, supervisors can assess what works best and understand how their actions contribute to the achievement of their objectives.

4. **Translating the overall objectives into both measurable and qualitative indicators can reduce the level of abstraction and focus the monitoring process.** Quantifiable indicators with clearly defined targets of ambition provide informative input for further discussion. The overall evaluation of effectiveness is best considered within the relevant context, which for example could consist of supportive, plausible (qualitative) evidence.

5. **Regular management reports create an important feedback loop.** Evaluating supervisory impact benefits from frequent reporting to senior management or board level, monitoring and discussing progress and possibly adjusting supervisory action. To support this process, good management information systems are important to register the follow-up and results of supervisory measures.

6. **A structured control and quality assurance process supports the supervisory cycle.** The design of supervisory actions and intended impact can be improved if supervisors are challenged by other experts within the organisation, following a structure approach. This responsibility can be assigned to a separate, dedicated department or through internal checks and balances within the existing governance structure.

7. **Decision-making and supervisory processes benefit from clear internal processes and procedures.** This includes rules about delegation, guidelines for internal decision-making and regular internal reporting. This provides for checks and balances within the organisation.

8. **Various mechanisms for promoting external accountability have been implemented.** These include the establishment of channels for supervisors to disseminate relevant information

to allow different stakeholder groups to make informed judgments. These include a mixture of peer reviews, stakeholder analyses and external evaluations that offer a broad picture from various perspectives. A well designed system of accountability supports operational independence, strengthens supervisory authority and enhances transparency of supervisory actions and decisions, without disclosing confidential institution-specific information.

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Annex A – Selected Basel Core Principles of Effective Banking Supervision

This report of the Task Force on Impact and Accountability (TFIA) is based on the relevant Basel Core Principles of Effective Banking Supervision and most importantly on Principles 1 and 2, which are included below.

Principle 1: Responsibilities, objectives and powers

An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups.[5] A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorise banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.[6]

Essential criteria

1. The responsibilities and objectives of each of the authorities involved in banking supervision[7] are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
2. The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
3. Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile[8] and systemic importance.[9]
4. Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
5. The supervisor has the power to:
   (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations;
   (b) review the overall activities of a banking group, both domestic and cross-border; and

[5] [In this document], "banking group" includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

[6] The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

[7] Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.

[8] [In this document], "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

[9] [In this document], "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

(c) supervise the foreign activities of banks incorporated in its jurisdiction.

6. When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardise the bank or the banking system, the supervisor has the power to:

(a) take (and/or require a bank to take) timely corrective action;

(b) impose a range of sanctions;

(c) revoke the bank's licence; and

(d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.

7. The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.

Principle 2: Independence, accountability, resourcing and legal protection for supervisors

The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.

Essential criteria

1. The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.

2. The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.

3. The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.[10]

4. The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.

5. The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.

[10] Please refer to Principle 1, Essential Criterion 1.

6. The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:

   (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised;

   (b) salary scales that allow it to attract and retain qualified staff;

   (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks;

   (d) a budget and programme for the regular training of staff;

   (e) a technology budget sufficient to equip its staff with the tools to supervise the banking industry and assess individual banks and banking groups; and

   (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (eg supervisory colleges).

7. As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.

8. In determining supervisory programmes and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.

9. Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.