The universe of supervisory mandates – total eclipse of the core?[1]

Executive summary

Banking supervisory authorities are vested with multiple mandates, objectives and responsibilities alongside their main role of promoting the safety and soundness (S&S) of banks and the banking system. In certain jurisdictions, these mandates encompass a range of objectives such as supporting the development of the financial sector or fostering competition.

The Great Financial Crisis (GFC) that began in 2007 revealed supervisory failures that may be due in part to unclear and/or conflicting mandates of banking supervisors. The Financial Stability Board and the International Monetary Fund emphasised the importance of a clear S&S mandate in order to encourage supervisors to act early and fulfil their role. The *Core Principles for Effective Banking Supervision* (BCPs), including BCP 1, were revised to clarify that the main objective of banking supervisors is to promote the S&S of banks and the banking system. They also noted that if other tasks are assigned to supervisors, they should be subordinate to, and should not conflict with, this primary objective.

Developments in the post-GFC era have further stretched supervisory mandates. The post-GFC period exposed limitations in the tools for managing financial stability and resolving large banks, and also uncovered a number of misconduct and money laundering scandals. There has also been an increase in the digitalisation of financial services, which presents new opportunities and risks to banks. These developments expanded the remit of some banking supervisors to include other areas such as macroprudential powers and the promotion of fintech and innovation. At the same time, the risks relevant to an S&S remit have expanded to include climate and cyber risks while the prudential implications of banks' misconduct and money laundering scandals have come to the fore.

This paper explores the supervisory mandates of banking authorities in 27 jurisdictions and examines how banking supervisors interpret and navigate their S&S remit in relation to other objectives. The findings are based on responses to a Financial Stability Institute questionnaire from the applicable banking supervisory authority in each surveyed jurisdiction, along with a review of relevant publications. Unless otherwise noted, the terms "mandates", "objectives" and "responsibilities" are used interchangeably to refer to all statutory and non-statutory objectives of the surveyed authorities.

While all surveyed authorities have a statutory S&S remit, the term "safety and soundness" is difficult to define, clouding the powers it confers, including a mandate for early intervention. As the term "S&S" is not clearly defined in legislation, some authorities have attempted to interpret it. In such cases, the definitions provided are high-level, reflecting the ambiguity of S&S terminology. Some focus on the "financial safety" of banks and banking systems to determine the contours of their remit, particularly if other agencies are assigned statutory mandates in areas of potential overlap. Others interpret their mandate broadly to encompass added duties that may impact a firm's overall risk profile, such as consumer protection or anti-money laundering/combating the financing of terrorism (AML/CFT). Importantly, if there is no consensus on what constitutes "safe and sound", it may hinder supervisors' will to take early action.

In addition to S&S, surveyed authorities report having up to 13 other objectives, highlighting the extraordinary pressure placed on supervisors to juggle multiple responsibilities. The majority of surveyed authorities are charged with at least 10 or more objectives and these supervisory authorities are mostly central banks (SA-CBs). Supervisory authorities in emerging market and developing economies have slightly broader mandates than their counterparts in advanced economies, mainly due to

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a greater propensity to promote certain objectives – such as competition, financial inclusion and fintech development – that can collectively expand financial services to un(der)banked consumers.

Despite their numerous objectives, only some of the surveyed banking authorities prioritise between their mandates. Seven authorities prioritise their mandates in law, while two others prioritise via non-legislative means. S&S and financial stability are generally prioritised should there be tensions with other mandates. While prioritisation of mandates is important for all supervisors with objectives beyond S&S, it becomes vital when these additional tasks are statutory. Among 18 surveyed authorities with more than five statutory mandates, only five prioritise their mandates via legislation or other means.

This paper classifies objectives according to a "constellation of supervisory mandates" to determine the relative proximity of these numerous supervisory objectives to the S&S function. The constellation groups objectives into two categories: "surveillance and oversight" (S&O) and "promotional and developmental" (P&D). The S&O category covers five objectives: financial stability, AML/CFT, crisis management, resolution and consumer protection. These tasks are the most common statutory objectives (apart from S&S) among the surveyed authorities, suggesting that they may complement the S&S mandate. The P&D category covers seven objectives that may have less obvious relevance to an S&S remit. The climate risk objective straddles both categories, depending on whether emphasis is placed on promoting green finance or on extending the supervisory framework for climate-related risks.

Some S&O mandates, particularly resolution and consumer protection, present potential conflicts with the S&S mandate. Supervisory and resolution teams could have different views on when to trigger resolution of a bank. In addition, regulatory consumer protection actions such as fines for abusive sales practices could, in theory, jeopardise the S&S of a bank.

Certain P&D objectives can conflict with the S&S mandate and may warrant special scrutiny to ensure that policy trade-offs are well considered. Some P&D goals, such as competition, can accentuate risks in the banking system. Lower barriers to entry could admit players with aggressive strategies that may lead, for example, to an erosion in credit underwriting standards. Other P&D objectives, such as fintech and innovation, may attract non-traditional bank owners and new business models that rely on technology to underwrite and manage risk, introducing new threats to the banking system.

To deliver on their core S&S remit while addressing potential conflicts with other objectives, authorities can consider various initiatives such as:

- providing operational clarity to the term "safety and soundness" that is sufficiently flexible to encompass emerging risks within an S&S remit and granular enough to foster early intervention;
- establishing the prioritisation of the S&S mandate to promote supervisors' independence, which can, in turn, help with balancing their core S&S remit against certain P&D objectives championed by national governments;
- utilising a number of institutional arrangements, such as separate governance structures for different objectives, to minimise potential frictions between competing objectives;
- procuring adequate resources to fulfil the S&S remit and other supervisory mandates, while considering the staffing implications of some P&D objectives – such as competition or fintech development – that may draw resources away from the core S&S function; and
- publishing public statements that specify authorities' interpretation and prioritisation of their mandates, and how potential conflicts are mitigated in order to promote sound accountability.

Above all, the staggering range of objectives imposed on supervisory authorities risks diluting their ability to deliver on the core S&S mandate. For many authorities, multiple layers of objectives are stacked on top of an S&S mandate whose scope and complexity have evolved over time. Therefore, an open question to society and the political class is whether supervisory authorities are being asked to do too much, perhaps at the expense of losing sight of their main S&S mandate.