POLICY FRAMEWORK FOR EFFECTIVE AND EFFICIENT FINANCIAL REGULATION: HIGH-LEVEL OECD CHECKLIST

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Approved for public consultation by the joint CMF-IPPC task force on financial regulation, on behalf of the Committee on Financial Markets and Insurance and Private Pensions Committee.

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POLICY FRAMEWORK FOR EFFECTIVE AND EFFICIENT FINANCIAL REGULATION:

High-Level OECD Checklist

I. Financial landscape

A. Benchmark reference

Have the attributes of a well-functioning system been identified?

- Have the principal functions of the financial system been identified? Have the features of these functions been properly identified?
- Have the boundaries of the system been defined? Have the expected linkages been the financial system and the broader economy been identified?
- Has the relationship between the financial system and the conduct of monetary policy been clarified?
- Have the anticipated linkages between the domestic financial system and the international financial system been identified?
- Have the expected outcomes of a well-functioning financial system been identified?
- Have the essential foundations (e.g., legal, behavioural, institutional) of a well-functioning financial system been identified?
- Have possible country-specific features regarding the operations of the financial system been identified?
- Has this vision of a well-functioning financial system been communicated to the public? If so, how and when? Has this vision been updated to reflect changes in the financial system?

B. Transparency

Is the functioning of the financial system, its features, and evolution transparent?

- Is comprehensive, relevant, and timely information currently being collected and, to the extent possible, disseminated on:
  - i) Products, services, processes, and transactions in the financial system?
  - ii) Institutions?
  - iii) Private and off-balance sheet vehicles?
  - iv) Markets?
  - v) Systems
  - vi) Supporting infrastructures?
  - vii) Participants?
  - viii) Interlinkages (e.g., macroeconomic, international)?
- Are comprehensive, relevant, up-to-date, and internationally comparable sets of statistics and indicators for the entire financial system being collected and disseminated?
- Have considerations of cost, confidentiality, financial stability, and security been properly assessed in determining the appropriate level of transparency?

• Do governmental authorities have the legal powers, if necessary, to compel the collection and, if appropriate, dissemination of data and information? • Are timely, relevant, comparable, international data and information available to permit comparisons and foster an understanding of the international financial system? • Is there scope for the private sector, possibly in collaboration with government, to improve further the relevance, quality, timeliness, comprehensiveness, and comparability of data and information? • Are relevant international organisations supporting domestic and global efforts to promote greater transparency of the financial system?	
C. Analysis	
Are financial system developments and macroeconomic trends being properly surveyed? Are emerging risks consistently being identified and monitored closely? • Have effective surveillance tools and mechanisms been established? • Is there adequate expertise to properly understand risks, conduct analyses, identify policy options, and formulate a policy response?	
Has market failure analysis been conducted to better understand the operations and efficiency of the financial system and define the key problems? • In this respect: i) Have relevant market and participants have been identified? ii) Has the source of the market failure been identified (e.g., asymmetric information, spillovers, market power, market abuse)? iii) Has the materiality of the market failure been assessed? iv) Have the risks and effects of the failure been identified? v) Has the market failure been substantiated empirically? vi) Have the possible global and dynamic nature of the market failure been assessed, including whether the failure might be self-correcting?	
Is there collaborative information-sharing, discussion, and analysis among relevant governmental authorities, both domestically and internationally? • In this respect: i) Are professional secrecy standards applicable to governmental authories in relation to the exchange of confidential information? ii) Are there discussions and analysis of the financial system and related developments, risks, and possible contagion channels, domestically and internationally? iii) Are there effective mechanisms to promote continued collaboration and information-sharing?	
II. Policy objectives	
A. Identification of problem and case for intervention	
Have the problems and needs been clearly identified?	

• Have actual and potential market failures in the financial system been clearly identified and analysed? • Have any relevant broader economic needs (e.g., competitiveness, market development) and social needs (e.g., access, equity, social solidarity, health and income protection, and long-term savings) been identified and analysed? • Have these problems and needs been ranked in terms of gravity and impact on welfare?	
Has the case for intervention been established? • Have the expected benefits of the government intervention to address these problems and needs been identified? • Have the direct and indirect costs of intervention been assessed? Have the possible problems, complications, or costs of government intervention been carefully considered, including the possibility that certain policies or approaches may be unsustainable or lead to a build-up of risks? • Have the alternatives to government intervention have been assessed? • Overall, do the benefits of intervention exceed the costs?	
B. Policy objectives	
Have clear policy objectives been elaborated for the financial system? • Do the objectives correspond to the anticipated beneficial outcomes of intervention? • Are they sufficiently general to be applicable to the entire financial system? • Have they been prioritized? Do they give top priority to promoting confidence in the financial system and addressing systemic risks? • Might it be possible to assert that, with the policy and regulatory framework currently in place, a financial crisis will not emerge from within the financial system, but arise only as a result of an external source or shock? If not, why not? • Have the trade-offs or mutual reinforcement among policy objectives been identified and carefully analysed? • Do more specific objectives need to be elaborated for particular sectors, institutions, or products? Why? How are they linked to the general objectives?	
C. Accountability	
Have policy objectives been clearly and publicly articulated? • Are they clear enough to assess the effectiveness of intervention? • Have they been explicitly incorporated, in part or whole, into the mandated objectives of governmental authorities involved in intervention?	
Have accountability mechanisms been established? • Do relevant governmental authorities publish annual reports in which they outline their objectives, provide an overview of the regulatory framework and relevant developments in the financial system, identify key risks, and provide information information on how	

the regulatory framework is addressing these risks and achieving stated objectives?

- Have internal governance mechanisms been established within government to ensure ongoing review of, and reporting by, relevant authorities?
- Have indicators been developed to help monitor progress toward the achievement of policy objectives?
- Are remedies available within government to address any serious failure by governmental authorities to meet mandated objectives?

III. Policy instruments

A. Identification of financial sector policy instruments

Have the range and features of policy instruments available to address the problem been identified and are they well understood?

- Policy instruments include:
    - i) Surveillance
    - ii) Market-based solutions
    - iii) Regulation
    - iv) Guarantees
    - v) Lending and liquidity support
    - vi) Subsidies, grants, and programmes
    - vii) State ownership and control
- Have the impacts of each policy instrument been identified, particularly in respect of costs, incentives of affected parties, and international spillovers?
- Has consideration been given, in particular, to addressing how any expected negative incentive effects or international spillover effects can be reduced?
    - i) Have *ex ante* risk mitigation measures been adopted to help control the effects of negative incentives? Has consideration been given to adjusting the use of other policy instruments to reduce these risks?
    - ii) Has the need and scope for international cooperation and coordination been specified to optimise the impact of policy instruments?

B. Matching policy instruments to policy objectives

Are the selected combinations of policy instruments appropriate for the identified problems or needs in the financial system? Are they the least-cost approach?

- Has the mix of policy instruments been carefully considered? What is the role, if any, of financial regulation in this mix?
- Do the instruments, taken together, address the identified market failures or broader economic and social needs underlying each policy objective?
- Have potential conflicts in policy objectives been taken into account in the choice of policy instruments?
- Has the choice and design of policy instruments taken into consideration possible negative incentive effects that may affect, and cut across, policy instruments? Have possible international policy spillovers also been considered?
- Have specific factors, such as industry sector, type of institution, and type of consumer

been explicitly considered in the choice and design of instruments for each policy objective? Has such such specificity been well justified?

- Has the possibility of international policy spillovers been considered in the choice , design, and implementation of policy instruments?
- Do the selected combinations of instruments represent the least-cost approach to addressing the policy objectives?
- Has the choice of policy instruments, and their mapping to policy objectives, been made transparent and publicly justified?
- Once made operational, has the use of policy instruments been made transparent to the extent possible and appropriate?
- Has international coordination been established, where necessary and possible, to maximise the impact of domestic policy instruments?

C. Specification and principles of financial regulation

Financial regulation is a policy instrument designed to induce certain behaviours and actions or specify certain fixed outcomes -- has consideration been given to the nature and content of the "directive order" in question, the degree of compulsion, and (if relevant) the extent of supervision?

- Regarding the nature and content of the directive order in regulation, has careful thought been given to the appropriate mix of principles and rules?
- Is the system of compulsion appropriate?
    i) Adequacy of administrative penalties and sanctions?
    ii) Extent of civil law provisions?
    iii) Relevance and extent of criminal law provisions?
- Is the system of supervision (if relevant) adequate?
    i) Proper legal authorities?
    ii) Adequate expertise and level of staffing?
    iii) Effective techniques of supervision?
    iv) Accountability mechanisms in place?
    v) Complementary role of criminal law prosecution?

Have the following principles been met in financial regulation?

- A ***pre-cautionary*** approach has been adopted in financial regulation; policymakers pro-actively anticipate and address emerging risks and problems and do not initiate reforms solely in response to the onset of crises.
- Financial regulation is ***risk-based*** and is thus oriented to the risks in the financial system and gives priority to those risks that, due to their nature or impact, have the greatest potential of compromising the achievement of policy objectives. Regulation is aligned with, and promotes, sound risk management in the financial system and strengthens incentives for prudent and proper behaviour.
- Financial regulation promotes ***sound incentives*** (i.e., incentives that are aligned with policy objectives) and, to do so, clarifies that financial institutions may fail and specifies orderly failure resolution procedures for them, as well as makes use of market forces as appropriate to promote sound incentives.

• Financial regulation is ***comprehensive*** and ensures that all identified market failures and broader economic and social needs are properly addressed, at a domestic and global level, and involve the full use of all regulatory tools and mechanisms to achieve policy objectives, including through the combination of regulation with other policy instruments. In this context: i) all relevant financial system participants and related products, services, institutions, systems, and markets are subject to appropriate regulatory and supervisory frameworks and oversight; ii) interconnected components of the financial system, be it in terms of financial groups, sectors, systems, or markets, are appropriately subject to an integrated, global view so that interrelated risks and contagion channels can be appropriately identified and, where necessary, addressed; and, iii) all appropriate tools and mechanisms are being used to ensure a global, integrated approach to the regulation and supervision of relevant participants, products, services, institutions, systems, and markets. • Financial regulation is **consistent and competitively neutral** and is applied in a consistent, "functionally equivalent" manner (i.e., neutral from a product, institutional, sectoral, and market perspective). Consistent, integrated forms of regulation and supervision have been adopted across: (i) products, services, sectors, systems, and markets; and (ii) financial firms and groups. • A **high-quality and transparent decision-making process** for regulation-making is in place, with **effective mechanisms for enforcement** (see below for further questions regarding the regulatory process and enforcement). • Financial regulation is subject to **systematic review** and is assessed with respect to quality, implementation, and impact in due course folllowing its adoption. This assessment evaluates whether the regulation achieved its specific objective(s) and did so in a cost-efficient manner, and whether the decision-making process could be improved. • Finanical regulation is involving **international coordination, convergence, and implementation in policy and rule-making**: Financial regulation is, to the extent possible, comprehensive and consistent internationally, with effective coordination where relevant and gradual convergence over time insofar as policy objectives are shared. Where financial regulation is developed internationally, efforts are made to coordinate implementation to ensure consistency in application and prevent regulatory arbitrage. • There is **international coordination in the regulation and supervision of internationally active financial firms and groups**, The growth and size of internationally active financial firms, and the special challenges they pose for nation-based systems of regulation and supervision and insolvency, suggest that close international coordination and cooperation is required in relation to their regulation and supervision and failure resolution. • There is **a level international playing field** and **unnecessary duplication, burdens, conflicts and barriers are being removed**. ***In the context of the development of specific financial regulations, has a sound, open, transparent, process been followed?*** • Have the following steps been taken? i) Defining the specific problem in question	

ii) Assessing whether government action is justified, whether regulation is the most appropriate policy instrument, and whether there is a legal basis for regulation iii) Assessing the appropriate level of government for implementation and establishing effective coordination if there are multiple levels iv) Assessing the costs and benefits of regulation in a manner proportionate to the importance of the regulation and its impact v) Ensuring that any distributional impacts are transparent vi) Conducting consultations with interested parties in an open and transparent manner, and ensuring adequate time for responses vii) Assessing and ensuring effective compliance mechanisms • Has consideration been given to possible circumstances (e.g., supervisory interventions, emergency and crisis management) where an open, transparent process may not be appropriate? • Has consideration been given to the international dimension of regulation-making? Are appropriate domestic or international consultation mechanisms in place, involving all relevant stakeholders? • If applicable, has the regulation been reviewed by central governmental agencies charged with reviewing governmental regulations?	
IV. System design and implementation	
A. Appropriate institutional setup	
Is the institutional setup for government intervention and financial regulation effective and efficient? • Does the institutional setup reflect realities in the domestic and global financial system? • Do the government institutions ("administrative institutions") responsible for intervention and regulation have clear, mandated objectives? Do they have sufficient authorities and adequate tools for implementation? • Have available synergies been maximised in terms of the assignment of policy objectives and instruments to these institutions? Synergies include: i) Policy objectives ii) Policy instruments iii) Information and expertise iv) Administration • If more than one administrative institution is involved in the use of a policy instrument and policy objectives are shared, have effective coordination mechanisms been established to ensure consistency and coherence? • Are the interests and incentives of relevant administrative institutions aligned with their objectives? What external pressures exist? Has the institutional setup accounted for these factors? • Are appropriate accountability mechanisms in place for these institutions? • Have the financial exposures of government been properly taken into consideration in the institutional setup? • Where self-regulatory organisations (SRO) are directly or indirectly involved in government intervention and regulation, is this setup appropriate? Is the public interest	

being served in an effective and efficient way? Is there adequate government oversight over the SROs clearly established? • Has consideration been given to the establishment of enhanced international coordination and institutional mechanisms, as appropriate?	
B. Systems for coordination, oversight, and control	
Is there an effective system of coordination, oversight, and control in the institutional setup? *Coordination* • Have mechanisms been established to ensure adequate information flows, collaborative analysis, discussion, and policy development, and effective and coordinated implementation of policy instruments? • Do these mechanisms include other relevant levels of government? • Do these mechanisms have a legal foundation to ensure their effectiveness and continuity? *Oversight* • Have elements of oversight (informal or formal) been integrated into this system to ensure a degree of checks and balances? *Control* • Is it clear which institution gets a final say, and when, in respect of interventions and regulatory measures? Has this allocation of responsibilities and decision-making been determined for different types of scenarios, ranging from ordinary circumstances to emergency conditions involving crisis management?	
V. Review	
Has the framework for government intervention and financial regulation been reviewed and evaluated on a regular basis? • Is the framework for intervention and regulation keeping pace with the evolution of the domestic and international financial system? • Is the policy framework reviewed periodically (e.g., every 5 to 8 years) to: i) Reassess previously identified problems and needs? ii) Identify new problems and needs? iii) Adjust policy objectives and their weightings? iv) Assess the effectiveness and efficiency of policy instruments and the institutional setup for implementation? v) Assess the processes for regulation-making and implementation? • Have mechanisms for international peer review been fully exploited? Has use been made of the IMF and World Bank Financial Sector Assessment Program and of a related Report on the Observance of Standards and Codes?	