

**POLICY FRAMEWORK FOR EFFECTIVE AND
EFFICIENT FINANCIAL REGULATION:**

Draft OECD High-Level Checklist

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

Committee on Financial Markets

Insurance and Private Pensions Committee

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POLICY FRAMEWORK FOR EFFECTIVE AND EFFICIENT FINANCIAL REGULATION:

DRAFT OECD High-Level 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 between 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 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) Markets?
 - iv) Systems?
 - v) Supporting infrastructures?
 - vi) Participants?

<p>vii) Interlinkages (e.g., macroeconomic, international)?</p> <ul style="list-style-type: none"> • 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 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? 	
C. Analysis	
<p><i>Are financial system developments and macroeconomic trends being properly surveyed? Are emerging risks consistently being identified and monitored closely?</i></p> <ul style="list-style-type: none"> • 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? 	
<p><i>Has market failure analysis been conducted to better understand the operations and efficiency of the financial system and define the key problems?</i></p> <ul style="list-style-type: none"> • In this respect: <ul style="list-style-type: none"> 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? 	
<p><i>Is there collaborative information-sharing, discussion, and analysis among relevant governmental authorities, both domestically and internationally?</i></p>	
II. Policy objectives	
A. Identification of problem and case for intervention	
<p><i>Have the problems and needs been clearly identified?</i></p>	

<ul style="list-style-type: none"> • 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? 	
<p><i>Has the case for intervention been established?</i></p> <ul style="list-style-type: none"> • 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 alternatives to government intervention have been assessed? • Overall, do the benefits of intervention exceed the costs? 	
<p><i>B. Policy objectives</i></p>	
<p><i>Have clear policy objectives been elaborated for the financial system?</i></p> <ul style="list-style-type: none"> • 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? • 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? 	
<p><i>C. Accountability</i></p>	
<p><i>Have policy objectives been clearly and publicly articulated?</i></p> <ul style="list-style-type: none"> • 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? 	
<p><i>Have accountability mechanisms been established?</i></p> <ul style="list-style-type: none"> • Do relevant governmental authorities publish annual reports in which they outline their objectives, review progress in meeting them, and identify risks? • Have internal governance mechanisms been established within government to 	

<p>ensure ongoing review of, and reporting by, relevant authorities?</p> <ul style="list-style-type: none"> • Have indicators been developed to help monitor progress toward the achievement of policy objectives? • Are remedies available to address any serious failure by governmental authorities to meet mandated objectives? 	
III. Policy instruments	
<i>A. Identification of financial sector policy instruments</i>	
<p><i>Have the range and features of policy instruments available to address the problem been identified and are they well understood?</i></p> <ul style="list-style-type: none"> • Policy instruments include: <ul style="list-style-type: none"> 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? <ul style="list-style-type: none"> i) Have <i>ex ante</i> 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? 	
<i>B. Matching policy instruments to policy objectives</i>	
<p><i>Are the selected combinations of policy instruments appropriate for the identified problems or needs in the financial system? Are they the least-cost approach?</i></p> <ul style="list-style-type: none"> • 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 	

<p>negative incentive effects that may affect, and cut across, policy instruments? Have possible international policy spillovers also been considered?</p> <ul style="list-style-type: none"> • 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? 	
<i>C. Specification of financial regulation</i>	
<p><i>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?</i></p> <ul style="list-style-type: none"> • 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? <ul style="list-style-type: none"> 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? <ul style="list-style-type: none"> 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? • Has consideration been given to harnessing market forces and related incentives to promote compliance? If so, has market failure analysis been conducted to assess the appropriate scope for the use of market forces? • Has the international dimension been taken into account? <ul style="list-style-type: none"> i) Is regulation-making more appropriately done at the international level? If so, is there coordination and consistency in the adoption of these standards? ii) Have the risks of unnecessary regulatory duplication, burden, conflict, or barriers for globally active financial firms been minimised? 	

D. Principles of financial regulation

Have the following principles been met in financial regulation?

- A **pre-cautionary** approach is warranted in financial regulation; policymakers should not wait for a crisis to unfold in order to implement reforms.
- Financial regulation is **proportional** to the scope and magnitude of the market failure to be addressed and any identified broader economic or social needs.
- Financial regulation is, in combination with other instruments of government intervention, **efficient** in that it is able to achieve objectives at the lowest cost.
- Financial regulation is consistent with market practices and **risk-based**, and thus focussed on those institutions, systems, and products that have the greatest potential of compromising the achievement of policy objectives.
- Regulations are sufficiently **parsimonious, flexible, and simple** to accommodate changes in the financial system while still achieving objectives.
- Financial regulation is **consistent, comprehensive, and competitively neutral** across products, institutions, sectors, and markets.
- Financial regulation seeks methods to **align the incentives** of participants with policy objectives.
- Financial regulation is **timely and responsive** in its reaction to the rapid pace and complexity of innovation in the financial sector.
- Regulations are drafted in a **clear, accessible, and understandable** manner.
- There are **effective compliance and enforcement** mechanisms in place.
- There are, where appropriate, adequate **redress mechanisms** and related safeguards against arbitrary rules and unequal treatment.
- Regulators are **accountable** for their actions and inactions and justify their policies in a clear, consistent and, if possible, comprehensive fashion.

E. Process for financial regulation

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?
- Have plans have been established to review, in the future, the impact of the regulation?

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

<p>objectives and instruments to these institutions? Synergies include:</p> <ul style="list-style-type: none"> i) Policy objectives ii) Policy instruments iii) Information and expertise iv) Administration <ul style="list-style-type: none"> • 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? Has adequate government oversight over the SROs clearly been established? • Has consideration been given to the establishment of enhanced international coordination and institutional mechanisms, as appropriate? 	
<p><i>B. Systems for coordination, oversight, and control</i></p>	
<p><i>Is there an effective system of coordination, oversight, and control in the institutional setup?</i></p> <p><i>Coordination</i></p> <ul style="list-style-type: none"> • 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? <p><i>Oversight</i></p> <ul style="list-style-type: none"> • Have elements of oversight (informal or formal) been integrated into this system to ensure a degree of checks and balances? <p><i>Control</i></p> <ul style="list-style-type: none"> • 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- 	

<p>making been determined for different types of scenarios, ranging from ordinary circumstances to emergency conditions involving crisis management?</p>	
<p>V. Review</p>	
<p><i>Has the framework for government intervention and financial regulation been reviewed and evaluated on a regular basis?</i></p> <ul style="list-style-type: none"> • 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: <ul style="list-style-type: none"> 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? 	