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# Session II: Issues in Governance of Central Banks

**Discussion by  
governor Boris Vujčić**

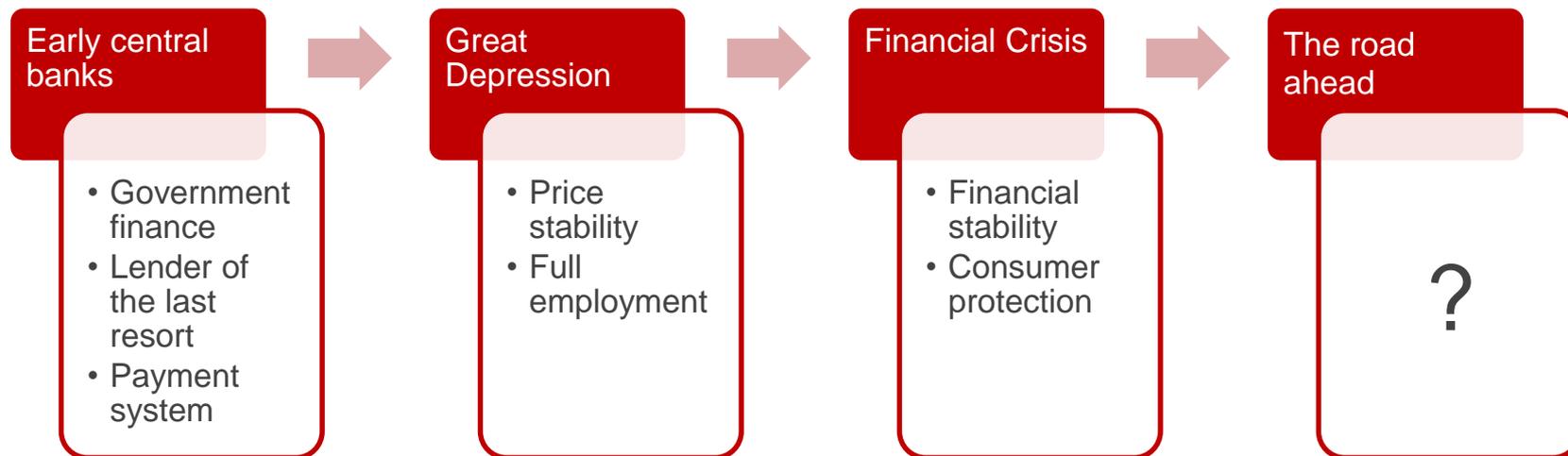
THE 41st MEETING OF THE CENTRAL BANKS GOVERNORS' CLUB OF THE CENTRAL ASIA, BLACK SEA REGION AND BALKAN COUNTRIES  
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# 1. Evolution of central bank tasks – a bumpy road ahead ?

## Evolution of central bank tasks



# Mandate creep – central banks are being asked to do more

Adding financial stability increased appetite for expanding central banks' mandates

ESCB's secondary objective - supporting the economic objectives of the EU (TEU 3(3)):

*'The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.'*

## Problem with too many tasks

Conflict between different tasks and objectives

- Monetary policy vs financial stability
- Consumer protection vs financial stability vs market

Failure to achieve one task weakens the overall central bank position (independence, mon. policy)

- *Bank failures and replacement of central bankers*

Preferred approach – smaller number of tasks

- But is it politically feasible?

# Framework for assessing new tasks for central banks

Assesment framework	Financial stability	Consumer protection
1. Is it in the mandate?	Included in legal texts	(Mostly) not included in the legal texts
2. Is there a political (popular) support for adding the new task?	Reaction to the the Great Financial Crisis International cooperation (FSB,ESRB)	Anti-banking sentiment on rise since the GFC, CHF loans in some countries due to carry trades
3. Feasibility: can it be done?	Good examples that it can be done	Limited resources and soft powers
4. Should CB be accountable for it?	Difficult to assess	Evolving legal framework
5. Conflict with other tasks?	Possible conflict with other tasks	
6. What instruments are needed?	Development of microprudential and macroprudential instruments; increased resources (SSM)	Weak regulatory instruments and soft powers: financial literacy, provision of information, intermediation, nudging; Stronger instruments needed (borrower based measures)

# The Road Ahead (?): Potential new challenges/tasks

## **Green central banking (within green/sustainable finance)**

General acceptance that the climate change has an impact on central banks – both impact on macroeconomic stability and financial stability – consensus is building that it is within our mandate!

International cooperation - The Network for Greening the Financial System (NGFS)

But can we do it? Instruments not yet defined; monetary vs supervisory vs other policies?

## **Government financing**

Need for public investments in new infrastructure/technology/employment (modern monetary theory)

Price stability?

## **Ethical finance / inequality**

Critique of unconventional monetary policy (QA and negative interest rates) - inflated asset prices and contributed to the increasing inequality; not yet on the table

# Emerging market economies often face new challenges before the advanced economies

## **Transformation of financial systems (transition to market economy)**

Central banks played a major role in guiding the financial sector transition from planned to market economy

## **Financial stability**

Large capital flows to EM's raised both monetary and financial stability challenges

*CNB developed a number of macroprudential measures prior to the Financial Crisis*

## **Green central banking**

EME's central banks more ahead than AE's central banks

*Broader mandate, more exposed to the effects of climate change*

# Changed narrative regarding the financial sector regulation

## Before the Financial Crisis

Strong support for unified regulation, often outside central banks

1. Matches industrial structure (universal banking)
2. Economy of scope and regulatory arbitrage
3. Economy of scale and use of scarce supervisory resources
4. Independence of supervisor
5. Eases international cooperation

## Post Financial Crisis

Banks poorly regulated and supervised before the Crisis +  
Re-emergence of the CB's LOLR role

⇒ Need for better regulation and supervision, often by CBs

Creation of the Banking Union in the EU

- SSM created within the ECB
- Increased CBs' involvement in bank supervision and resolution

The European system of financial supervision (ESFS)

- The European Systemic Risk Board (ESRB)
- 3 supervisory authorities: EBA, ESMA and EIOPA (by industry)

⇒ no longer strong support for unified regulation outside CBs

Country specific solutions relevant

# Evolution of the financial regulation in Croatia

<b>Transition to market 1990s</b>	Bank supervision bestowed upon the central bank with separate regulators for other financial services: insurance, pensions and financial market
<b>1998</b>	Failure of a number of new small and mid-sized banks – pressure on the central bank
<b>2005</b>	The Croatian Financial Services Supervisory Agency (Hanfa) established integrating three existing supervisors: securities, pension funds and insurance
	Before the Crisis some discussion on creation of a single financial regulator outside CNB
	After the Crisis no discussion of those changes – established twin-agency model (+)
<b>2013</b>	The EU membership strengthened the position of regulators; <ul style="list-style-type: none"> <li>• Established Financial Stability Council; CNB got clear mandate for financial stability</li> </ul>
<b>2018</b>	Bankruptcy of largest company in Hr – banks not affected due to the CNB's prudential measures

# Current structure of financial regulation in Croatia

## Twin agency plus model - 2 financial supervisors + MoF:

1. Central bank (banking and payments)
2. Agency for supervision of financial services
3. Ministry of finances – other (audit firms, FINA, laws)

## Weaknesses:

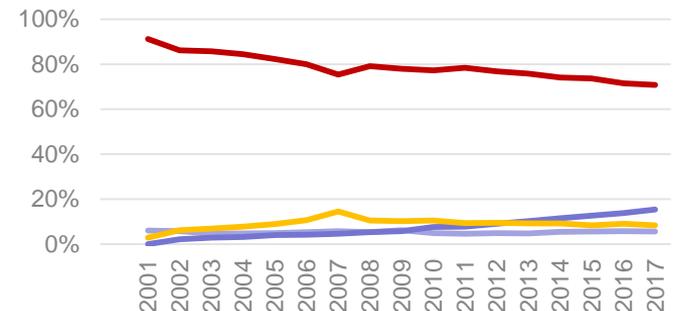
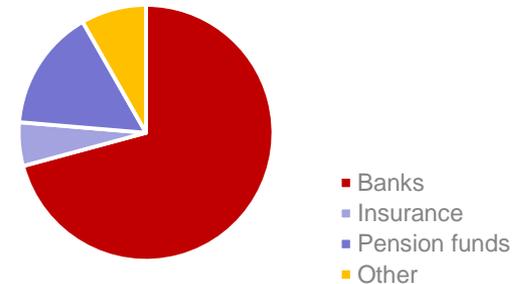
- Capacity building
- Universal banking, cross ownership and regulatory arbitrage

## Advantages:

- Clear division of responsibilities
- Fits well with the EU/EMU structure:
  - bank supervision key for the close cooperation with the SSM/ECB as a step for the euro adoption

Future changes likely in line with further EU reforms

Structure of Croatian financial industry 2017





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Thank you for your attention !