

# **Cooperation and Coordination between the Financial Authorities: A Review of the Experiences of the United Kingdom, Norway, Sweden, and Korea**

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As far as institutional collaboration between the financial authorities in pursuit of financial stability is concerned, Korea has remained seriously backward. Although the issue is widely regarded as important, scholars and policymakers in Korea have tended to stop short of putting microscopic lenses to it. Presented is a comparative review of the experiences of the United Kingdom, Norway, and Sweden, all of which, like Korea, have adopted the regime of integrated financial supervision. The paper finds that in Norway and in Sweden institutional collaboration is more about substance and practice over form and procedure, whereas the opposite is true in the United Kingdom. Policy implications to Korea as well as a couple of tentative interpretations of these findings are discussed.

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## I. Introduction

Cooperation and coordination between the financial authorities — including the government, central bank, and the financial supervisor<sup>1</sup> — have been regarded as important for financial stability (Borio *et al.* 1999; Financial Stability Forum Working Group on Deposit Insurance 2001).

As it happens, the current global financial crisis has driven home to the whole world the fact that cooperation and coordination between the financial authorities really matter. Although the complete set of lessons from the crisis is yet to be explored fully, already evident is a general lesson: *Systemic risk is important* (FSA 2009; The de Larosi re Group 2009; The U.S. Department of Treasury 2009). This lesson lays renewed stress on the macro-prudential supervision being appropriately grafted onto the micro-prudential supervision.<sup>2</sup> Such a process of operationalizing the macro- and micro-prudentials requires, in essence, strengthened cooperation and coordination between the financial authorities, and in particular, between the central bank (macro-prudential regulator) and the financial supervisor (micro-prudential regulator).

Some countries have already begun to explore reform measures. In the United Kingdom, for example, “ensuring effective coordinated action by the Authorities [*i.e.*, the HM Treasury (HMT), Bank of England (BoE), and Financial Services Authority (FSA)]” is listed as one of the five reform objectives (BoE · HMT · FSA 2008, p.9). This renewed emphasis on interagency coordination is perhaps due, in part, to their recent experience of malfunctioning tripartite relationship<sup>3</sup> that led

<sup>1</sup> In the paper, ‘financial supervisor’ and ‘financial regulator’ are used interchangeably.

<sup>2</sup> The micro-prudential supervision takes market conditions as exogenously given, and is concerned with limiting the probability of failure of an individual institution within a certain magnitude. Financial supervisors have traditionally used this approach when they supervise a financial institution. In contrast, the macro-prudential supervision takes market conditions as endogenously determined, and is concerned with limiting the probability of the systemic collapse within a certain magnitude. Central bankers have traditionally used this approach when they pursue their dual mandates of price stability and financial stability. For details, see Crockett (2000) and Borio (2003).

<sup>3</sup> In that incident of coordinative malfunctioning, “[t]he FSA proved a careless and supine supervisor and the Bank of England tardy and flat-footed” (*The Economist* 2008, p. 65).

finally up to the run on the Northern Rock in September 2007. Such an emphasis is not confined to the United Kingdom. The U.S. Department of Treasury (2009, p. 3) has recently announced its plan to create “[a] new Financial Services Oversight Council of financial regulators ... to improve interagency cooperation.” In its recent report (FSF 2008), the Financial Stability Forum (FSF) calls for “[a]uthorities’ exchange of information and cooperation in the development of good practices ... at national and international levels” (p. 41), together with a variety of other initiatives.

As far as institutional collaboration between the financial authorities in pursuit of financial stability is concerned, Korea has remained seriously backward. Although interagency cooperation and coordination for financial stability are stipulated by relevant laws, the financial authorities there have often proved to be very poor at institutional collaboration in practice. Clumsy and inconsistent policy reactions reportedly (*e.g.*, *JoongAng Ilbo* 2008) shown by those Korean financial authorities when the domestic economy was threatened by the onset of the all-out global financial crisis during Fall 2008, were the mirror image of such backwardness.

Nevertheless, most macroeconomic scholars and financial policymakers in Korea have tended to stop short of putting microscopic lenses to it.<sup>4</sup> This paper attempts to discuss how other countries have been doing in this area and to suggest, given such institutional backwardness in Korea, some ways out of a virtual absence of collaboration there over the past decade. Our focus is on domestic dimensions of institutional cooperation and coordination in normal times (*i.e.*, crisis prevention) rather than a crisis situation (*i.e.*, crisis management and crisis resolution).<sup>5</sup> We have selected three countries, in addition to Korea, for our review. They are the United Kingdom, Norway and Sweden, all of which have adopted, like Korea, the regime of integrated financial supervision for more than a decade. We will look closely at the

<sup>4</sup> In fact, most journal articles (*e.g.*, Kwon 2004) on the Korean financial reform have tended to focus on issues of *policy substance*, but not on those of *regulatory governance* that may crucially relate in some way or other to the former.

<sup>5</sup> This is because the institutional arrangements and activities for crisis prevention in normal times may differ across the countries, whereas the protocols for handling the crisis situation tend to be rather stylized, normally with the government taking the lead in restructuring and infusing public funds into the economy as necessary.

Memoranda of Understanding (MoUs) of these countries for a comparative analysis. To the best of our knowledge, such a systematic review of the MoUs has *never* been done.<sup>6,7</sup> Accordingly, this paper contributes to the literature by providing a timely and important starting point to understand how to organize efforts to cooperate and coordinate between the domestic financial authorities.

The plan of the paper is as follows. Section II discusses why coordination and cooperation between the financial authorities responsible for the financial system are so much valued for financial stability. We also explain that reviewing a tripartite (or bipartite) MoU can be a valid approach to understanding how the financial authorities cooperate and coordinate in practice. In Section III, we look into how the financial authorities have so far cooperated and coordinated in each of the three European countries. We also discuss how the arrangements of cooperation and coordination between those authorities compare and contrast across those countries. Section IV presents a review of the Korean MoU and discusses how the financial authorities in Korea have done the job of cooperation and coordination in the narrower area of financial examination. In Section V, we suggest some tentative interpretations of our findings regarding the supervisory experiences of the United Kingdom, Norway, Sweden, and Korea. Policy implications to Korea are also discussed.

## **II. Interagency Cooperation and Coordination: A Primer**

Having both microeconomic and macroeconomic aspects, financial stability is “multi-faceted” in nature (Healey 2001). This is why one observes in practice that in most countries the national financial safety net is *not* typically composed of a single element, *but* of such multiple elements as lender of last resort, financial regulation and supervision (including crisis management), and deposit insurance functions. In the literature, these three elements are regarded as being complementary to each other and thus as the standard set for a national financial safety net, which is also consistent to the practice across the world

<sup>6</sup>The only exception that we know of is Hawkesby (2000) in which a brief comparison is made between the Australian MoUs and the United Kingdom's in the appendix.

<sup>7</sup>The MoUs that are discussed in the paper are available from the author upon request.

(e.g., Hayward 2000; Kim *et al.* 2002; IMF 2005b; Chung and Kim 2007). Abstracting from the fundamental issue of market *vs.* government that relates to each element in the standard set, we take this mainstream view as given.

Typically, the financial supervisor(s), the central bank, the deposit insurance agency, and the government (usually the ministry of treasury or finance), participate in the net, with each being given a unique function. Their respective functions are closely interrelated by nature. For example, deposit insurance tends to create moral hazard on the part of the insured banks, which in turn requires prudential supervision. As these differentiated functions involve correspondingly differentiated mandates, powers, and policy instruments, institutional points of view may differ across the financial safety net participants. In some cases, there may appear interest conflicts between them. Hence arises the need for cooperation mainly in the form of information-sharing and for coordination through checks and balances between these agencies with a view to achieving systemic stability finally (Kim *et al.* 2002; Kim 2004a, 2004b; Chung and Kim 2007). Note that interagency cooperation and coordination form part of regulatory governance to the extent that it helps with each authority contributing to financial stability.<sup>8</sup>

Before we proceed to take up reviewing the MoUs of the sample countries in the next section, we will briefly discuss the relevance of our particular approach of using the MoUs to understand how the financial authorities cooperate and coordinate in practice. Recently, it has become a kind of fashion for a country to adopt the regime of integrated financial supervision in which the single financial supervisor is responsible for all types of institutions and markets. That fashion often involves separating bank supervision from a central bank and having it transferred to a newly set-up integrated financial supervisor. As a result, there arise some concerns that “a significant overlap between the role of the central bank and [that of] the ... [integrated financial] supervisor ... [should] negate some or all of the reduced costs of performing supervision expected from merging [multiple] supervisors” and that the “synergies between bank supervision and central banking

<sup>8</sup> Interagency coordination and cooperation tend to be costly in terms of *compliance* cost and *institutional* cost of regulation. From the perspective of the society as a whole, however, coordination and cooperation will greatly reduce the *structural* cost of regulation, so that they will certainly result in a fall in the total cost of regulation. For further discussion on the cost of regulation, see Goodhart *et al.* (1998).

... should be lost" (Hawkesby 2000, p. 121). It is the MoUs that are a safeguard device, installed in response to such concerns, "to formalize the relationships" between the financial authorities concerned (Hawkesby 2000, p. 121). It is thus no surprise to find that such an MoU tends to be utilized particularly among those countries in which an integrated financial supervisor operates outside the central bank. The MoUs can be a proper type of document on which to describe detailed procedures and specific arrangements that formal legislation usually finds it hard to deal with. It is certainly written based on laws and regulations.

The paper takes a *de jure* approach in the sense that it basically focuses on how the financial authorities are required to act by an MoU. It is acknowledged that this leaves room for limitations, since what is written on paper may not necessarily coincide with what is done in practice.<sup>9</sup> However, the paper is certainly more than simply a *de jure* approach. Proper interpretation of what the MoUs say requires some significant knowledge of the regulatory governance issues. In addition, the on-site interviews done with relevant staff in each country in question can also be a good source of information with which to judge what is done in practice.<sup>10</sup> Our *de jure* approach, appropriately combined with relevant knowledge in the literature and the information from the on-site interviews, is thus enabled to get at the realities. This way, it is judged that the MoUs have been in effect respected and observed in Norway, Sweden, and the United Kingdom, whereas they

<sup>9</sup>In this respect, an anonymous referee has been critical of the *de jure* approach which this paper takes. However, the approach taken by the paper can be still reasonably justifiable on several important counts. First, such country-specific raw data as are compiled as part of the IMF-World Bank FSAP (Financial Sector Assessment Program) are not generally available to outside researchers, although they can be a good source of information for a *de facto* approach. Thus, a *de jure* approach may be considered as a second best, given a lack of available *de facto* information. Second, the fact that a *de jure* approach may not be free from limitations does not, by itself, deny the usefulness that the approach may prove to bear. Third, a *de jure* approach is often adopted in the literature on regulatory governance (e.g., Masciandaro *et al.* 2008; Quintyn *et al.* 2007). Fourth and as discussed in the text, our *de jure* approach, being appropriately combined with relevant knowledge and information, may bring us closer to the realities.

<sup>10</sup>The interviews were done in October 2007 with a set of inquiries sent *via* email in advance to each authority in Norway and in Sweden, respectively. For the United Kingdom, an interview was done similarly with FSA staff in August 2002. For Korea, we have frequently relied on a variety of informed sources from BOK and from FSS.

have not in Korea.<sup>11</sup>

### **III. The Experiences of the United Kingdom, Norway and Sweden: The Review of General MoUs**

This section reviews the experiences of the United Kingdom, Norway, and Sweden. These countries have two things in common. First, each country has adopted the regime of integrated financial supervision, like Korea, in which a single financial supervisor is located outside of the central bank that takes no direct responsibility for financial supervision. Second, each country has an experience of operating the regime for over a decade.<sup>12</sup>

#### *A. The United Kingdom's MoU*

The tripartite MoU, initially set out in October 1997 by HMT, BoE, and FSA, and later revised in March 2006, had been highly regarded internationally as the paragon framework of cooperation between those authorities involved in the financial system stability, until the run fell on the Northern Rock in September 2007. We will review each version of the MoU and discuss the recent reform initiatives.

##### *a) The 1997 Version*

The 1997 version of the United Kingdom's tripartite MoU made it clear that its purpose was to set up "a framework for cooperation in the field of financial stability." It was the first document in the world that delineated how the three parties should cooperate and coordinate for financial stability. The MoU consisted of three main components as follows (HMT · BoE · FSA 1997):

- Institutional division of responsibilities between the three parties;

<sup>11</sup> The reasons for such judgment will be discussed in appropriate places in the paper.

<sup>12</sup> According to Masciandaro (2006), 12 out of 91 countries in the world pass the first test in fact. They are: Belgium, Denmark, Estonia, Hungary, Iceland, Korea, Latvia, Malta, Nicaragua, Norway, Sweden, and the United Kingdom. If we further apply our second test, 5 out of 12 countries pass. They are: Norway (1986), Denmark (1988), Sweden (1991), United Kingdom (1997), and Korea (1997). The number in the parenthesis indicates the year when the regime was set up in the country in question. Denmark is omitted, for lack of relevant information, from the review.

- Information flows between them; and
- Protocol for crisis management.

First, concerning the division of responsibilities, the MoU stated that it was driven by such guiding principles as accountability, transparency, avoidance of duplication, and information exchange. The first two principles mainly represent regulatory governance, while the last two, cost efficiency. BoE was stipulated to “be responsible for the overall stability of the financial system as a whole,” whereas FSA to “be responsible for the authorization and prudential supervision of ... [all financial institutions and for] the supervision of financial markets and of clearing and settlement systems,” and HMT to be “responsible for the overall institutional structure of regulation and the legislation which governs it” (HMT · BoE · FSA 1997).

Second, information flows were governed by such operational principles as avoidance of “separate collection of the same data” and minimization of “regulatory burdens on financial firms” (HMT · BoE · FSA 1997). In this vein, the MoU articulated the division of labor between FSA and BoE and the need for information gathering and sharing arrangements between the two. The MoU also stipulated a variety of mechanisms for information exchange between FSA and BoE including cross-board membership, secondment, mutual cooperation in relations with the international regulatory community, and prior consultation in policy changes, *etc.* In addition, the Standing Committee, consisting of the representatives from the three authorities, was supposed to serve as the main channel and forum for policy coordination and information sharing.

Third, the Standing Committee was given, in addition to its role in normal times as mentioned above, a prominent role of managing the situation should the financial crisis ever occur. The MoU provided the protocol that the Committee was supposed to follow in such an extraordinary situation. BoE and FSA were expected to inform each other, for consultation, of a possible crisis situation coming. Either institution would act as the lead institution “in its area of responsibility ... [,] manag[ing] ... the situation and co-ordinat[ing] ... the authorities’ response” (HMT · BoE · FSA 1997). Both BoE and FSA were charged with keeping the Treasury informed, which should enable the Chancellor of the Exchequer to exercise the power of veto over support action proposed by both.



## b) The 2006 Version

The initial MoU had been operative for about nine years before it was revised in March 2006. The new version reflected the evolution of financial markets and institutions in such a way that enhances the “response framework for managing both financial crises and major operational disruption[s]” (Bank of England 2006). Keeping intact the overall framework and context of the initial version, the new one has incorporated three important changes.

First, the new version introduced a distinction between a financial crisis and an operational one, highlighting how to manage either type of crises. Regarding managing a financial crisis, it placed an added emphasis on the respective roles of BoE and FSA to “encourage negotiations between third parties” from the systemic stability point of view (HMT · BoE · FSA 2006). Regarding managing an operational crisis, HMT was given a role of keeping ministers well-informed of developments for their timely decision making and for “coherence between measures taken in the financial sector and the operation of public sector continuity arrangements” (HMT · BoE · FSA 2006). The unique roles of BoE as the market functioning overseer and emergency liquidity provider, and of FSA as the prudential supervisor of financial institutions, were expounded, respectively.

Second, further dwelled upon were the workings of the Tripartite Standing Committee in a crisis situation as distinct from normal times. It was newly made clear that the chairmanship rested with HMT and that the committee was to meet at deputies level in normal times and at principals level in a crisis.

Third, BoE was mandated simply to “contribute ... to the maintenance of the stability of the financial system as a whole” in the revision (HMT · BoE · FSA 2006). This was in contrast with its previous task of “be[ing] responsible for the overall stability of the financial system as a whole” (HMT · BoE · FSA 1997). Accordingly, “the BoE mandate of financial stability was apparently shrunk” (*The Economist* 2008, p. 65), and the change turned out to be an unfortunate setback only later.

## c) Recent Banking Reform

The current global financial crisis has witnessed the strong case for banking reform in the United Kingdom.<sup>13</sup> Specifically in our context,

<sup>13</sup>The UK Banking Reform has focused on the following key objectives of

there has arisen the need for strengthening the BoE role in financial stability and for enhancing the coordination between the three financial authorities. As part of the current banking reform efforts, BoE was given a statutory objective of “contribut[ing] to protecting and enhancing the stability of the financial systems of the United Kingdom” through the Banking Act 2009.

In line with this and other legislative changes incorporated in the Act,<sup>14</sup> the MoU is expected soon to go through a revision.

### *B. The Norwegian MoU<sup>15</sup>*

As for organizational structure of financial supervision and institutional collaboration therein, Norway has had some unique features of its own. First, Norway was the first country in the world that adopted the regime of integrated financial supervision in 1986, over a decade earlier than the United Kingdom. Second, Norway was the first as well to produce formal documentation of collaboration, over *broad* dimensions

which the fifth pertains directly to the theme of this paper. (BoE·HMT·FSA 2008):

- “stability and resilience of the financial system” (p. 10);
- “Reducing the likelihood of banks failing” (p. 11);
- “Reducing the impact of banks failing” (p. 13);
- “Effective compensation arrangements” (p. 15);
- “Strengthening the Bank of England and coordination between the Authorities” (p. 17).

<sup>14</sup> Related, the Banking Act stipulates that “[i]n pursuing the Financial Stability Objective the Bank shall aim to work with other relevant bodies (including the Treasury and the Financial Services Authority)” and that “[t]here shall be a sub-committee of the court of directors of the Bank (the “Financial Stability Committee”).” The Act also introduces a Special Resolution Regime which provides a new framework for division of labor between the financial authorities for the purpose of resolving insolvent financial institutions.

<sup>15</sup> In writing this subsection, I have benefited from a couple of discussions I had at Norges Bank and at Kredittilsynet. At Norges Bank, I met with Mr. Arild J. Lund (Director of Contingency Planning), Ms. Hilde Øiseth Nordlid (Chief Internal Audit), and Mr. Andreas Sand (Senior Legal Advisor) on October 8, 2007, while at Kredittilsynet I met with Ms. Nina Moss (International Coordinator), Mr. Anders Nikolay Kvam (Special Advisor), and Mr. Emil Steffensen (Head of Off-site Supervision and Analysis) on October 9, 2007. At each meeting, the Norwegian regulatory governance in general, and the relationships between Norges Bank, Kredittilsynet and the Government in particular, were extensively discussed. I am quite thankful to those people named above for providing me with quite useful information and answers in response to my inquiries.

of financial supervision, between Norges Bank and Kredittilsynet (Financial Supervisory Authority of Norway), when the two institutions wrote, in April 1993, the Ministry of Finance (MoF) a joint letter titled "Broader Collaboration between Norges Bank and Kredittilsynet." Third, the MoU has been regularly revised at a 4-year interval since 1993, and these revisions show how cooperation and coordination between the two institutions have evolved in Norway for the last 15 years, 1993-2008. In this subsection, we review each version of the Norwegian MoU.

#### a) The 1993 Version

Norges Bank and Kredittilsynet began to collaborate in supervisory matters with each other when the Norwegian economy was recovering itself from the banking crisis of 1988-1992. The banking crisis witnessed the need for a shift toward what can be now termed as "a proper balance between the micro- and macro-prudential dimensions of regulatory and supervisory arrangements" (Borio 2006). This practical need for a shift may have driven the two authorities toward supervisory collaboration.

Institutional collaboration was first put under an internal review<sup>16</sup> at the behest of the parliamentary Standing Committee on Finance and Economic Affairs, which recommended "steps to be taken to strengthen collaboration and coordination with Norges Bank with a view to ensuring Kredittilsynet access to the necessary socio-economic expertise" (Norges Bank and Kredittilsynet 1997). Considering that Kredittilsynet was then perhaps toiling at its task right in the middle of the banking crisis that had stricken at the Norwegian economy no more than several years after its establishment in 1986, the Committee's recommendation seemed to have been made with a view to having Kredittilsynet get into its stride through strengthened collaboration with Norges Bank. This resulted in the first version of the Norwegian MoU that "took stock of the collaboration between the two institutions and set out proposals for new collaborative routines" (Norges Bank and Kredittilsynet 1993).

Remarkably, the version stipulated, ahead of the times, that institutional collaboration aim at cost efficiency in the use of resources by

<sup>16</sup> A working group that consisted of staff from both institutions was set up for an internal review of the practices of institutional collaboration. The group prepared a report, and on the basis of it, the 1993 letter (*i.e.*, MoU) was written.

“avoid[ing] unnecessary duplicate work through appropriate responsibility-sharing” and “endeavor[ing] to utilize ... the specialized skills present in both institutions” (Norges Bank and Kredittilsynet 1993). Note that such aims have now become a standard part of the objectives for supervisory cooperation and coordination between the financial authorities in any country.

In the joint letter submitted to the Ministry of Finance (MoF), the two authorities encapsulated the following methods and arrangements for mutual collaboration that had already been practiced by function and by area (Norges Bank and Kredittilsynet 1993):

- “[R]egular quarterly meetings between the Financial Market Department at Norges Bank and the Financial and Insurance Supervision Department at Kredittilsynet”;
- “[C]ontact in individual cases”;
- “[W]orking groups ... from both institutions to address special matters such as equity capital requirements, interest rate risk, and liquidity risk”;
- Norges Bank’s representation on Kredittilsynet’s Board as Observer.

In addition, the following areas were listed in which institutional collaboration was to be further broadened, systematized and developed (Norges Bank and Kredittilsynet 1993):

- “Supervision and surveillance of financial markets and supervised units”;
- “Regulatory framework”;
- “Method development and studies”;
- “Competence training”;
- “Individual applications concerning establishments, structure, [and] increase of capital, *etc*”;
- Other areas such as “reporting, international activities, and press relations.”

Taken together, the letter provided a succinct description of the collaborative practices between the two institutions by function and by area, and a concrete vision for enhanced and extended collaboration that they agreed to go forward with.

## b) The 1997 Version

At the MoF's request of January 1997 for "a follow-up review of ... collaboration [between the two public agencies]," the 1993 version of the MoU was replaced by a new one in April 1997 (Norges Bank and Kredittilsynet 1997), which judged favorably of the overall climate for enhanced and extensive collaboration at the time.

Newly added to the initial cost efficiency aims was "safeguarding the two institutions' independent roles and functions" (Norges Bank and Kredittilsynet 1997). The new version elaborated on how institutional collaboration had been in practice systemized and broadened since the publication of the 1993 version. As for regular meetings, the review described how collaboration through 'top-level meetings' and 'liaison meetings' had been evolving. Top-level meetings were held quarterly to discuss various issues of common interest including financial stability. Liaison meetings were held in three different kinds — that is, held monthly, bimonthly, and quarterly.<sup>17</sup> Of these, quarterly liaison meetings deserve a special mention. They were held between Kredittilsynet's macroeconomic surveillance staff and Norges Bank's International Department, being made operative following Kredittilsynet's launch of the new program for macroeconomic surveillance in 1994 (to be discussed later).

Regarding exchange of information, some specific examples of collaborative activities through joint working groups, systematic exchanges of memos and reports, joint developments of methodology, or through written or oral communications about research results and methods, were illustrated.

The 1997 version also dealt with a couple of the then new areas of collaboration as follows (Norges Bank and Kredittilsynet 1997):

<sup>17</sup> First, monthly liaison meetings were held "between ... the Financial and Insurance Supervision Department at Kredittilsynet and Wing II, Financial Markets and Payment Systems, at Norges Bank" (Norges Bank and Kredittilsynet 1997). Second, the financial markets group consisting of participants from Norges Bank, Kredittilsynet, and Statistics Norway, was established to meet every two months and discuss reporting by the supervised institutions to the three institutions involved. In addition to the financial markets group which was permanent, there were joint working groups organized on a temporary basis to carry out collaborative projects. The institutional division of labor in this area was made between Norges Bank and Kredittilsynet since 1996 when the former took "technical responsibility for the database" whereas the latter "[was charged with] framing and updating regulations" (Norges Bank and Kredittilsynet 1997).

- “Macroeconomic analysis and monitoring financial stability”;
- “Payment and settlement systems.”

As for the first new area, bilateral collaboration had already been made systematically. Norges Bank, being “represented on the external reference group,” provided technical assistance for Kredittilsynet when the latter “drew up a programme for macroeconomic surveillance” in 1994 (Norges Bank and Kredittilsynet 1997). In fact, this new program was none other than what is now known as ‘macro-prudential’ supervision.<sup>18</sup> Notably, it was Norges Bank that assisted Kredittilsynet in becoming the world’s first financial supervisor with the macro-prudential perspective formally built-in. This was a historic event that tells the high-quality and open-minded communications between the two authorities. Upon installation of the program, collaboration in this area took the form of “exchange of reports, discussion on method development, briefings on ongoing and planned projects, *etc.*” (Norges Bank and Kredittilsynet 1997). As for payment and settlement systems, suggested was the need for “greater clarification of how responsibilities ... [were] to be shared between the two institutions” (Norges Bank and Kredittilsynet 1997). At the time of the 1997 review, specific legislative and practical preparations were under way in recognition of the need felt in this area.

#### c) The 2001 Version

This version was apparently drawn up voluntarily on the part of both authorities in March 2001. It consisted of two main parts, one for a synopsis of how the two institutions had cooperated meanwhile and the other for a description of the then recent, further collaborative developments.

As for regular meetings, there were two types of them as before — ‘meetings of the executive management’ (previously ‘top-level meetings’) and ‘liaison meetings.’ Collaboration in some areas merits discussion. First, payments systems were an area in which collaboration was newly intensified between the two institutions. As each institution was given a clearly differentiated mandate in this area by the Act relating to

<sup>18</sup> Although the term has now become a buzzword within the policy circles, it did not find its proper place in the literature at that time. Only later, perhaps around the turn of the 21<sup>st</sup> century, the term began to be found in the articles produced by some BIS economists such as A. Crockett and C. Borio.

Payment Systems, *etc.* of 1999,<sup>19</sup> the two authorities made further clarifications regarding their institutional division of labor and described how they were cooperative in interpreting the Act, sharing relevant information, and in developing expertise.

Second, there were a couple of areas which reasonably experienced a reduction in collaboration. As its resource allocation was, in an effort made to avoid unnecessary overlaps of work between the two, oriented more towards financial stability, Norges Bank began to be involved in reviewing only those applications from the largest, but not all, financial institutions regarding licenses and approvals before decisions were finally taken by Kredittilsynet. The other area of reduced collaboration was press relations, in which it proved that “[w]ith a very few exceptions, it [had] ... not been found expedient to develop joint information arrangements” (Norges Bank and Kredittilsynet 2001).

Third, newly highlighted was collaboration in a couple of new areas such as contingency and Nordic financial conglomerates. As for contingency, Kredittilsynet and Norges Bank collaborated on several programs bilaterally or multilaterally with other institutions. As for Nordic financial conglomerates, “a need for close cooperation and exchange of information between the supervisory authorities and the central banks of the countries involved” was raised and the cross-border supervisory initiatives and activities were described (Norges Bank and Kredittilsynet 2001).

Finally, collaboration remained active in all other areas. For example, in the area of methodology and reporting activities, Kredittilsynet’s “loan figures obtained from banks” were linked in autumn 1998 to Norges Bank’s SEBRA database and its methodology of risk classification (Norges Bank and Kredittilsynet 2001). This provided a nice example that showed how the specialized expertise of each institution was optimally combined and effectively utilized to launch a joint project. Also in the area of financial stability, the tripartite meetings (*i.e.*, the two authorities plus MoF) at the departmental level were held to discuss financial stability reports drawn up biannually by Norges Bank and by Kredittilsynet.<sup>20</sup> Other forms of collaboration such as

<sup>19</sup> “Kredittilsynet [was] ... responsible for the customer-oriented parts of the payment systems (systems for payment services), while Norges Bank [was] ... responsible for authorising and supervising interbank payment systems” (Norges Bank and Kredittilsynet 2001).

<sup>20</sup> Norges Bank and Kredittilsynet each began to produce a biannual report on financial stability in 1995. The author learned from the interviews with staff

discussion of results, methodology, and of current and future projects, continued to be made in this area through both upper- and lower-level regular meetings.

#### d) The 2005 Version

Now we are ready to review the current version of the Norwegian MoU. At the MoF's request of October 2005, the two authorities drew up the joint report in December 2005. The report was prepared in a follow-up response to the IMF-World Bank FSAP work (IMF 2005a).<sup>21</sup> Note that the report was written in an explicit awareness of the then recent EU agreement, which was about the division of labor, with financial stability and crisis management in mind, between the supervisors, the central banks, and the finance ministries in the European Union.<sup>22</sup> Encouraged by the EU agreement and the FSAP work, the two institutions, in their cover letter of the report, requested MoF to endorse the EU agreement, and recommended that MoF "should ... consider establishing the necessary national structures for a closer tripartite cooperation between Norges Bank, Kredittilsynet and the Ministry of Finance" (Norges Bank and Kredittilsynet 2005a). They went on to propose that the regular tripartite meetings be held at least biannually with the MoF chairmanship. It seems quite extraordinary that it was the two institutions, but not MoF, that initiated such a move voluntarily. Their proposal touched off the tripartite cooperation that finally began in 2006. MoF, Kredittilsynet, and Norges Bank have since met as a forum twice a year to discuss financial stability outlook and crisis management and to evaluate contingency arrangements and

of Norges Bank and of Kredittilsynet that every financial stability report issued by each authority had been subject to tripartite discussions all along since 1995. Norges Bank had the report published in its *Economic Bulletin* since 1997 until it began to publish the separate report in 2000. Kredittilsynet had the report produced biannually and circulated only for internal discussion within Kredittilsynet, Norges Bank, and MoF until it began to publish the report annually in 2003.

<sup>21</sup> IMF (2005a, p. 6) recommended that Norway "[f]ormalize ... regular high-level meetings between FSAN[Kredittilsynet], MoF, and NB[Norges Bank] on financial stability issues, and consider establishing a formal tripartite financial stability MoU on respective roles and responsibilities."

<sup>22</sup> It refers to "The Memorandum of Understanding on Co-operation between the EU Banking Supervisors, Central Banks, and Finance Ministries of the European Union in Financial Crisis Situations," which was concluded in May 2005. This MoU was recently updated in June 2008. See ECOFIN Council (2008).



related measures (Norges Bank 2007).

Norges Bank and Kredittilsynet provided in the report a clear, detailed description of the tripartite roles and responsibilities concerning financial stability, in addition to an updated stocktaking of their collaborative works. Regarding the division-of-labor part, MoF is defined to have “the overall responsibility for ensuring that Norway’s financial industry functions smoothly” and to play the role “in coordinating the activities of the three institutions in the event of a financial crisis” (Norges Bank and Kredittilsynet 2005b). The aims and responsibilities of Kredittilsynet and of Norges Bank are defined in parallel under each of the following three identical main areas of work (Norges Bank and Kredittilsynet 2005b):

- “Preventing financial instability”;
- “Monitoring risks to financial stability”; and
- “Crisis management.”

This way of defining each institution’s aims and responsibilities under the same set of main areas of work is unique. It reflects the idea that the two institutions’ tasks are not only differentiated to some extent but also closely interrelated with overlaps in their responsibilities relating to financial stability. It also reflects the fact that they pursue to make explicit efforts to elevate their division of labor practically to a considerably sophisticated level. This unique feature of the Norwegian MoU is certainly expected to contribute to highly efficient and effective collaboration between both institutions.

Regarding an updated part of institutional cooperation, it illustrates the general methods of institutional cooperation as follows (Norges Bank and Kredittilsynet 2005b):

- “[E]xchange of information on an ongoing basis”;
- “[E]fficient division of tasks”; and
- “[J]oint development of expertise.”

The report then elaborates, area by area, on how the two institutions had cooperated. The aspects of cooperation described for each area remain roughly the same as before. Note that the 2005 version provides a rich set of examples of a specific event or project which embodies efforts of both authorities to collaborate with each other. Note also that institutional cooperation has been intensified particularly in the area of

'crisis management and contingency planning.'<sup>23</sup>

### *C. The Swedish MoU<sup>24</sup>*

In Sweden, institutional collaboration between Finansinspektionen (Swedish Financial Supervisory Authority) and Sveriges Riksbank was first formalized by the MoU concluded in February 2003. It was later revised in June 2005. We examine each version below.

#### *a) The 2003 Version*

Relevant laws, international agreements and the supervisory practice were the sources that had helped define the Swedish framework of supervisory cooperation and coordination before they were first put together into the 2003 version of the Swedish MoU. The aims of the Swedish MoU were to clarify the division of responsibilities and to promote cooperation between Finansinspektionen and Sveriges Riksbank.

As for division of responsibilities, Sveriges Riksbank was charged with "a general oversight of the financial system as a whole with the main focus on the largest banks and clearing organizations ... [and with] emergency liquidity assistance [i]n the event of serious threats to the payment system," while Finansinspektionen with "regularly monitoring and analyzing developments in the financial sector ... to identify risks at an early stage and detect any signs of financial instability, ... conducting supervision of individual financial companies, marketplaces and clearing organizations, ... [issuing or revoking]

<sup>23</sup> A variety of contingency exercises had been done either by Norges Bank and Kredittilsynet or by the two institutions plus others. Kredittilsynet was supposed to follow the procedures for alerting Norges Bank, as stipulated in the Bank Guarantee Act, upon knowledge of a financial institution's liquidity or solvency being threatened. The roles to be played by Norges Bank in such a situation were specified in 2004.

<sup>24</sup> In writing this subsection, I have benefited from a couple of discussions I had at Sveriges Riksbank and at Finansinspektionen. At Sveriges Riksbank, I met with Ms. Malin Alpen (Head of Financial Infrastructure Division), Mr. Johan Molin (Adviser to Financial Stability Department) and Mr. Pär Torstensson (Policy and Analysis Division) on October 11, 2007, while at Finansinspektionen I met with Mr. Eric Wolrath (Senior Investigator) on October 11, 2007. At each meeting, the Swedish regulatory governance in general, and the relationships between Sveriges Riksbank, Finansinspektionen and the Government in particular, were extensively discussed. I am quite thankful to those people named above for providing me with quite useful information and answers in response to my inquiries.

[l]icenses and [taking] sanctions ... and [i]ssuing regulations ...” (Finansinspektionen and the Sveriges Riksbank 2003).

According to the MoU, the explicit recognition of the inevitable overlap in the tasks of the two authorities led them to cooperate with each other in gathering and exchanging information and in reducing their duplication of work as well as the reporting cost of the supervised institutions. The MoU stipulated that the two authorities have routines for information exchange and for information sharing in case of each authority making an international contact. Further, it encouraged the two authorities to utilize their joint competence by way of sharing expertise and experience in their analysis of the issues in financial stability and efficiency.

As for regular contacts between the two, the MoU stated that there were four consultation groups, in which one group consisted of Finansinspektionen’s Director General and Sveriges Riksbank’s Executive Board member responsible for financial stability. This group was supposed to meet at least biannually, discussing financial stability issues and making an annual review of division of responsibilities and cooperation between them. Note that the group was responsible for updating the MoU. Each of the remaining three groups consisted of directors from both authorities responsible for payment systems, banking stability, and financial statistics, respectively. These regular contacts made at both top and staff levels were believed to promote a culture of mutual cooperation and to help maximize the supervisory efficiency.

Finally, some general protocols for crisis management were explicitly covered in the MoU. The two authorities were supposed to hold joint crisis exercises in normal times, and to inform the other of a possible threat if detected. As the lender of last resort, Sveriges Riksbank was expected to seek, before making its final decision, assistance from Finansinspektionen in assessing a request, if any, for an emergency liquidity assistance.

#### b) The 2005 Version

The 2003 version of the MoU was replaced by the June 2005 version, which was in fact a national parallel to the EU agreement of May 2005.<sup>25</sup> The new MoU took the form of the tripartite agreement,

<sup>25</sup> This refers to “Memorandum of Understanding on Cooperation between the Banking Supervisors, Central Banks and Finance Ministries of the European

unlike the old bipartite one. Incorporating the aims stated earlier, the current version restated its purpose: “[T]o establish guidelines for cooperation and information sharing between the three parties in the areas of financial stability and crisis management.”

It comprises two main sections. The first section focuses only on the tripartite cooperation, specifying the roles and functions of each of the three parties — the Ministry of Finance (MoF), Finansinspektionen, and Sveriges Riksbank — both in times of a crisis situation and in normal times. It deals with the issues in financial stability and crisis management. Note that MoF is assigned the responsibility for the financial sector legislation and, in a crisis situation, “the power to initiate and implement ... measures” over and above those available to either Finansinspektionen or Sveriges Riksbank (The Swedish Ministry of Finance, Sveriges Riksbank and Finansinspektionen 2005). On the other hand, the second section focuses only on the bipartite cooperation. Given that there are some unavoidable overlaps in their activities, it elaborates further on the institutional division of responsibilities and on the procedures for cooperation between Finansinspektionen and Sveriges Riksbank.

Tripartite information sharing is emphasized for efficient crisis management. When a party detects a possible threat to financial stability, it should provide others with the relevant information, its assessment of it, and its suggested measures. In normal times, each party should promote its crisis preparedness, for instance, through collaborating with other parties to develop a common position in international work.

In particular, the tripartite consultation group deserves a special mention. It has been newly created to replace the bipartite one and to enable and ensure consultation and information sharing among the three parties. The group is also to evaluate the tripartite cooperation. As a device for tripartite communication, it was to meet quarterly and whenever any member saw it necessary. “[C]alling meetings, [setting up] agendas and [taking care of] minutes” are to be done on a rotating basis between the three parties (The Swedish Ministry of Finance, Sveriges Riksbank and Finansinspektionen 2005), although Sveriges Riksbank is widely recognized as the group leader in normal times.<sup>26</sup>

Union in Financial Crisis Situations.”

<sup>26</sup> This is based on a remark made by staff from Sveriges Riksbank during the author's interview.

The tripartite consultation group is to be supported by a non-executive drafting group.

The relationships between Finansinspektionen and Sveriges Riksbank and all the arrangements for their collaboration have remained the same as described in the 2003 version. In addition, each authority is now supposed to consult its forthcoming major policy change with the other, which implies that the transparency principle works well in practice between them.<sup>27</sup>

#### *D. General MoUs of the United Kingdom, Norway and Sweden: An Assessment*

We have reviewed the various versions of the general MoUs<sup>28</sup> agreed between the financial authorities in the United Kingdom, Norway, and Sweden, respectively. Now we are ready to make some general points regarding how the MoUs and thus the features of institutional collaboration are compared and contrasted across these countries.

First, each MoU serves the same purpose of providing a framework for institutional cooperation. Such a framework has been designed mainly from the perspective of cost efficiency and regulatory governance.<sup>29</sup>

Second, all the current versions of the MoUs discuss the roles of each of the three financial authorities including the central bank, financial supervisor, and the government (HMT/MoF). This is the case even with the Norwegian MoU which is bipartite in form. The roles of each financial authority, as stated in the MoUs, suggest that they are rather stylized to some extent. In a word, the central bank is to provide a macro-prudential perspective, whereas the supervisory authority a micro-prudential one. MoF takes up the leading role in the manage-

<sup>27</sup> The Scandinavian countries have been noted for their political culture that cherishes transparency and openness. See Taylor and Fleming (1999) and Section V of this paper.

<sup>28</sup> The paper distinguishes between a general MoU and a special one, depending on whether its scope is broader or narrower. That is, a *general* MoU is when it covers various areas of institutional collaboration, whereas a *special* MoU is when it covers a specific area.

<sup>29</sup> As for cost efficiency, all the MoUs reviewed make it explicit from the outset that collection of duplicate data and information must be avoided and that regulatory burdens and disruptions on financial firms must be minimized. As for governance, such features as accountability, transparency, integrity, and independence are embedded, explicitly or implicitly, into all the MoUs.

ment and resolution of the crisis, while its presence is not very visible in normal times when the central bank and the supervisory authority are supposed to collaborate with each other in pursuit of crisis prevention. In detail, there are certain differences, visible or nuanced, in their respective roles across the countries, however.

Third, as far as institutional collaboration is concerned, more weight has been given to the formal workings of the tripartite group in the United Kingdom, whereas a variety of less formal interactions between the central bank and the financial supervisor have been more intensely exploited both in Norway and in Sweden. By less formal interactions, the activities through joint projects, joint working groups, and regular meetings at directors level, *etc.*, are meant.<sup>30</sup> Apart from the tripartite standing committee, the United Kingdom operates no joint committees or meetings between the central bank and the financial supervisor. Note further that the cross-board membership and the secondment of staff have been used between BoE and FSA in the United Kingdom whereas no such formal arrangements have been instituted either in Norway or in Sweden.

Related to this last point, Norway deserves a special attention. Our probe into each of the four versions of the Norwegian MoU in a chronological order reveals that institutional collaboration has continued to be adjusted, enriched, and enhanced for the last 15 years, in terms of its modes and contents, in response to the ever-accelerating changes in financial institutions, products, markets, and financial infrastructure.<sup>31</sup> These developments have been clearly incorporated in each version of the Norwegian MoU, as some areas of cooperation and coordination emerged while others submerged over time. That is, each version

<sup>30</sup> Both Norwegian and Swedish MoUs attach greater importance to the effectiveness of institutional collaboration, *i.e.*, to the synergies from the optimal use of specialist expertise that their respective central banks and supervisory authorities have. The practical and substantial aspect of institutional collaboration as reflected in the Norwegian and the Swedish MoUs is perhaps related, in one way or other, to the fact that the tradition of Scandinavian civil law has been prevailing in the region for long. See the last section of the paper for details.

<sup>31</sup> As a result, Norges Bank and Kredittilsynet have been increasingly collaborating since the mid-1990s in such areas as 'macroeconomic analysis and monitoring financial stability' and 'payment and settlement systems.' Collaboration for 'crisis management and contingency planning' has been active as well since the turn of the current century. On the other hand, both 'matters concerning individual financial institutions' and 'external information (press relations)' were among those areas in which collaboration proved to matter only to some limited extent.

of the Norwegian MoU provides an *update* that shows how institutional collaboration has further developed in practice since the preceding version was drawn up. This feature implies that in Norway the practice has been incorporated into the MoUs, rather than the reverse, and that collaboration has been more about substance and practice than about form and procedure.<sup>32</sup> An important factor that has underlain this Norwegian substance-over-form approach is that the two authorities, being with “no statutory restriction on the exchange of information [with each other]” (Norges Bank and Kredittilsynet 2005b),<sup>33</sup> have been free to “share *any* piece of information upon request” (*italics added*).

Although the Swedish MoU appeared as late as 2003, there has since been a substantial catch-up in both formalizing and substantiating institutional collaboration as discussed earlier in the paper. Sweden also seems to have put substance and practice before form and procedure to a considerable extent. For example, Sveriges Riksbank and Finansinspektionen were involved in performing the stress-testing exercises a few years ago. They often hold ad-hoc seminars for both. It is notable that, even before the Swedish MoU came into existence, IMF (2002, p. 72) mentioned on the basis of its FSAP work for Sweden as follows: “There is a very high level of transparency in financial supervisory policies and practices in Sweden.” This is a piece of circumstantial evidence in support of the idea that the practice has been incorporated into the MoUs in Sweden as well.<sup>34</sup>

<sup>32</sup> These points relate to why the paper judges that the Norwegian MoU has been respected and observed in practice. It is the practice that has led to the revision of the MoU. The author’s interviews done with the relevant authorities also confirm these important points. In addition, the author learned from the interviews that the then recent examples of joint development of expertise between Kredittilsynet and Norges Bank included developing relevant legal structure for crisis management, holding joint competence-enhancing seminars, operating a common training course for newly hired people at both authorities, and working on how Norway should adjust the current financial system to the EU Directives, *etc.* There were joint annual research projects as well, concerning, say, operational risks in payment and settlement systems from a consumer protection perspective.

<sup>33</sup> Mr. Arild J. Lund of Norges Bank has emphasized this feature in his recent correspondence with the author in July 2009. In particular, the Financial Supervision Act (Section 7) stipulates that “[t]he duty of confidentiality ... does not apply to disclosure of information to Norges Bank.” The Norges Bank Act (Section 12) stipulates to the same effect as well.

<sup>34</sup> We will also note later that Sweden shares with Norway both the same Scandinavian legal tradition and the same political culture of openness and

The case of the United Kingdom is different, however. There, institutional collaboration as embodied in a couple of versions of the tripartite MoU, has been the form-over-substance approach as discussed earlier. In a sense, the UK tripartite MoU provides a *commitment* rather than an update. This aspect seems to relate to the fact that the UK's financial authorities have a much shorter history of formally practicing financial supervision.<sup>35</sup> The UK's short history of formal financial supervision and its form-over-substance approach notwithstanding, both the relevant literature and the interviews done with the FSA staff strongly suggest that the MoUs have been respected and observed in practice.<sup>36</sup>

Regulatory governance aspects regarding each version of the Norwegian MoU deserve a special attention as well. Since the Norwegian Parliament helped both Norges Bank and Kredittilsynet initiate an internal review of institutional collaboration for the first time in 1993, three additional reviews have so far been done at regular intervals of four years, with each review formally carried out at the request of Mo F.<sup>37</sup> In this respect, it is both the Norwegian Parliament and the

transparency. Accordingly, we may well judge that the Swedish MoU has been respected and observed in practice.

<sup>35</sup> In the United Kingdom, banking supervision was formalized no more than three decades ago, whereas financial supervision only twelve years ago after all. BoE, having supervised the banks informally for long, was formally mandated to take care of banking supervision only with the 1979 revision of the Banking Act. A variety of self-regulatory organizations (SROs), together with some government agencies, had been informally supervising the insurance companies, the securities firms, and the markets until the new formal regime of integrated financial supervision was adopted in 1997. See Kim (2002) for details. On the other hand, the Scandinavian governments had begun to organize and administer financial supervision formally since early in the 20<sup>th</sup> century (Ecklund and Knutsen 2001).

<sup>36</sup> According to the IMF assessment, for example, that was made on the basis of its FSAP work for the United Kingdom (IMF 2003a, p.12), "The authorities' [i.e., both the FSA and the BoE's] strong commitment to policy transparency is reflected in the assessments of a very high degree of observance of the IMF *Code of Good Practices on Transparency in Monetary and Financial Policies*." Note that the IMF *Code* deals with, in addition to other issues, "clarity of roles, responsibilities, and objectives of financial agencies responsible for financial policies," which includes "formal arrangements for cooperation and exchange of information among various supervisory agencies" and other sub-items (IMF 2005b, p. 247).

<sup>37</sup> The only exception was when the review was done in 2001 apparently voluntarily with no formal request coming from the MoF. Note however that each and every version of the Norwegian MoU has taken the form of a letter



Ministry of Finance that has had decisive influence on Norges Bank and Kredittilsynet's excellent tradition of institutional cooperation and coordination. Notably, neither the Norwegian Parliament nor MoF has ever imposed any specific guidelines *ex-ante* on how Norges Bank and Kredittilsynet are supposed to collaborate with each other, or has ever publicly commented *ex-post* on versions of the MoUs between the two. Instead, both authorities have been allowed to cultivate collaborative efforts on their own in pursuit of "inter-agency accountability" (Hayward 2000) in the broad field of financial stability. This unique political and administrative atmosphere is another factor that has contributed to the Norwegian substance-over-form approach to interagency collaboration.

In Sweden, Finansinspektionen had its governance structure restructured with the agreement of the Swedish MoU between Sveriges Riksbank and Finansinspektionen in February 2003.<sup>38</sup> Later, the division of labor and the relations thereof between the three parties including MoF were further clarified and formalized in the form of the tripartite MoU in June 2005. Sweden has thus quickly caught up with Norway by mid-2005 in terms of some important aspects in regulatory governance.

In the United Kingdom, the 2006 revision of the tripartite MoU has brought in some changes in governance regarding the tripartite relationship. They include, for example, the HMT chairmanship of the Standing Committee both in normal times and in a crisis situation, in addition to the weakened role of BoE in the oversight of financial system. These changes represent more presence of HMT and less presence of BoE both in normal times and in a crisis.

Considering collaborative practices between the financial authorities, together with their regulatory governance aspects, we assess that Norway ranks first, Sweden second, and the United Kingdom last, within our sample. Note that the validity of this assessment certainly passes the test of the current global financial crisis. We recall that there has been no news coming from either Norway or Sweden regarding any concerns about institutional collaboration during the crisis. Our review suggests that the recent malfunctioning of the

sent to the Ministry of Finance.

<sup>38</sup> As a result of the restructuring of Finansinspektionen, the Board of Directors, which had been an advisory body, became the decision-making authority within the institution. The Director General was no longer a member of the Board, let alone the Chair. Mr. Johan Altersten of Finansinspektionen informed the author of these and other changes by mail in June 2003.

tripartite committee may have been attributed to those factors including: (i) the weakened role of BoE in financial stability since the revision of the tripartite MoU in 2006 and (ii) the form-over-substance approach to institutional collaboration.<sup>39</sup> It is our view that the UK's tripartite MoU should go through another revision in line with the strengthening of the BoE involvement in the oversight of systemic stability and that the UK's financial authorities should make efforts to put substance and practice before form and procedure when they cooperate and coordinate.

#### **IV. The Experiences of Korea: The Review of the Special MoU**

Korea is a laggard in institutional collaboration between the financial authorities. This fact has frequently been the focus of the media (*e.g.*, *JoongAng Ilbo* 2008; *Edaily* 2009; *Maeil Business Newspaper* 2009, *etc.*), and is well documented in the literature (*e.g.*, Kim 2004a, 2004b, 2006; Kim and Yoon 2005; Kim and Lee 2006, *etc.*). In this section, we exemplify such institutional backwardness by way of reviewing the *special* MoU that covers cooperation and coordination between the Financial Supervisory Service (FSS) and the Bank of Korea (BOK) in a joint financial examination.<sup>40</sup>

<sup>39</sup> Many critics argue that the faulty administrative design of the tripartite committee has been responsible for its malfunctioning during the crisis. Goodhart (2008) does not agree with such an argument. Goodhart (2008, p. 16) says that “[l]ack of foresight, lack of information, and human error can overwhelm any administrative design, however excellent.” This view is in line with what our review suggests regarding the possible factors that have underlain the malfunctioning of the tripartite relationships in the UK.

<sup>40</sup> In addition, there are two more MoUs in which BOK has been involved. One is the *special* MoU agreed in February 2006 between FSS and BOK on a joint financial examination of FX transactions (FSS 2008). Since the way this MoU is stipulated is basically similar to the one we discuss in the paper, we do not review it. The other is the *special* MoU agreed in January 2004, between FSS, BOK and the Korea Deposit Insurance Corporation (KDIC), on the sharing of financial information (FSS 2008). According to the MoU, the Council for Financial Information Sharing, which consists of representatives at executives level from the three parties mentioned above, is supposed to meet twice a year to determine the set of principles on, and the scope and ways of, sharing the financial information. The working group is also supposed to exist to support the Council, and meets quarterly, plus whenever the need arises. Little is known in public about the activities of the Council and of the working group.

A joint examination has been considered as one of those channels for information sharing. There have however been pros and cons regarding this channel (Kim 2002). Some argue that conducting a joint examination should be costly both for the supervisor involved and the supervised. They thus say that the supervisory authority has only to provide the information it has obtained from conducting a financial examination with other financial authorities including the central bank. Others maintain that the benefits of conducting a joint examination should far outweigh the costs. According to them, the information indirectly available may not be always satisfactory to the eyes of the central bankers in terms of, say, substance, timeliness, and focus.<sup>41</sup>

Collaboration in financial examinations has been made for years between FSS and BOK. BOK is legally empowered, provided a certain condition is met,<sup>42</sup> to request FSS to examine a financial institution and, if necessary, to require FSS to have BOK staff participate in a joint examination. BOK also has the power to request FSS to submit the findings from the examination which has been done by its request and, if necessary, to request FSS to take due corrective measures (BOK 2008).<sup>43</sup>

Equipped with this set of powers, BOK has been increasingly involved, over the last decade, in the examination process of which FSS is in charge. In October 2002, the MoU on the joint examination was first agreed between FSS and BOK.<sup>44</sup> The MoU has later been revised twice, in July 2004 and in July 2007, for improvement of some technicalities (FSS 2008).

The current version of the MoU begins with clarifying its objectives

except that institutional tension has often been highlighted in the process of information sharing.

<sup>41</sup> The Federal Reserve has long been on the camp that argues for its direct involvement in examining its member state banks and banking organizations. For details, see Peek *et al.* (1999).

<sup>42</sup> The relevant condition is “when the Monetary Policy Committee deems it [i.e., the request] necessary for the implementation of its monetary and credit policies ....” See Article 88 of the Bank of Korea Act (Bank of Korea 2008).

<sup>43</sup> KDIC has been similarly empowered as well. We do not discuss the KDIC-FSS relationship in the paper.

<sup>44</sup> FSS (2008) states that both the duplication of examination efforts and unnecessary burdens on the financial institutions have led to the conclusion of the MoU. Note however that BOK simply denies this view. According to BOK (2009, p. 55), “the MoU was concluded to help remove the tension that had been created by non-cooperative attitude on the part of FSS.”

and the distinct focuses of each authority in the conduct of the joint examination as follows (FSS 2008):

- Objectives: “Both FSS and BOK make efforts to conduct joint examinations adequately by taking financial and economic circumstances and regulatory burden on financial institutions into account, and to minimize the workload of financial institutions by information sharing.”
- Focuses: “In process of a joint examination, FSS focuses on establishing a sound credit system and fair practices in financial transactions and on protecting financial consumers, whereas BOK focuses on conducting monetary policy in accordance with the purpose and scope of the joint examination as requested to FSS.”

The current MoU elaborates on the general procedures for, and the methods of, planning, coordinating, and conducting a joint examination, and on post-examination actions that BOK may follow up if necessary, thereby specifying how FSS and BOK are expected to interact. A joint examination working group is stipulated to work out practical matters ensuing from BOK-requested joint examinations.

The acute problem with this Korean special MoU is that word is often not as good as deed. For example, a joint examination working group has been seldom set up in practice to begin with.<sup>45</sup> This implies that there has been almost an absence of pre-examination collaboration and that there has been no post-examination mechanism to resolve differences in views, if any, between FSS and BOK. Worse than all, deep-rooted institutional distrust has dominated the joint examination process for years.<sup>46</sup>

<sup>45</sup> The author has learned this from the informed sources of BOK in May 2009.

<sup>46</sup> The parliamentary process concerning the revision of the Bank of Korea Act during March-April 2009 provided yet another occasion to witness this very distrust. For example, BOK Governor was then reported to bring to light, before the Committee of Strategy and Finance in the National Assembly, several instances in which BOK had not been able to get access to the pertinent information due to discords with FSS over joint examinations (*Edaily* 2009). This divulgence of the acute circumstance has led to the recent efforts within policy circles to enhance institutional cooperation and coordination over joint examinations and information sharing (*Maeil Business Newspaper* 2009). Note that the IMF's earlier remark made on the basis of its FSAP work for Korea is still as effective as it was six years from now (IMF 2003b, p.30): “[T]here is a

## V. Concluding Remarks

We have reviewed the general MoUs agreed between the financial authorities in the United Kingdom, Norway and Sweden, respectively, and the special MoU on financial examinations agreed between FSS and BOK in Korea. In terms of collaborative practices between the financial authorities and regulatory governance aspects of cooperation and coordination, these four countries can be graded in order of precedence as follows: Norway, Sweden, United Kingdom, and Korea. Tentative interpretations of this finding in terms of the legal tradition and the political culture, are provided as follows.

First, consider the legal tradition. The MoU can be thought of as a means to expounding contractual obligations and well-defined procedures and enforcing them on the financial authorities involved. In this sense, the operational effectiveness of the MoU may be closely related, in some way or other, to the general quality of law enforcement in the country in question. Viewed this way, our finding from the review may be understood in a broader context of the country-specific legal tradition. Our assessment of the country-specific performance in terms of institutional collaboration is consistent to what La Porta *et al.* (1998) have found.<sup>47</sup> According to them, the Scandinavian countries (Scandinavian family) and the German-civil law countries (German family) rank first in terms of the quality of law enforcement. In particular, the quality of law enforcement has turned out the highest in Norway in their sample of 49 countries. Sweden ranks slightly lower than Norway. It is interesting that the United Kingdom ranks high in the English common-law countries (English family), whereas South Korea ranks bottom in the German family.<sup>48</sup>

Second, consider the political culture. Openness and transparency,

need for the BOK and the FSS to strengthen their information sharing arrangements."

<sup>47</sup> La Porta *et al.* (1998) have measured the general quality of law enforcement using such a set of proxies as "efficiency of the judicial system, rule of law, corruption, risk of expropriation ..., and likelihood of contract repudiation by the government." They have classified 49 countries in their sample into four families by the legal origin: English, French, German, and Scandinavian families.

<sup>48</sup> The scores given each country in the quality of law enforcement were reported as follows (full scores=50): Norway (49.59); Sweden (48.98); United Kingdom (47.01); and Korea (33.55). See La Porta *et al.* (1998) for further details.

having been traditionally embedded in the political culture of the Scandinavian countries (Taylor and Fleming 1999),<sup>49</sup> are among the fundamental virtues that the financial authorities are supposed to have in common for smoother collaboration. In their political culture, “decision-makers recognize the legitimacy of public scrutiny of their decisions” (Taylor and Fleming 1999, p. 29). It is this open and transparent social climate that must have contributed much to enhancing institutional cooperation and coordination in both Norway and Sweden. In stark contrast, the public sector in Korea is known to be notoriously closed-minded and opaque (Kim 2008). In particular, the credit-card fiasco in 2003-4 turned out to be caused by a supervisory failure which resulted in turn from a virtual lack of supervisory cooperation and coordination on the part of the financial authorities (Kim 2004a). In short, the political culture in a country and the social climate engendered by it, are responsible at least in part for how well the financial authorities therein work to collaborate with each other.

Now we turn to institutional collaboration through an on-site joint examination. In fact, that the financial authorities *do* cooperate through it in some countries while they *do not* in others. For example, such a channel of cooperation is explicitly mentioned in the current MoUs of Australia, Canada, Germany, Korea, and the United States, whereas no such mention is found in those of Denmark, Iceland, Ireland, Norway, Sweden, and the United Kingdom (Financial System Stability Department of the Bank of Korea 2007). In the former group of countries, there exist some differences in the way each country makes use of the channel. For example, the United States and Germany are on the more active side than others in the group. In the latter group, there is certainly a complete absence of it in practice, except for Norway.<sup>50</sup> This overall picture may be interpreted as implying that there are widely-varying degrees, depending on an individual country, of

<sup>49</sup> In this respect, Sweden is most outstanding. Sweden is the first country all over the world that put forward ‘open government’ in law (Freedom of the Press Act of 1766). This was exactly 200 years ahead of the Freedom of Information Act of 1966 in the United States. In Sweden and in Norway, all the information concerning government administration has long been open to the public unless forbidden by law (Secrecy Act) for some particular reasons (Kim 2006).

<sup>50</sup> Mr. Arild J. Lund of Norges Bank has recently informed the author *via* email that an on-site joint inspection is done, if ever, “on a totally voluntary basis” at the request of Norges Bank, which “take[s] part in [on-site] inspections ... only for the purpose of expertise buildup ... [and] not in order to get first hand information about the situation in a specific institution.”

perceived substitutability between the on-site joint examination and other arrangements of institutional collaboration.

Finally, some words for Korea. So far as institutional collaboration is concerned, the Korean financial authorities certainly have a long way to go. It is quite unusual for a country having operated the regime of integrated financial supervision to do without the *general* MoU for more than a decade. The consequence is that many of those methods and arrangements usually used in foreign countries with integrated financial supervision remain uninstalled and unexploited at all in Korea. In particular, the complete lack of any formal, legally-based tripartite machinery or of any unified set of protocols for crisis management bears mute witness to how serious the problems have been. What is worse, bureaucracy seems to dominate the process of a joint examination, often generating mutual distrust and tension between FSS and BOK. This may be partly because the joint examination channel, which has been virtually the only effective form of institutional collaboration, tends to get easily overburdened.

Given these dire circumstances in Korea, interagency collaboration is not an issue to tinker with. Instead, it is an issue that requires a serious and fundamental treatment. Although the legal tradition and the political culture are largely predetermined, there must be a way out. With financial stability in mind, Kim (2008, 2009) has recently put forward the strong case for the public sector governance reform in Korea. Institutional collaboration between the financial authorities is, by nature, a holistic matter after all. The issue could be successfully dealt with only in such a broader context.

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