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Gamekeepers turned poachers: Why cooling-off periods are necessary for ECB supervision[1]

1. Introduction

The European Commission has published proposals that would transfer responsibility for the supervision of Eurozone banks to the European Central Bank (ECB). The published proposals do not contain any measures to manage the potential conflicts of interest associated with such a role.

On 29 November 2012, the European Parliament Economic and Monetary Affairs (ECON) Committee overwhelmingly voted for a mandatory “cooling off” period for members of the Banking Supervisory Board, the body which will oversee the ECB’s supervisory functions. Members will be prevented from taking paid employment in the private institutions for which the ECB has responsibility for a period of two years after leaving office.

MEPs also voted to establish a permanent Ethics Committee that will assess if the prospective employment opportunities of ECB staff engaged in supervision create conflicts of interest. The results of these assessments will be publicly disclosed.

Transparency International welcomes these measures and outlines below the rationale for strong rules that address the risks to integrity posed by the “revolving door”.

2. Financial supervision and conflicts of interest

The poor performance of banking supervisors during the recent financial crisis is widely recognised. This failure of supervision in some of the most sophisticated financial centres has been attributed to the “cosy relationship” between supervisor and supervised, which some believe has resulted in a form of regulatory capture.

One of the mechanisms by which this capture can occur is the “revolving door” i.e. the movement of individuals between positions in supervisory agencies and jobs in the financial services sector, in either direction. Other risks associated with this phenomenon include abuse of office, undue influence and profiteering. At a minimum, the revolving door can give rise to conflicts of interest, which need to be carefully managed. Specifically, supervisory officials may be called upon to make critical decisions which will impact on the financial health or reputation of firms that are likely future employers. Alternatively, once an official is employed by a private

[1] This is an updated version of a position paper originally published in December 2012

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financial institution, there may be the temptation to use privileged knowledge or access in the interests of the firm.

A 2009 study[2] gives some indication of the scale of the revolving door phenomenon. Between 2000 and 2008 there were 36 different members of the Board of the UK Financial Services Authority: 26 of them had high-level connections with the banking or finance industry either before or after their term of office.

3. The importance of "cooling-off" periods in managing conflicts of interest

The kinds of conflict of interest that result from the "revolving door" phenomenon are not unique to financial supervision. Such conflicts – real and perceived – have long been recognised as a feature of public service and there is an evolving body of good practice to manage them.

Placing restrictions on post-employment opportunities for public officials is one method of resolving these conflicts. The restrictions range from prohibiting contact with former colleagues to a ban on taking up employment in specific firms or sectors for a period after leaving office. The latter is known as a "cooling off" period and is increasingly common in OECD countries. For example, public servants in **Japan** are forbidden from assuming a position with a commercial enterprise that has close connections with a state agency for up to two years. In **Canada**, there is a one year "cooling off" period where public servants, or their subordinates, have previously had significant dealings with an entity.

4. "Cooling-off" periods in Central Banks and Financial Supervisors

The general principle that supervisors should have in place rules to handle conflicts of interest is not controversial. The *"Core Principles for Effective Banking Supervision"* published by the Bank for International Settlements (BIS) states that "the supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest…with sanctions in place if these are not followed".

Consequently, there are already a number of central banks which have in place restrictions on post-office employment of senor officials. Many of these central banks also have supervisory duties. A 2008 study[3] found that just under half of the central banks surveyed operate some kind of restriction with respect to their governors (see Annex 1). A 2009 International Monetary Fund (IMF) working paper with a focus on regulatory and supervisory agencies also found that approximately half had some form of "cooling off" period[4].

Specific examples of "cooling off" periods operated by EU central banks with supervisory powers include:

- **National Bank of Belgium:** The governor, the vice-governor and other members of the board of directors may not hold office in a credit institution for two years after the end of their mandate.

- **Czech National Bank:** There is a six month "cooling off" period for the governor and board of directors.

[2] *Revolving Doors, Accountability and Transparency - Emerging Regulatory Concerns and Policy Solutions in the Financial Crisis,* Millar and Dinan, OECD, May 2009
[3] *Governing the Governors: A Clinical Study of Central Banks*, Frizell, Roszbach, Spagnolo, Sveriges Riksbank Working Paper Series No 221, 2008.
[4] *Governing Practices at Financial Regulatory and Supervisory Agencies,* Seelig and Navoa, IMF Working Paper (WP/09/135)

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- **Bank of France:** The governor and deputy governors may not engage in professional occupations for three years after leaving office, unless authorised by the monetary policy council. A one year restriction applies to all members of the monetary policy council.

- **Bank of Spain:** Once their term of office ends, the governor and deputy governor may not engage in any professional activity linked to credit institutions or securities markets.

- **Swedish Riksbank:** The governor and deputy governor cannot take up positions with banks under their supervision for one year after leaving the executive board, unless permitted by the governing board.

5. What is the current situation at the ECB?

The ECB's Code of Conduct for the governing council has a very weak provision in place regarding post-mandate employment, requiring members to avoid conflicts of interest in their first year after leaving office. Members are required to inform the council in writing of prospective employment and to seek their advice, which is issued in writing after an internal assessment. Such advice is not binding however. How effective the provision is in addressing the "revolving door" can be gauged by the governing council's decision in 2006 to permit former executive board member Otmar Issing to take up a paid role as advisor to Goldman Sachs less than 6 months after leaving his post with the ECB[5].

There is currently no "cooling off" period in place for ECB staff members.

In conclusion, mandatory "cooling off" periods are both a necessary and common feature of handling conflicts of interest at senior levels of bank supervision. Their application to the ECB would improve its effectiveness and ensure public trust in its new mandate.

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[5] http://www.ft.com/intl/cms/s/0/42036b94-5cb3-11db-9e7e-0000779e2340.html#axzz2E6SQ9qsa

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Annex 1: "Cooling off periods" for central bank governors around the world

In a 2008 study ("Governing the Governors: A Clinical Study of Central Banks" *op.cit.*), researchers found that approximately half of the 47 banks surveyed had some form of restriction on the subsequent employment of central bank governors.

Figure 18. Employment Restrictions after End of Mandate
The bars illustrate to what extent cooling-off periods are imposed on governors after leaving their post at a central bank [Source: Frisell Roszbach Spagnolo, N=47].