

# Legal Governance, Risk Management, and Compliance in Central Banks

Atilla Arda, November 2014  
International Monetary Fund

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**6<sup>th</sup> International  
Seminar on Central  
Banking: Challenges,  
Trends and Best  
Practices**

**Organized by  
Türkiye Cumhuriyet  
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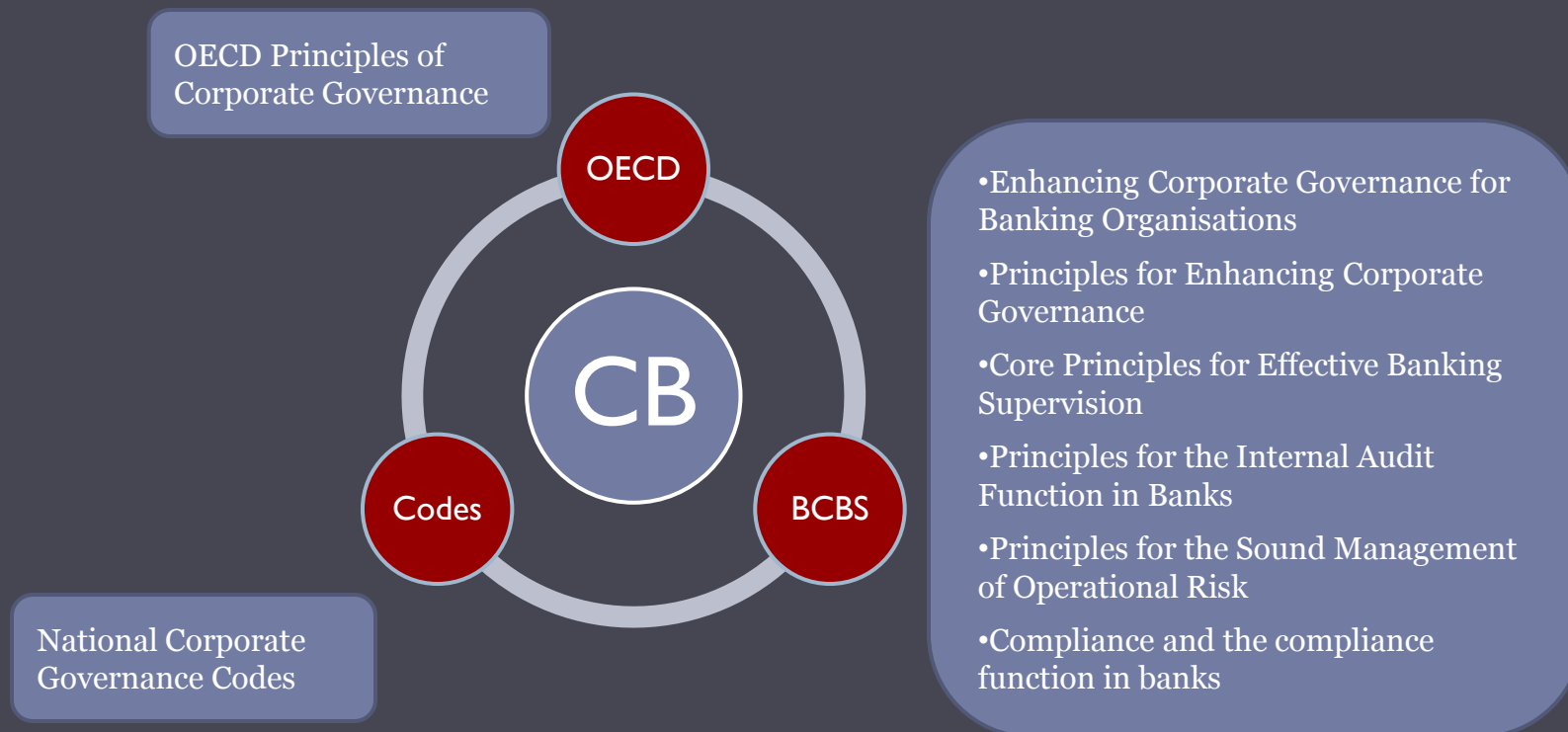
# Key Messages

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- ▶ legal governance, risk management, and compliance is relevant for all central banks, but its scope and organization may differ
- ▶ one size (LGRC framework) does not fit all (central banks)

# Why Should We Talk About LGRC?

- ▶ *no comprehensive standard*
- ▶ *many sources of inspiration*
- ▶ **an aspiration to lead by example**



# Legal Basis for Good Governance

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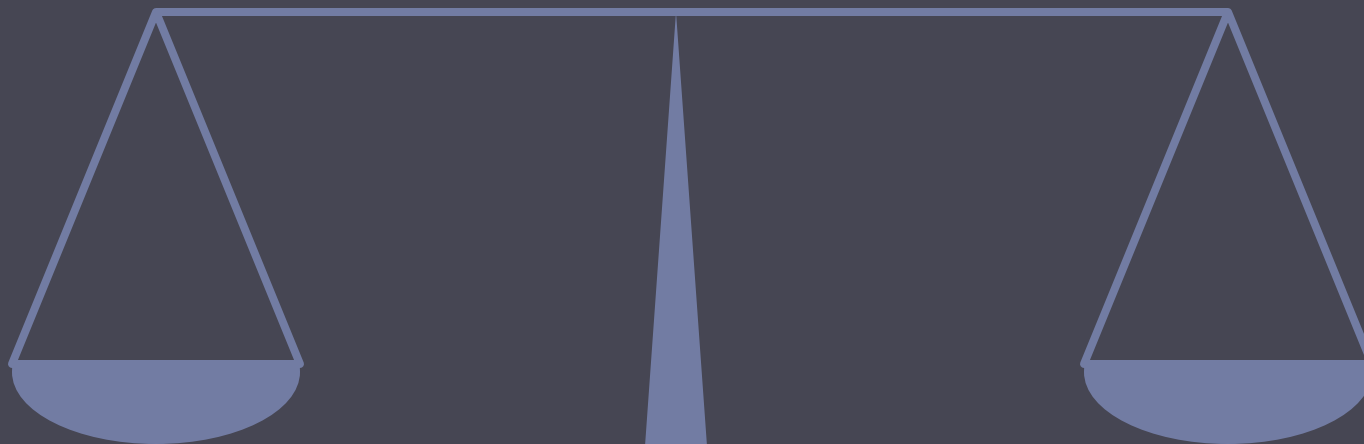
*“Good corporate governance requires appropriate and effective legal, regulatory and institutional foundations.”*

*Principles for Enhancing Corporate Governance,  
Basel Committee on Banking Supervision, October 2010*

This applies even more so to central banks; as creatures of statute they can only exercise the authority provided for in the legal framework, which dictates the **why, what, who, and how** of central bank operations.

# Legal vs. Compliance Risk

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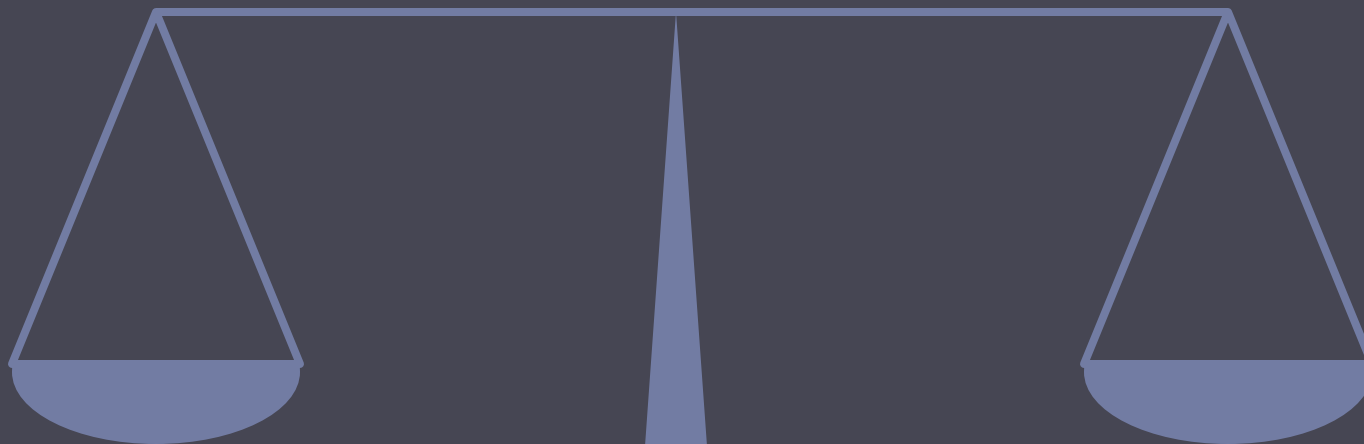


**Legal risk** includes, but is not limited to, (i) exposure to fines, penalties, or punitive damages resulting from administrative and judicial actions, as well as private settlements, (ii) risk of losses stemming from legal uncertainty, or (iii) risk of losses stemming from legal technical deficiencies of contractual and other legal arrangements, default of a contracting party, or from inadequate protection of assets.

**Compliance risk** means the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a central bank may suffer as a result of its failure to comply with laws, regulations, rules, and codes of conduct applicable to its activities (together, “compliance laws, rules and standards”).

# Compliance Function vs. Task

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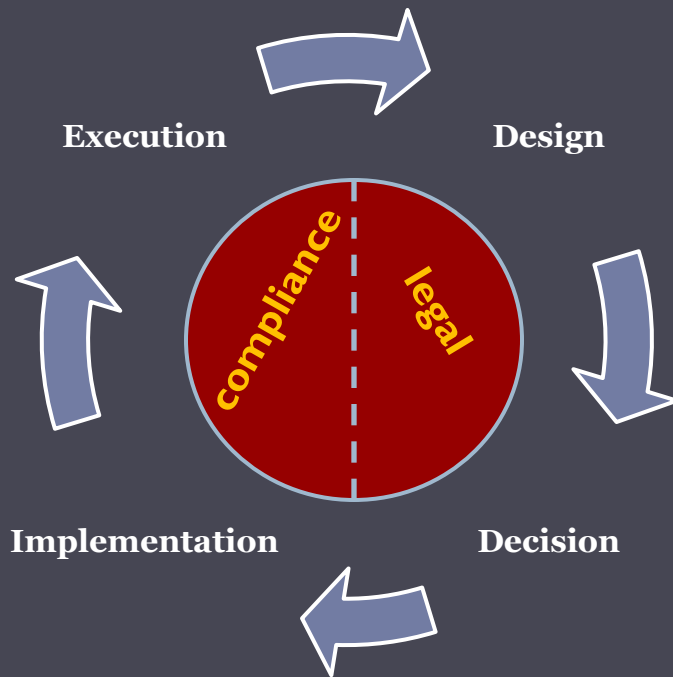


**Compliance function:** a continuous, independent function that identifies, assesses, advises on, and monitors and reports on a central bank's compliance risk.

**Compliance task of Internal Audit:** a periodic duty to monitor compliance with laws, regulations, and internal policies/rules.

# Role of Legal & Compliance Functions

Closely involving the legal and compliance functions in central bank operations and decision-making helps a central bank to carry out a key function of governance, that is:



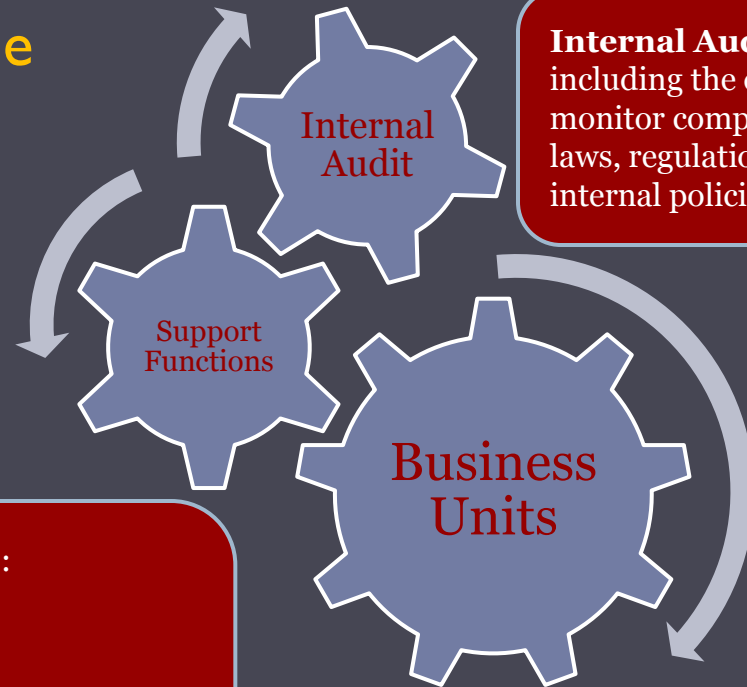
**“Corporate governance involves the allocation of authority and responsibilities [among a bank’s] board and senior management, including how they... align corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations.”**

*Principles for Enhancing Corporate Governance,  
Basel Committee on Banking Supervision, October 2010*



# Three Lines of Defense...

...working together to provide assurance on control systems



**Internal Audit** (periodic), including the duty to monitor compliance with laws, regulations, and internal policies/rules.

**Risk management** includes management of legal risks. ('Principles for the Sound Management of Operational Risk,' BCBS, June 2011)

## **Support Functions** (ongoing):

- risk management
- compliance
- legal
- finance
- information technology
- security
- etc.

**Compliance:** an independent function that identifies, assesses, advises on, and monitors and reports on a bank's compliance risk, that is, the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organization standards, and codes of conduct applicable to its banking activities. ('Compliance and the compliance function in banks,' BCBS, April 2005)

# IMF 2014 Global Survey on LGRC

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What follows are preliminary results of a very few selected issues.

86

central banks

78%

BIS

90%

EU

75%

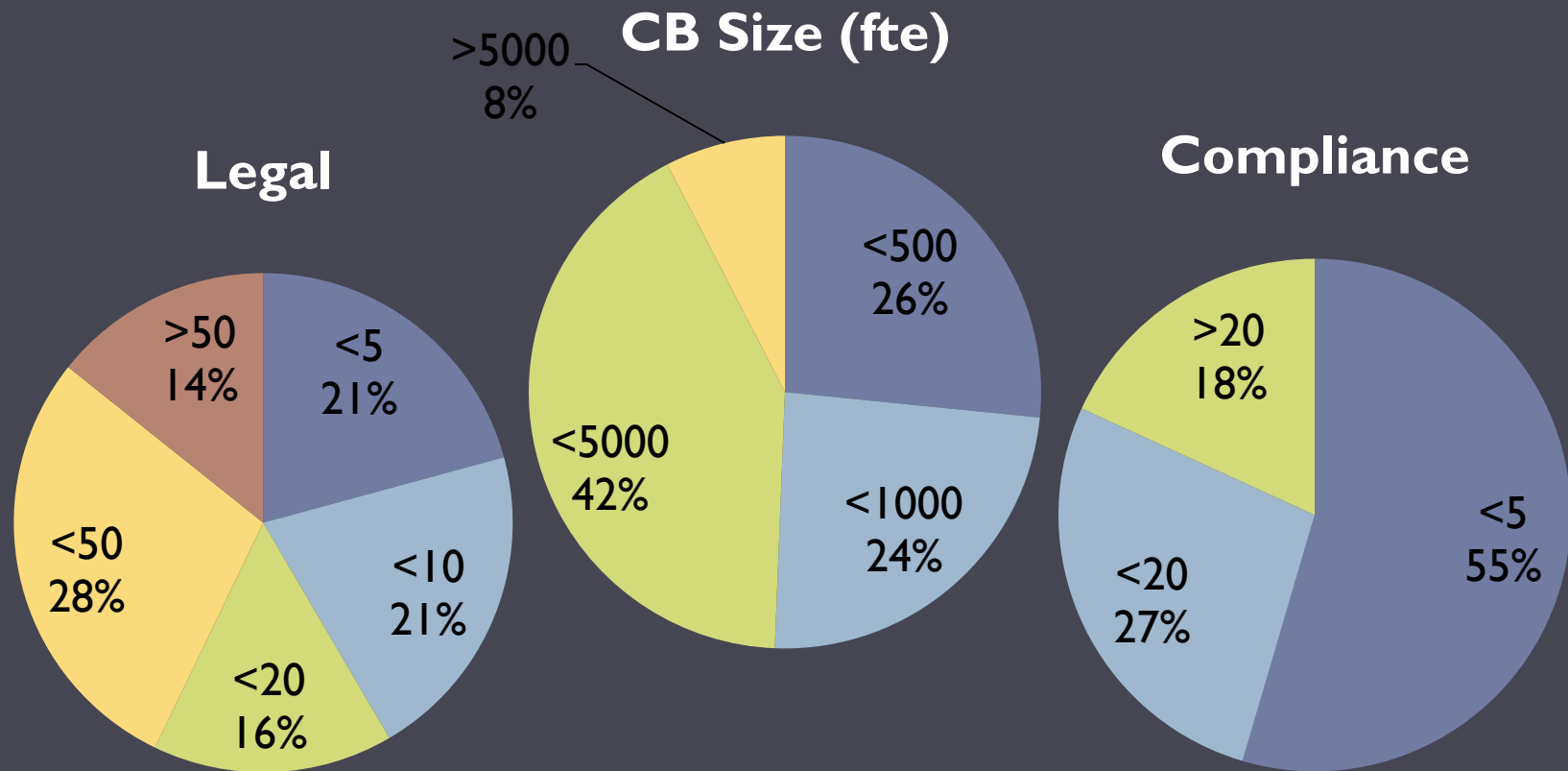
G20

88%

OECD



# IMF 2014 Global Survey on LGRC

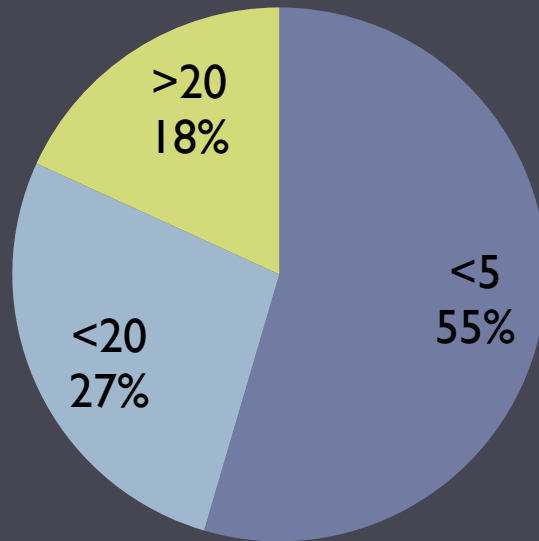


While all legal and compliance functions report to the Governor or a Deputy Governor, it is not always clear whether they have direct access to the Board.

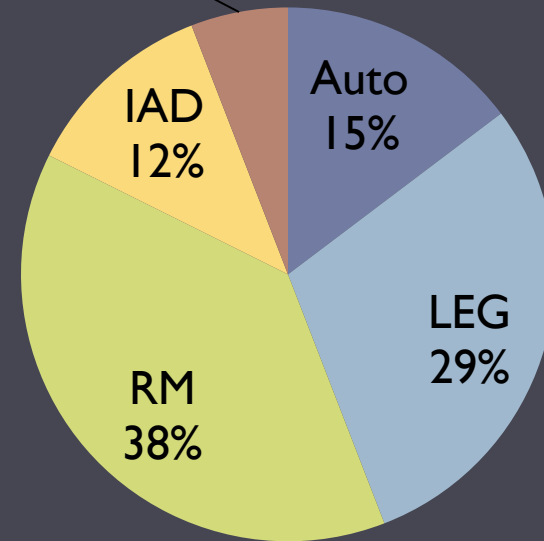
# IMF 2014 Global Survey on LGRC

45% of central banks has a dedicated compliance unit

## Compliance (fte)



## Location

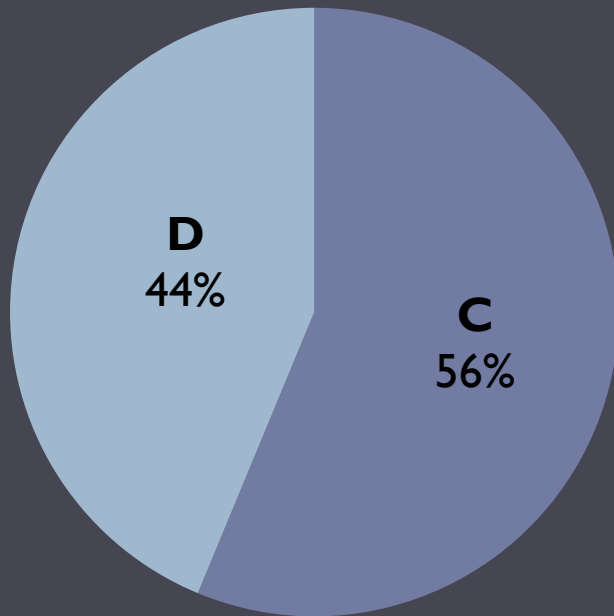


in 25% the division of labor between compliance unit and Legal/IAD is not documented

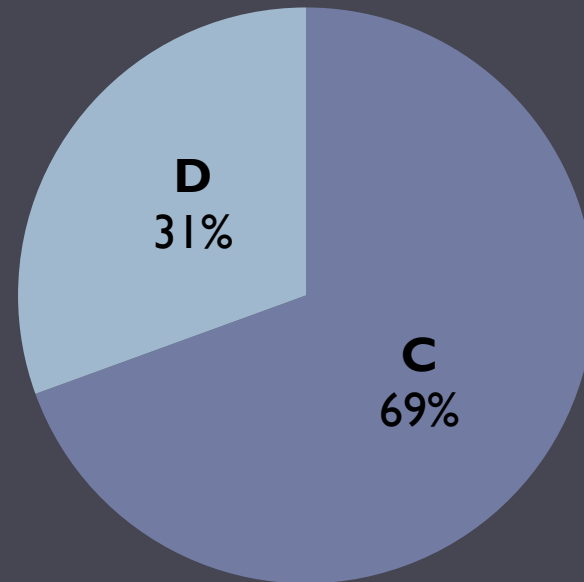
# IMF 2014 Global Survey on LGRC

## Centralized or Decentralized

### Legal



### Compliance



# Contact information

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