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The Institutional Framework for the Supervision of the Financial Intermediary System in Hungary

Summary: The economic crisis unfolding in 2007 had significant implications in terms of reinterpreting the role and responsibility of central banks. This paper presents a set of criteria for a "good" institutional framework and based on that it examines the reform of the Hungarian supervisory system. Political implications have integrated the powers of the Hungarian Financial Supervisory Authority within the organisation of the National Bank of Hungary (MNB); however, policy coherence has not been fully achieved. While capability is provided, the supervisory system may become overloaded, potentially affecting the capacity of MNB. The operations of the financial supervisory function are not fully independent. The resilience of regulation has been achieved; however, in some cases it may come into conflict with the principle of an independent supervisory authority. The new Hungarian financial supervisory system basically meets the criteria of a "good" institutional framework; however, in respect of several of these criteria, certain "risks" may arise.

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JEL codes: E58, G18, K23

The essence of the way market mechanisms work is that the final outcome is a result of the individual activities and actions of isolated economic operators (Vigvári, 2008). And, brought about by the "invisible hand" of classical economics, this final outcome is the equilibrium of markets. Also building on these conceptual foundations, in recent decades neoliberal market economy has given rise to a growing prevalence of views that permitted a limited presence of banking regulation, or even its absence. According to the so-called *free banking* theory, the state (governments) need not regulate banks and subject them to supervision that influences their activities, since a bank, being an autonomous market participant, will satisfy the requirements set for it by maintaining its safe operations (Selgin, 1988; Lentner, 2013a). However, in the context of modern markets, a perfect market equilibrium is by no means a natural state: market failures emerge, deteriorating the operation of financial markets. Indeed, economic collapses have demonstrated that there exists neither a self-healing market, nor unlimited rationality, nor a (public) financial system operating efficiently without regulations (Lentner, 2013b, 28). For the prevention and management of market failures, while obviously allowing room for the self-organisation of market participants, state intervention is needed; indeed, as shown by the collapse of the deregulated, liberalised

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and globalised financial market, there is a need for much stricter and tighter regulation and supervision. Even in the age of globalisation, states (and federations of states) continue to be the main and ultimate stabilisers of the economy, the state being, in certain cases, the ultimate obligor, the main regulator of the economy, the developer of economic policy, as well as a shareholder and public service provider (Gál, 2010).

In the aftermath of the world economic crisis, the institutional system responsible for financial supervision was reviewed in a number of countries worldwide, and was reformed in major countries such as the United States, the United Kingdom and Russia, but also in states with relatively small financial markets such as Ireland or Hungary. Such decisions concerning institutional changes may be seen primarily as political decisions, typically taken on grounds of the centralisation of supervisory instruments and budgetary considerations. It is to be noted, however, that "there is no perfect security" (Botos, 1995, 33) despite the centralisation of powers. In this paper, the definition of institutional framework is viewed as a preliminary issue in connection with the strengthening state regulation and supervision of the financial market. With that in mind, the first chapter of the paper presents a set of criteria for a "good" institutional framework which are selected as the aspect of analysis, and the second chapter examines the reform of the Hungarian supervisory system against the criteria specified. A summary is provided at the end of the paper.

THE SEVEN CRITERIA OF A "GOOD" INSTITUTIONAL FRAMEWORK

Political science has long emphasised the importance of an institutional framework to government performance (Wilks, 1999; Cseres, 2013). It is now widely recognised that institutions are significant but underappreciated mediators of public policy, the effects of which are perceived through the sophisticated interaction of regulations and decisions (Crane, 2011). According to proponents of institutional economics, the institutional framework also influences behaviour, which may lead to different results (North, 1995). As *Gerber* puts it, specific institutional contexts shape the ways in which decisions are made, which could lead to different uses of legal regulations and therefore different outcomes (Gerber, 2008).

In his work, *Coase* essentially sought to explain the basis on which a company chooses to perform a function in-house or contracts others, and in the latter case, how it decides on contracting, acquisition or a joint venture (Coase, 2004). Applying it to public administration, this question can be asked as how the "optimal" boundaries of the core functions of an administrative body may be determined. It should be noted at this point that in this paper, the MNB is considered as an (atypical) administrative body only in the context of providing for the supervision of the financial intermediary system.

In their latest paper, applying Coase's work to the administrative organisations, *Hyman* and *Kovacic* (2013) highlight seven criteria that may help decide the question of who should do what, i.e. in a particular case, which organisation should be competent for the functions and powers relating to the regulation and supervision of the financial market. In order to delimit my analysis, I first provide an overview of the seven criteria of a "good" institutional framework, following which I examine the Hungarian institutional reform of the supervision of the financial intermediary system against each of the criteria.

POLITICAL IMPLICATIONS. Politics is of major significance in allocating powers of public authority, since powers are essentially allocated by Parliament by drawing up the Constitution

and adopting acts to specify its provisions. For that reason, the operations of an organisation are influenced by the level of trust granted to it by the political system. Without political implications, the stable operations of the authorities are difficult to conceive.

Policy coherence. The criterion of policy coherence is of profound significance and relates to the extent to which the objectives of an organisation are coherent with one another. In economic terms, the question is whether the functions of an organisation are complements or substitutes. If they are complements, their combination has the potential to result in benefits that drive efficiency, whereas if they are substitutes, their combination may involve negligible benefits, or even degrade existing performance. Consequently, synergies and efficiencies are more likely to result from the implementation of objectives and the performance of functions which are complementary, as the specification of long-term objectives requires a balance of competing interests.

Just consider, in the case of financial market supervision, the conflict between prudential rules and the provisions for consumer protection. If the enforcement of prudential rules and that of the provisions for consumer protection fall within the competence of two separate authorities, then each authority will be concerned with the full achievement of its own objective, and will, as a rule of thumb, ignore the responsibility of the other authority. It is to be noted that even in such cases at least a "nominal" cooperation exists between the authorities. The implementation of different objectives may be a permanent source of conflict. Whether or not the functions concerned are integrated within a single organisation, the decision to balance the various objectives must be taken by someone.

Capacity and capability. The material and human resources of authorities, like any other resource, are scarce. Assigning *N*+1 functions to an authority that only has adequate resources to perform *N* functions may become a source of severe operational and efficiency problems. In other words, an authority with a large number of different functions may easily find itself in a situation where it should do too many things for which it does not have a sufficient number of trained professionals. The performance of a variety of functions requires adequate capacity and the efficient allocation of resources. In the absence of such conditions, the authority will inevitably prioritise its functions and will pay less attention to the implementation of those which are deemed less central to its mission. It is to be noted that capacity and capability are different concepts. Capability means that an authority has the adequate means to make the right decisions by which its capacity can be measured. An authority may make two types of error: 1. intervening when it should not (false positive); 2. not intervening when it should (false negative). Essentially, both types of error may be equally problematic.

A related point needs to be highlighted. Expansion of an authority's substantive mandate can degrade capability. As the powers of the authority grow, its leadership and staff may acquire an exaggerated sense of the institution's ability to perform effectively, and pay less attention to whether its commitments match its abilities.

Capability may be also influenced by the degree to which the personnel of the authority assess identified causes of the problems and the responses to them in a self-critical fashion. When multiple authorities share responsibility for a particular function, the option of internal feedback is always integrated in the system. This is a typical case of the principle of "two heads are better than one" at play. However, when a single authority has sole responsibility for the supervision of an entire market and the responses to the problems arising are

provided in-house, the responses may fall victim to groupthink and tunnel vision.

Credibility, branding. The "brand" of an authority conveys a message about its internal and external priorities. The brand can easily become diluted and/or confused if the authority has too many responsibilities, or if the responsibilities are not complementary and consistent. A confused "brand" can also affect the decision-making processes of the authority: amid a sea of confused goals and amorphous standards, methodologies or decisions may result in completely ad hoc reasoning. A situation like that may also distract the authority from the fulfilment of its core mission, and may even affect its culture adversely. These branding dynamics may also influence the credibility of the authority. The better the reputation of the organisation, the easier it will receive adequate funding and defend its decisions in court. Credibility obviously depends on multiple factors, including the history, past decisions and political capital of the authority, as well as its susceptibility to capture.

Internal organisational cohesion. When discrete functions are combined within the organisation of a single authority, the result is usually the creation of separate organisational units for each function. The relationship of internal organisational units is essentially characterised by rivalry, which may be either beneficial or destructive, and it is also possible that individual units will simply not acknowledge the existence of the other units. According to *Hyman* and *Kovacic*, the nature of rivalry within the organisation is determined by organisational culture and the history of the organisation.

Resilience. Legal regulations generally grant powers to authorities by specifying the service or the organisation providing the service. However, the services or organisational structures determining the powers of the authority may change as the market evolves, as a result of which the standards delimiting the powers must be sufficiently flexible so that they can respond to changes. Nevertheless, resilience should not hurt legal certainty: the requirement for the rule of law also prescribes that powers should be set out explicitly in legal regulations.

Collateral effects on the regulatory ecosystem. A government's system of administrative organisations comprises a multitude of bodies which are different in type and legal status, since in a modern state, due to the large number of functions to be performed, it is not possible for a single government body to perform all government functions. For that reason, in a system of administrative organisations constructed according to the principles of decentralisation and deconcentration, complemented by those of integration and centralisation, powers will inevitably overlap. This entails the requirement for the bodies to cooperate and act in a coordinated manner as needed. Cooperation and coordination may be achieved by numerous means ranging from formal understandings (cooperation agreements) through inter-organisational working groups to informal interaction at a personal level. When regulatory and supervisory powers are reallocated, or a new authority is added to the system, or new powers are given to an existing authority, these changes will also affect the regulatory ecosystem, and all organisations must reposition themselves within the confines of the system.

REFORMS ON THE SUPERVISION OF THE FINANCIAL INTERMEDIARY SYSTEM IN HUNGARY

Until October 2013, the Hungarian financial intermediary system was supervised by the Hungarian Financial Supervisory Authority, which was organised as an integrated supervisory authority separately from the National Bank

of Hungary. As of 1 October 2013, the HFSA discontinued its operations and had its powers and responsibilities integrated into the organisation of the National Bank of Hungary pursuant to Act CXXXIX of 2013 on the National Bank of Hungary (the MNB Act) adopted by the National Assembly. Based on the seven criteria of a "good" institutional framework, the following is an examination of the institutional framework of the new MNB, which was created as a result of integration as an authority responsible for the supervision and, in part, for the regulation of the financial intermediary system.

Political implications

The question of the allocation of responsibilities in the supervision of the financial sector cannot be conceived of as a purely economic question, nor can it be solved merely on the basis of economic theories. According to *Pierluigi Ciocca*, the issue of which institution should be put in charge of financial supervision in a given country is not a purely economic question, but a result of multiple interrelated circumstances and factors. Among these aspects, he refers to the "legal experience" of the country, i.e. its legal system, understood as the constitutional and institutional framework and operations within which the question is set. In the second place, he highlights the circumstances in which supervision was established, how it has been and is performed, specifically referring to the key aspect of institutional independence. As a third influence, he mentions changing and changeable market conventions and opinions (Ciocca, 2001). Overall, he claims that regarding the supervision of financial markets, the allocation of powers is primarily not an economic question, but much more of a political one. The same findings are reported by *Kleibl*, who examined 65 banking regulatory agencies of 29 OECD countries between 1975 and 2010 (Kleibl, 2013).

A review of the recent history of the Hungarian supervisory system will produce examples of numerous organisational models and supervisory approaches. In the period following the regime change alone[1], the Hungarian supervisory system was initially characterised by continuous integration, then decentralisation from government, and finally Europeanisation. Even in 2012, the political will existed to integrate the supervision of monetary policy and the financial intermediary system into a new type of body; however, this was not implemented at the time due primarily to pressure from the European Union. Following the appointment of new central bank management, the concerns of the European Central Bank (ECB) subsided, and the two main functions were integrated within the organisation of the central bank. An inquiry limited to the period since the integration shows that in that short period, there have been no signs of weakening political trust in the MNB; indeed, political and professional discourse has not been able to offer a convincing counterargument against integration. Therefore, the MNB may be considered to fulfil the most important criterion of a "good" organisational structure. It is to be noted, however, that over a longer period, the series of reforms and the continuous change in the legal status of the authority responsible for financial market supervision may also mean that long-term political trust in the authority of this area, a prerequisite for stability, never even existed. Indeed, as Kleibl demonstrated, decision-makers usually respond to stability problems with organisational reform (Kleibl, 2013).

Policy coherence

In the European model, the primary duty of a central bank is clearly to preserve the value of its currency (Bod, 2012, p. 126), which

is an obligation otherwise consistent with the treaties establishing the European Union. Accordingly, the MNB Act also provides that the primary objective of the MNB is to achieve and maintain price stability. Without compromising its primary objective, MNB supports the maintenance of the stability of the financial intermediary system, the increase of its resistance, its sustainable contribution to economic growth; and within its means, it also supports the economic policy of the government. The MNB Act *expressis verbis* specifies the mitigation of inflation as the MNB's primary objective, and that the rest of its objectives must be achieved without compromising the primary objective. It is to be noted, however, that the low level of inflation, the attainment of which is defined as the primary role of the central bank, has become a questionable means of driving economic growth (Lentner, 2013b, p. 198). Indeed, the previous years' consensus on monetary policy has been completely overridden by the crisis (Kolozsi, 2014).

The MNB Act provides that the functions falling outside the scope of the MNB's core functions are additional functions, which may only be performed, as specified in legislation, without compromising the fulfilment of its primary objective and core functions. Consequently, the MNB may only supervise the financial intermediary system without compromising price stability; i.e. in the course of prudential supervision and financial consumer protection, the key prerequisites are monetary policy objectives. The MNB Act therefore unambiguously prioritises objectives, whereby the legislator also fulfils its obligations enshrined in EU law. According to the literature, however, there is a systemic conflict of interest between monetary policy and the supervision of the financial intermediary system, because the considerations of monetary policy will, from time to time, be different from those of prudential supervision. Tightening or easing monetary policy may deteriorate banks' prudential situation, which in turn may affect the achievement of inflation targets. Additionally, it is possible that the central bank will not control inflation aggressively enough amid concerns that higher key policy rates create problems for banks (Goodhart – Schoenmaker, 1995). As a result, there may be a *moral hazard* to monetary policy from the allocation of prudential supervision to the central bank, which is only exacerbated by the integration of securities and exchange supervision into the central bank as well (Botos, 1996).

The European Union also created the Single Supervisory Mechanism within the Banking Union mostly based on the arguments presented in pre-crisis literature, on the foundations of separating the responsibilities of monetary policy and financial supervision. It should be noted that, as individual objectives are in conflict at the macroeconomic level, the solution is not to favour one objective or another, but to find their appropriate balance (the appropriate *trade-offs*), which is why it is not possible to superimpose one objective over another by the force of law, because that will only conserve their substantive conflict. The MNB is thus bound by national legislation, with no leeway in the event of a conflict between decisions aimed at price stability and those aimed at financial stability, because it is required to give priority to the primary objective. This in turn could lead to tensions in the discharge of the MNB's duties.

Then, overall, the second criterion of a "good" institutional framework is apparently not fully satisfied in terms of substance as in certain cases, a tension or a systemic conflict of interest may arise between the constitutional functions allocated to the MNB, which regulation will not necessarily reduce, but may restrict the MNB's leeway.

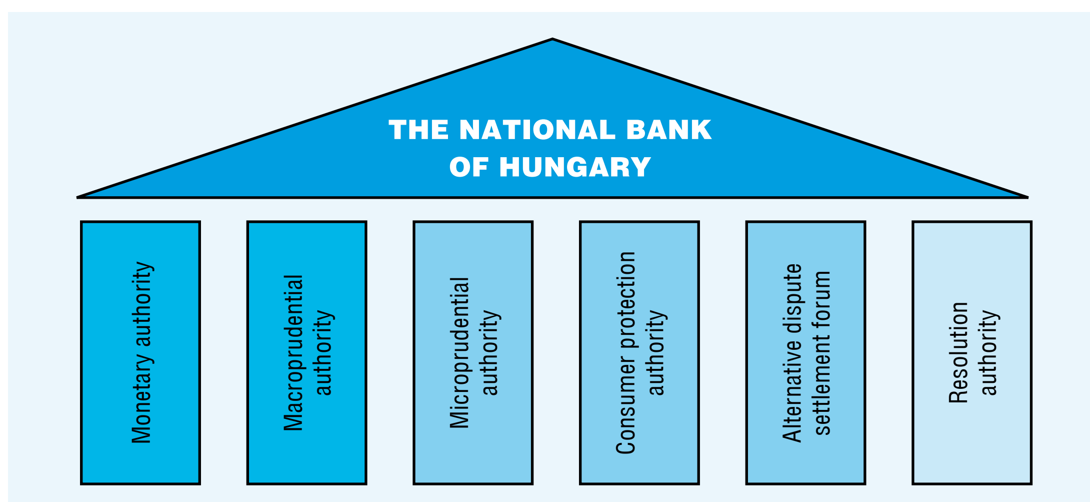
Capacity and capability

To provide a reason for integration, the general explanation of the MNB Act claims integration to be a fundamental pre-requisite for ensuring that the systemic risks to the overall stability of the financial system can be monitored and controlled, i.e. for providing adequate efficiency in the coordination of macroprudential and microprudential supervision. In my view, adequate and efficient coordination between the two supervisory pillars and monetary policy is not only possible through organisational integration; an efficient system of cooperation may also be provided between separate bodies. However, it should be pointed out that the integration of monetary policy and the supervision of the financial intermediary system into a single organisation, as implemented in a number of countries, carry potential benefits. Nevertheless, in order to neutralise intrinsic conflicts of interest, individual functions should be separated so that their synergies are ensured but their fields of responsibility are separated, and that there are not too many tasks requiring different approaches, which would fragment resources. It should also be noted that even if the supervisory system is reinforced, the supervisory function cannot take over the financial organisation's internal governance and related internal audit responsibilities. To borrow a phrase from *Botos*, supervision is only a traffic warden and not the driver (Botos, 1996).

Consistently with the specification of objectives, the MNB distinguishes between its core and additional functions. Core functions include the implementation of monetary policy, the issuance of bank notes and coins, the allocation of foreign reserve holdings, the oversight of payment and settlement systems – i.e. the functions traditionally performed by central banks , as well as the formulation of macroprudential policy. The microprudential supervision of the financial intermediary system, consumer protection and the performance of functions relating to alternative dispute settlement and resolution are classified as additional functions. *Chart 1* illustrates the

Chart 1

ROLES AND FUNCTIONS TO BE PERFORMED BY THE MNB



Source: own editing

functions within the organisation of the MNB after the integration.

The extension of the MNB's functions may increase the probability of errors and wrong decision-making, which could become critical, particularly at times of crisis (Neményi, 2012). The risk may arise that integration places an excessive burden on an organisation, which calls for the consideration of decoupling certain functions to allow the MNB to focus on the achievement of its objectives. A solution supported by professional arguments could be to establish an autonomous authority to exercise the regulatory and alternative dispute settlement powers related to consumer protection (Financial Arbitration Board), given the differences in the logic required for the legal practice of consumer protection and for prudential supervision (the "twin peaks" regulatory model). Similarly to consumer protection, *Lentner* claims that the functions of market supervision and insurance supervision are also less closely related to the MNB's other core functions (Lentner, 2013b).

As a result of integration, the full control of the financial system from the implementation of monetary policy to the resolution of distressed banks is essentially concentrated within a single organisation, which is coupled with relatively weak social accountability mechanisms due to central bank independence (Kolozsi, 2013). Monetary policy is decision-making on economic policy, while supervision is clearly a regulatory power exercised through a unique set of regulatory relations; consequently, individual decisions require different mindsets. This difference raises the question of whether a single person or a decision-making body comprising the same members is suitable for efficient and effective decision-making in each field of responsibility.

In the MNB's case, decision-makers for the supervision of the financial intermediary system, as will be shown in the sub-chapter on internal organisational cohesion, are partly also decision-makers for monetary policy. This is definitely useful in ensuring the flow of information between the supervision of monetary policy and that of the financial intermediary system, which in turn will contribute to quality decision-making in the fields of responsibility concerned. Any objections that may arise from the overlaps between the decision-makers of the two fields may be overcome through the adequate professional preparation of the decisions.

Regarding the third criterion of a "good" institutional framework, it is found that while capability is provided, a large number of functions involving different approaches, economic analyses and legal practices have been brought under the same roof, in the context of which the supervisory system may become overloaded, potentially affecting the capacity of the MNB.

Credibility, branding

The reinforcement of central banks' financial stability function involves risks and may also lead to conflicts with independent monetary policy, not only because the increased number of functions involves a greater possibility of error, but also in terms of credibility. The standard to which one function is performed affects the credibility of the other (Neményi, 2012, p. 205). When bank failures and stability problems occur, as a rule, supervisory authorities are the first to be questioned as to why they have not foreseen liquidity problems and why they have not done anything to prevent failure. The deteriorating credibility and reliability of a central bank as a supervisory body will also affect the credibility of its monetary policy.

Credibility results from a combination of factors, and the central bank must make continuous efforts to maintain its credibility as

well as its independence, because any deterioration in that regard may undermine the trust in its decisions and may be reflected in social costs associated with increasing interest premiums.

Already before the integration of supervisory functions, the MNB commenced a series of intensive rate cuts, which analysts considered particularly successful in macroeconomic terms (Kertész, 2014). In addition to using conventional monetary policy instruments, similarly to a number of central banks (Monoki – Nagy, 2013), the MNB has also made use of unconventional central bank instruments such as the Funding for Growth Scheme (Balog – Matolcsy – Nagy et al., 2014) which, combined with conventional instruments, have contributed to improving the credibility of monetary policy. Simultaneously, however, the MNB came under attack from several directions concerning its corporate social responsibility strategy, its foundations and its property purchase programme, which could have a negative impact on its credibility if such activities are not carried out transparently. Despite these events, the MNB has been performing well in my judgment, primarily due to the positive macroeconomic consequences of its rate cutting policy and of the unconventional central bank instruments it has applied; however, that performance needs to be maintained.

Internal organisational cohesion

The Monetary Council is MNB's supreme decision-making body, which also sets out the strategic framework of financial market supervision. The Monetary Council seats five to nine members and is comprised of the MNB's Governor as the chair of the Monetary Council, the MNB's Deputy Governors, and additional members. Pursuant to the Fundamental Law, the MNB's Governor and Deputy Governors are appointed by the President for six years on the recommendation of the Prime Minister. Additional members of the Monetary Council are elected by the National Assembly under the MNB Act. The Monetary Council must always have more members elected by the National Assembly than those appointed by the President. Within the scope of the strategy formulated by the Monetary Council, the powers relating to the oversight of the payment and settlement system, the design and implementation of the macroprudential strategy, the supervision of the financial intermediary system, and resolution, are exercised by the Financial Stability Board (FSB). The FSB was created by the MNB Act within the MNB's organisation as a body with three to ten members. Members of the FSB: (a) the MNB's Governor as chair; (b) Deputy Governors responsible for the functions specified in the MNB Act; and (c) the leaders appointed by the MNB's Governor. Currently the FSB is composed of the MNB's Governor, his three Deputy Governors, as well as the Executive Director for Financial Stability and Lending Incentives.

By merging the HFSA's supervisory powers into the MNB and thereby bringing the responsibility for monetary policy as well as macro- and microprudential supervision under the same roof, the legislator also linked these functions to one another in order to stabilise the financial system and to maintain stability. It should be remembered that the level of accountability for decisions is completely different for monetary policy decisions and those concerning supervision. Central banks enjoy a high level of independence when making monetary decisions, which is inappropriate when making supervisory decisions. The reason is that monetary policy is decision-making on economic policy, while supervision is clearly a regulatory power exercised through

a unique set of regulatory relations, requiring different levels and nature of independence. In order for the benefits arising from the structure of the system to be fully exploited, the efficient allocation of functions within the new system should separate monetary policy and supervision so that monetary policy decisions may be made independently of external influences. In setting the integrated organisational framework, consideration ought to be given to the legally non-binding recommendations of the Bank for International Settlements (BIS) and the ECB's organisational model, the latter being a model as well as a framework for Member States' central banks and European solutions alike. Within the ECB's organisation, the Supervisory Board performing functions of prudential supervision as part of the Single Supervisory Mechanism works separately from monetary policy.

According to the BIS, granting operational independence is a key principle of efficient supervision. Operational independence is understood by the BIS as the requirement for the supervisory body to have full discretion when adopting supervisory measures and decisions. In view of the above, my opinion is that while exercising its powers, the FSB should be granted a high level of operational independence, because in the absence of such independence, responsibility for prudential supervision cannot even be construed. This operational independence is not achieved in the framework of Hungarian institutions, because on the one hand, the FSB can only adopt decisions within the strategic limits specified by the Monetary Council, whereby it must not compromise the MNB's primary objective of achieving price stability. On the other hand, in a number of significant cases sector-specific legislation restricts the MNB's autonomous decision-making, and thus its supervisory independence, in determining sanctions. For example, the MNB may only revoke a credit institution's operating licence with the approval of the Minister in charge of the regulation of the money, capital and insurance market.[2] Similarly, to suspend stock exchange trading entirely for more than ten trading days, the MNB also needs the approval of the Minister in charge of the regulation of the money, capital and insurance market.[3]

Overall, in my view the principle of operational independence is not fully observed in respect of the FSB either within or outside the organisation. On the one hand, internal organisational cohesion may partly help to overcome the absence of operational independence within the organisation with a view to quality decision-making. On the other hand, the operational independence of the MNB's decision-making can only be restricted in exceptional cases by means of external intervention granted to central authorities.

Resilience

The MNB Act regulates the scope of supervision over the financial intermediary system in the form of a framework by listing the laws that govern the persons and organisations that are also supervised by MNB. The norm of assigning powers is flexible and inflexible at the same time. It is flexible in that abandoning previous regulation, instead of detailing the specific laws that govern the supervised persons and organisations it merely refers to the field being regulated. In this way, when the legislator re-regulates the area concerned, the appropriate naming of the new act will be sufficient without any amendments to the MNB Act. The MNB Act allows deviations from these provisions in acts, i.e. makes it possible for acts to restrict the MNB's powers in certain areas or extend the areas subject to supervision. Underlying that, also making regulation inflexible, is the fact that

these provisions of the MNB Act are cardinal rules which, in the absence of a two-thirds majority, render any changes to the system of functions subject to political bargaining. The responsibilities regulated in cardinal and non-cardinal acts are distinguished because the MNB is only allowed to adopt decrees under its powers set out in cardinal acts.

Regulation is also flexible in that functions relating to the supervision of the financial intermediary system may also be allocated to MNB by a legal regulation pursuant to the authority conferred in an act. That is, pursuant to the authority conferred in an act, both the government and sectoral Ministries, as well as the leaders of autonomous regulatory bodies and local governments may assign functions to the MNB in connection with the regulation of the financial intermediary system. The only restriction imposed on this by the MNB Act is that the functions set out in a legal regulation adopted pursuant to the authorisation conferred by an act must be consistent with MNB's core functions and responsibility as specified in the MNB Act. A further problem may arise from the provision of the MNB Act that the functions falling outside the scope of the MNB's core functions, i.e. additional functions, may only be performed, as specified in legislation, without compromising the fulfilment of its primary objective and core functions. In this case, the MNB Act does not even prescribe authorisation conferred by legislation in respect of the regulation of supervisory functions belonging with the MNB's additional functions. On these grounds, it is possible for even a local government decree to specify particular requirements for the discharge of the MNB's supervisory functions as long as they do not compromise the fulfilment of the MNB's primary objective and core functions.

This resilience clause also affects the MNB's independence, which is partly explained by the fact that the supervision of the financial intermediary system may never enjoy the degree of independence granted to the pursuance of monetary policy. This raises the possibility that the integration of the two discrete functions within a single institution is not necessarily consistent with the rules of national central bank independence, particularly with regard to the circumstance that under the re-codified rules of the credit institution system, certain MNB measures require ministerial approval.

Overall, therefore, Hungarian regulation satisfies the criteria of resilient and adaptable regulation, which may, however, come into conflict in certain cases with the principle of an independent supervisory authority.

Collateral effects on the regulatory ecosystem

A central instrument of governance in national economy is financial policy, the two main disciplines of which are fiscal and monetary policy. "Based on the widely accepted distribution of powers, the government of a given country defines, implements and is responsible for fiscal policy, while the central bank is concerned with monetary policy. I am not aware of any proposition (in stronger terms, evidence within the science of economics) according to which the interest of the national economy would not be the most perfect harmony possible between the two disciplines of financial policy. For the opposite, there are plenty of theoretical arguments and highly damning conclusions to be drawn from practical experience" (Bánfi, 2012). As *Kolozsi* puts it, the central bank is part of the public policy system. Central bank decision-makers are influenced by social and political factors (Kolozsi, 2013).

A key development in this field is the provision of MNB's Charter that the central

bank will step up efforts to support the government's economic policy, which is not an option but a legal obligation under the Fundamental Law of Hungary. The Charter also provides that monetary policy must support the government's economic policy. Additionally, the MNB Act details the bodies with which MNB interacts.

SUMMARY

The economic crisis unfolding in 2007 had significant implications, among other things in terms of reinterpreting the role and responsibility of central banks. On the one hand, a process started as part of which functions and powers relating to the supervision of the financial intermediary system are being integrated within the organisation of national central banks. Hungary has been following this trend.

In implementing organisational reforms, consideration must be given to the basic criteria which are essential for the establishment of the right organisational framework of a body exercising public authority. Based on Hyman and Kovacic, this paper explains the seven criteria for a "good" institutional framework before it proceeds to examine the reform of the Hungarian supervisory system against the criteria specified. Political implications have integrated the powers of the HFSA within the organisation of the MNB; however, in terms of the discharge of the supervisory function, policy coherence has not been fully achieved. While capability is in place, a large number of functions involving different approaches have been brought under the same roof, in the context of which the supervisory system may become overloaded, potentially affecting the capacity of the MNB. The MNB efficiently employs conventional and unconventional central bank instruments that continuously improve its credibility, which also has an impact on the credibility of its supervisory function. However, the principle of operational independence is not fully observed in respect of the FSB either within or outside the organisation. Hungarian regulation satisfies the criteria of resilient and adaptable regulation, which may, however, come into conflict in certain cases with the principle of an independent supervisory authority. A forward-looking change is that monetary policy must support the government's economic policy.

Organisational integration is essentially a welcome development, since in a country with such a small and open market as that of Hungary, strong mandates are needed, the exercise of which, however, requires the appropriate institutional framework and the appropriate accountability mechanisms to be provided. The new Hungarian financial supervisory system basically meets the seven criteria of a "good" institutional framework; however, in respect of several of these criteria, certain "risks" may arise, which might have to be managed in advance.

Notes

[1] For more details see Botos, 1996, pp. 46–63.

[2] Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, Article 33(3)

[3] Act CXX of 2001 on the Capital Market, Article 328

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