The Role of Ethics for Central Bank Senior Management: A Comparative Analysis of Recent Developments

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Abstract
The proper management of ethics and conflicts of interest is important for banks and particularly essential for central banks. Much of central bank’s success hinges on their credibility in markets and their standing among the public and thus if the public perceives a bank’s management as lacking worthy judgement on issues of personal conduct, he may even have misgivings on management’s decision-making concerning matters of policy. Indeed the failure of a bank to manage conflicts of interest effectively could also lead to actions that curtail its operational autonomy. Taking into consideration these abovementioned particular issues, the paper will analyse the legal implications of particular cases where a conflict of interest may arise for management staff when they have private-capacity interests which could improperly influence their performance and responsibilities. It shall concentrate on those ethical issues which senior officials of central banks may face, and the comparative legal solutions applicable to those cases. The paper would also analyse the chief elements that contribute in banks’ efforts to minimise the potential for conflicts of interest, including an analysis concerning the increase in labour mobility that has not left central banks untouched, since senior staff increasingly serve their institution for shorter periods, thus bringing upfront the question of conflicts of interest once they leave their jobs.

1. Introduction
It is worth pointing out that a conflict of interest may arise for a public official when he has private-capacity interests which could improperly influence the performance of his official duties and responsibilities. It is important to note that this paper focuses on such personal conflicts of interest which senior officials of a bank or the central bank may face, or be perceived to face. The paper is not concerned with conflicts of interest of an institutional nature that might arise when a Governor serves as the chairman of the central bank’s supervisory board or when the central bank has several objectives that it needs to achieve concurrently.

It is not surprsingly to find that the proper management of conflicts of interest is a key element in banks but especially important for central banks. It is evident that much of their success hinges on their credibility in financial markets and their reputation among the public. It is often argued that if the public perceives a central banker lacking good judgement on matters of personal conduct, it may bring about misgivings on his/her good

1 The views and opinions expressed herein in this article are those of the author only and do not necessarily reflect the position of the Bank of Albania.
2 This definition is taken from the OECD’s guidelines on Managing Conflict of Interest in the Public Service. These Guidelines set the first international benchmark to help governments review and develop comprehensive conflict-of-interest policies for the public sector in line with good practices in OECD countries. http://www.oecd.org/gov/ethics/managingconflictofinterestinthepublicservice.htm
judgement on matters of policy. The corollary of this is that the failure of a central bank to manage conflicts of interest effectively may also lead to actions that may eventually curb its operational autonomy.

At the same time even if it could be argued that questions of conflicts of interest have arisen on occasion in the past, serious cases are rare in central banking, particularly if one considers that the central bank community is a fairly large one and is scattered all over the world. Still, central banks are paying close attention to this matter and revising their codes of conduct and continually refining their monitoring procedures. In any sense it seems clear that several factors may explain this phenomenon. The first being the general change in the climate that makes all the private and public institutions seek to minimise the potential for conflicts of interest. A second is the general increase in labour mobility that has not left central banks untouched, as central bankers increasingly serve their institution for shorter periods; thus the question of conflicts of interest once they leave their jobs becomes relevant.

The essential point is that most conflicts of interest are addressed through personal integrity, but having well designed statutory provisions and effective codes of conduct helps individuals and banking institutions (both commercial banks as well as central banks) to exercise sound judgement. Nothing can detract from the central fact that judgements about what constitutes a conflict of interest depend on an array of local customs, trends in specific countries and evolving views on best practices. Therefore, devising statutory provisions and codes of conduct governing conflicts of interest may require a detailed assessment of these factors as well as the balancing of the benefits and costs.

The evidence of the abovementioned is even more obvious in the case of Albania, where law no.9662, dated 18.12.2006 “On banks in the Republic of Albania”, provides inter alia that the Steering Council of a commercial bank is responsible for the approval of the internal by-laws which determine the basic methods of prevention and efficient resolution of conflicts of interest. Indeed, the Steering Council may set up and

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3 In response to a congressional request, (US Government Accountability Office) GAO provided information on conflicts of interest in commercial banking institutions, focusing on: (1) the types of conflicts of interest and associated abuses; (2) how to control conflicts of interest and limit associated abuses; and (3) the impact of expanded banking securities powers on conflicts of interest and associated abuses. Conflict of Interest Abuses in Commercial Banking Institutions GGD-89-35: Published: Jan 27, 1989. Publicly Released: Feb 27, 1989.

4 GAO interviewed bankers, regulators, and legal and academic experts, and found that: (1) all concurred that, while conflicts of interest existed in banking institutions, the problems were not widespread; (2) banking institutions can face numerous situations where a bank's interests conflict with those of customers, stockholders, creditors, or deposit insurers; (3) competition, internal controls, and regulatory oversight are factors that deter institutional conflicts of interest and limit abuses; and (4) expanded securities powers might increase the likelihood of institutional abuses and of conflicts of interest. GAO also found that: (1) bank examination reports that it reviewed did not reveal any indications of widespread abuses; (2) data on consumer complaints was inadequate to assess the extent of institutional abuses of conflicts of interest; and (3) some regulators and experts expressed concern about individual insider abuses.


6 The Bank of Albania has approved decision no.46, dated 25.06.2003 on the “Approval of the code of conduct of the Bank of Albania”. This act regulates all aspects of conflicts of interest of the Bank’s staff as well as those of the members of the Supervisory Council. The Albanian text of the code of conducts may be accessed at http://www.bankofalbania.org/

7 Please see: http://www.bankofalbania.org/web/Law_No_9662_dated_18_12_2006_amended_by_Law_No_10481_dated_17_11_2011_On_banks_in_the_Republic_of_Albania_3181_2.php?kc=0.28.0,0,0
authorize ad hoc committees composed of non-executive members of bank Council, who would be responsible for dealing appropriately, on a case by case basis, with the conflict of interests in the bank. The law on banks also stipulates numerous administrative and disciplinary measures, where an administrator fails to declare such conflicts of interest as set out in the law or where the contract or juridical act is related to the conditions of the existence of such conflict of interest. On the other hand, seeking to avoid potential conflicts of interest by imposing ever-more restrictions can make a post at a bank less attractive for qualified candidates, or reduce the relevance of advice provided by non-executive directors if the bar is set too high to allow those with appropriate experience to serve on the board. An important point sometimes overlooked is that even comprehensive codes of conduct may leave an institution exposed to accusations of misconduct as a result of fluctuations in public expectations.

Comparing frameworks that deal of conflict of interests across institutions is useful, yet the important point to note is that a few caveats need to be borne in mind. In the case of central banks, one concern is the linkage between a central bank’s governance structure and the approach conflicts of interest are managed. Indeed, an institution with an undersized single board may need to rely on more restrictions to effectively prevent conflicts of interest. In the same way, some board structures make it possible for a board to provide advice to members who may face a potential conflict of interest, or make it practicable for members with a potential conflict of interest to recuse themselves.

It is significant to add that a second caveat concerns differences in cultural values, social practices and legal systems that may influence the behaviour of civil servants and attitudes towards privacy of information, personal investments, family ties, and gifts of financial institutions. It should be noted that in some countries public officials are paid much less than they would be able to earn in the private sector. Therefore, in these countries, civil servants and central bankers sometimes move on to the private sector at some point in their careers, and may regard severe restrictions on post-termination employment as irrational. However, in other countries, on the other hand, central bankers’ pay levels are particularly competitive, and the same restrictions on post-termination employment may therefore be deemed acceptable. It is not surprising to

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8 For a comprehensive information on central banks and related code of conduct visit [http://www.bis.org/cbanks.htm?m=2](http://www.bis.org/cbanks.htm?m=2)

9 Law No. 9662, dated 18.12.2006 “On banks in the Republic of Albania”, provides inter alia that bank administrators are responsible for the monitoring and solving potential conflicts of interests of the directors, members of the Steering Council and shareholders, including the potential conflict of interests rising out of the misuse of bank’s assets and transactions with connected persons. In addition this law provides that private interests of the administrator shall be interests based on or deriving from:

- a) relationships based on wealth or commerce, direct or indirect of any nature;
- b) any other juridical-civil relationship;
- c) gifts, promises, favours, preferential treatments;
- d) negotiations for potential employment or any other form of relationship constituting a private interest for the director in the future, after leaving the position as administrator carried out by him whilst in the position of the administrator of the bank;
- e) engagement in private activities with the view to profit or any other activities which generate income;
- f) family or cohabitation relationship.

10 The Code of Conduct of the Bank of Albania stipulates employment restrictions for staff after leaving the Bank of Albania. Thus, according to the Code, if an employee has left or is in the process of leaving the Bank of Albania, he must abide by the rules on using and keeping information, and not use or disclose reserved information which he has obtained owing to his post at the Bank. He must not contact any former colleagues to provide reserved information and not provide reserved information to his former colleagues, who, upon leaving the Bank of Albania are treated as any other third parties... If the employee left the Bank of Albania and, while employed by the Bank he has served in the Supervision or the Monetary Operations departments he must not seek employment (after leaving the Bank of Albania) in banks or other institutions that in a way
find that in some countries, information on individuals’ financial situation is considered private while in others there are practices (i.e. individual tax records being in the public domain) which make the mandatory disclosure of such information by senior officials much less portentous.

2. **Conflicts of interest while in office**

It is important to recognise that the vast majority of central bank laws contain fairly detailed restrictions on the type of external activities that senior central bank officials can engage in while they are working for the central bank. It is anticipated that outside employment is generally prohibited for full-time, internal members of central bank boards as well as staff. The only widely accepted exception is teaching or similar academic engagements, which are permitted in many cases, and considerably more often in emerging market economies than in industrialised countries.\(^{11}\) A number of central bank laws also contain provisions permitting senior officials to serve on the boards of subsidiaries of the central bank or on the boards of other organisations if they do so in their capacity as a central bank official. However, membership in political parties or participation in political activities is in most cases strictly prohibited.\(^{12}\)

Mention should also be made of the fact that external members of policy boards face fewer but still a significant number of restrictions on activities outside the central bank, and external members of supervisory boards (non-executive directors) a still smaller number of restrictions. This in turn means that other aspects of behaviour that may involve conflicts of interest are often not covered in the central bank law, but in codes of conduct that have been adopted by an increasing number of central banks in recent years. Indeed it might be argued that one function of such codes is to provide explicit rules on matters that are covered insufficiently (or not at all) in legislation; another – and often particularly important – function is to interpret or provide greater clarity to existing legal provisions. A classic illustration often cited is the code of conduct for employees of the Reserve Bank of Australia, which suggests that “You, and others who are involved in the activities of the Bank, have a critical role to play in achieving these objectives whether directly or in a supporting role. You have a responsibility to conduct yourself with a high degree of integrity, to strive for excellence in the work you perform and the outcomes you achieve, and to promote the public interest.”\(^{13}\)

In this respect it is important to note that most codes of conduct contain a statement of principle which asks those covered by the code to observe high standards of ethical behaviour, and (in many cases) also assure officers and staff that the central bank is itself committed to providing them with a working environment where high standards of conduct are maintained. For example, the European Central Bank’s (ECB) ethics

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\(^{11}\) The Code of Conduct of the Bank of Albania stipulates that an employee may not conclude another employment agreement, whether paid or unpaid, without prior written approval by Bank of Albania Administrators. Only upon approval by Bank of Albania Administrators, an employee may be allowed to engage in activities outside the Bank of Albania. However, the Code stipulates that employee’s request for permission for employment, business activity or freelancing outside the Bank of Albania is approved only if it does not interfere with his activity to perform properly his duties at the Bank of Albania, is in compliance with the Bank of Albania rules on its staff conduct and does not generate conflict of interests.

\(^{12}\) Article 47 of law no.8269, dated 23.12.1997 "On the Bank of Albania" stipulates that any member of the Supervisory Council, including Governor and Deputy Governors, shall be suspended from office by the Council of Ministers and removed by People’s Assembly, if he has participated actively in political activities during the period of his tenure. In addition, the Code of Conduct of the Bank of Albania provides that if an employee accepts a political appointment for a central party function, he must resign as a Bank of Albania staff member.

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framework provides *inter alia* that “The conduct of members of staff shall neither undermine their professional independence and impartiality nor harm the ECB’s reputation. Members of staff shall comply with the provisions of the ECB’s ethics framework and in particular respect the ECB’s common values and conduct themselves in their professional and private lives in a manner befitting the character of the ECB as a European institution; perform their duties conscientiously, honestly and without regard to self-interest or national interests; and avoid situations that give or may be perceived to give rise to conflicts of interest, including those arising from subsequent occupational activities and adhere to the ECB’s rules on dignity at work.”\(^{14}\)

It is worth pointing out that rules on the acceptance of gifts (including travel and hospitality) are an important part of essentially all such codes. It is for this reason that most codes of conduct of central banks provide a specific maximum value for gifts (for example, € 50 for staff members of the ECB)\(^{15}\) while the remainder use qualitative limits such as gifts of a customary or negligible amount. On the other hand, these codes stipulate that gifts of a higher value may sometimes be retained if the recipient makes an offsetting payment to the Bank, which may donate such payments to a charity in turn. Otherwise gifts of a higher value that cannot be declined are retained by the central bank or passed on to charity.

It should also be noted that policies on travel or hospitality typically rule out any such benefits after the business or official component of a trip has come to an end, and also rule out any benefits for third parties, except official partners where their participation is customary.\(^{16}\) Areas where detailed approaches differ to some extent are the costs of travel or the costs of accommodation while at an official event. While there is typically a presumption that the central bank will pay for the costs of official travel, some codes of conduct permit the organisers of events to pay for travel or accommodation, but the latter is subject to conditions (such as the central bank official making a speech, or the event being widely-attended) or qualitative limits on the amounts involved. Some codes of conduct cover speaking fees accepted by central bank officials explicitly, and require them to be turned over to the central bank. The guidelines formulated by a number of central banks demonstrate that it can be quite complex to balance politeness, widely accepted social customs and behaviour that may be clearly above criticism.

Moreover, it should be noted that a few central banks publish information on expenses or gifts received by officials on their websites on a regular basis, which largely eliminates the possibility of using such information for sensationalist news stories and thus harming


\(^{16}\) In this regard, the Code of Conduct of the Bank of Albania provides that while employed by the Bank of Albania, an employee may not request or accept, directly or indirectly, gifts, rewards, favours, entertainment, credits, loans or anything else that has monetary value, from persons or entities that have or want to obtain favouritism in administrative procedures, contractual relations or any other financial relation with the Bank of Albania; conduct transactions or other activities that are subject to supervision by the Bank of Albania or have interests, which are fundamentally influenced by discharge or failure to discharge duties by a Bank of Albania employee. In addition, while employed by the Bank of Albania, an employee may infrequently accept small-value food items. Such benefits are also permissible when offered in meetings, luncheons, or dinners as part of a programme of activities organised by the Bank of Albania. Also, an employee may not ask for contributions by other employees to buy a gift or make a donation for a supervisor, or accept a gift from another employee with a lower salary than his, but may accept spontaneous gifts given willingly for special occasions such as wedding, birthday, and retirement, end of mandate, sickness or condolences. These gifts, as a rule, are limited only to the close circle of collaborators. The Code of Conduct of the Bank of Albania also stipulates that supervisors shall not ask for contributions from employees under their supervision under no circumstance.
these institutions reputation. The evidence of the above-mentioned is even more obvious in the case of the Bank of England which publishes detailed information on staff benefits and salaries as well as related information how they were handled,¹⁷ whereas the Bank of Canada provides detailed trip-by-trip information on the travel expenditures of its senior officials.¹⁸

It is worth noting that in most Codes of Conducts of Central Banks the practical advice is followed by a reminder to take matters very seriously, as any breaches may initiate disciplinary action, including possible demotion or dismissal of those involved.¹⁹ The actual weight and implications of such statements of principle will probably depend on the applicable legal system as well as on concrete provisions contained in the central bank law and other legislation. This in turn means that indeed it is not easy to assess which provisions a code of conduct could usefully contain at a minimum (and therefore how they should be formulated in general).

3. Personal investment restrictions

It is clear that most banks, but especially central banks have policies or rules that restrict the range or nature of the personal investments that some or all staff can make. The purpose of these rules is to avoid actual or perceived conflicts of interest among staff members. Indeed it is not surprising to find that there is a considerable degree of heterogeneity in terms of overall approaches, persons covered, types of transactions or instruments covered, the periods in which they apply and the way in which compliance is monitored. A few examples may properly illustrate the point:

- At the Bank of Albania, an employee is free to take care of personal financial interests, accordingly, except for not engaging in short-term trading of gold, foreign currency or financial assets related directly to them, for speculation purposes or not use or supply others with confidential information, which the employee has learned owing to his position, for purposes related to private financial transactions. In cases where an employee is not certain about his course of action in certain situations, he may seek assistance from the designated expert for the matter. These prohibitions are applicable to financial transactions by the employee himself or any close family members (spouse, children and your dependants). In addition, ownership rights on shares or securities are considered as private interests, when the employee is a partner proprietor in a company or he possesses privatisation bills. An employee who holds directly or indirectly, shares or other securities in a licensed bank or financial institution, must immediately withdraw from examination or participation in any regulatory and supervisory action related to these institutions, must not recommend or suggest, directly or indirectly, on the purchase, selling or any other transaction of shares or securities of a licensed bank or financial institution, which is somehow related to his work.²⁰

- At the Bank of Spain, many senior officials must place all tradable securities they own in a registered blind trust. Other staff members are

¹⁷ Please see http://www.bankofengland.co.uk/about/Pages/humanresources/default.aspx
¹⁸ Please see http://www.bankofcanada.ca/about/governance-documents/
¹⁹ The code of Conduct of the Bank of Albania stipulates that failure to observe the provisions of the Code constitutes reasons for disciplinary action by the Bank of Albania and that serious breaches may lead to eventual termination of employment with the Bank of Albania. The same provisions are stipulated in the Ethics Framework of the ECB.
²⁰ Please see the Code of Conduct of the Bank of Albania, supra note 2.
covered by more selective restrictions, graduated in part by the nature of their responsibilities. At the Swiss National Bank, all senior officials who take part in monetary policy decisions are required to either use a professional investment manager or to manage their investments passively, and they must not buy, sell or hold shares (or related instruments) in financial institutions. In any sense it seems clear that most central banks have introduced formal compliance mechanisms to safeguard the implementation of codes of conducts, and the number of staff resources devoted to compliance but is a requirement that most central banks have implemented.

4. Conflicts of interest and employment termination (cooling-off period)

It is significant to note that in most cases when a senior official or a staff member of a central bank leaves the central bank and takes up employment elsewhere, questions may arise about actual, potential or perceived conflicts of interest. This issue has been addressed by most codes of conducts in central banks by imposing restrictions on certain types of activities once a staff member has given notice or has actually left the central bank.

The evidence of cooling off periods is even more obvious in the case of ECB. Article 4b of the ECB’s ethical framework stipulates that certain members of staff who intend to engage in a new occupational activity after the end of their employment with the ECB shall refrain for a specified period from engaging in an occupational activity that could lead to a conflict with the interests of the ECB. However, the framework also stipulates that upon the request of a member of staff, the Executive Board may exceptionally waive or reduce the cooling-off periods, if there are particular circumstances that exclude conflicts of interest resulting from the subsequent occupational activity. The exception requires the member of staff to submit a reasoned request including supporting evidence.

On the other hand, Article 27.3 of the Code of Conduct of the Bank of Albania, stipulates that if an employee has worked for the Supervision or the Monetary Operation departments of the Bank of Albania, he may not seek employment in banks or other institutions that in a way have been subject of his work at the Bank of Albania, for a period of 3 months following the termination of employment with the Bank of Albania.

What is really remarkable is that the vast majority of banks but especially central banks have policies governing activities by senior officials in two periods: a cooling-off period before leaving the central bank, and a period after leaving the institution during which post-termination restrictions apply. As regards other officials and staff members, the likelihood of being covered by such policies tends to be lower, the lower their rank is in the institution. In addition, Central banks with full or major supervisory responsibilities are more likely to impose post-termination restrictions on officials or staff members than central banks with little or no supervisory responsibilities.

At the same time it could be argued that the extent to which a central bank has sole responsibility for monetary policy decisions (and conducts an active monetary policy) does not appear to be a major factor shaping such policies. Compliance with post-termination employment restrictions can be enforced by taking legal action in cases where they exist. However, most often the legal action will be for breach of contract, where even criminal prosecution is possible.

5. Conclusion
It is difficult to escape the conclusion that, as noticed above, code of conducts are conditio sine qua non tools that many financial institutions, but especially central banks adopt with a view to prevent employees disseminating valuable company data/know how to other similar businesses that operate in the same market and/or limit and mitigate the effects of possible conflicts of interests. Judged by these criteria, these codes have evolved and become tools aiming at preventing conflicts of interest. In several cases their provisions are now part of many central bank laws, which aspire prevent any conflicts of interest that may arise while employed in a bank. Such provisions are part of employment conditions and restrictions, and it may be easily assumed that most financial institutions and especially central banks consider them an important and effective mechanism for addressing potential conflicts of interest, and thus mitigate reputational risks towards these institutions, especially following the recent financial turmoil and its impact on ethics.

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The Bank of Albania is the central bank of Albania. The economical-political and social developments since its establishment have enriched the functions carried out by the Bank. The Bank's main task is to maintain the currency's purchasing power and thus price stability in the country.