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Strengthening the Framework for Supervising International Banks

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The Honorable Henry B. Gonzalez, Chairman
The Honorable James A. Leach
Ranking Minority Member
Committee on Banking, Finance and
Urban Affairs
House of Representatives

The Honorable Donald W. Riegle, Jr., Chairman
The Honorable Alfonse M. D'Amato
Ranking Minority Member
Committee on Banking, Housing and
Urban Affairs
United States Senate

We evaluated U.S. and international efforts to increase international coordination and improve the overall quality of bank supervision worldwide. This report was prepared pursuant to GAO's statutory authority, not at the Committees' request.

We are sending copies to the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Chairman of the Federal Deposit Insurance Corporation. We will also make copies available to other interested parties upon request.

Please contact me on (202) 512-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix V.

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Executive Summary

Purpose

While international banking has grown and become the foundation for the global economy, no one regulator oversees international banks to ensure the safety and soundness of the entire system. In each country, bank supervisors are responsible for the quality of their supervisory efforts but their efforts to coordinate with supervisors in other nations are purely voluntary.

To evaluate the progress toward improving the quality of international bank supervision and coordination, GAO (1) reviewed the efforts by the Basle Committee on Banking Supervision, the principal mechanism by which regulators work to coordinate banking supervision; (2) assessed the effectiveness of the committee's approach and the extent to which the committee is pursuing further options to enhance its role; and (3) analyzed whether the U.S. Foreign Bank Supervision Enhancement Act of 1991 can be one model for implementing into national law the Basle committee standards to promote adequate international banking supervision.

Background

Cross-border banking is expanding as the number, size, types of activities, and organizational complexity of international banks increase. While these cross-border linkages generally bring efficiencies to the world's capital markets, they also increase the difficulty of ensuring effective supervision and, in the extreme, may add to systemic risk, whereby losses in one banking group can infect the entire financial system. Moreover, the stringency of national regulation varies considerably. There are differences among nations in their requirements for audit, internal control, and corporate governance standards. Also, due to the global nature of banking, problems of a multinational bank can spill over into other markets.

Created in 1974 under the auspices of the Bank for International Settlements in Basle, Switzerland, the Basle Committee on Banking Supervision is the main forum for central bankers and supervisors to reach agreement on how best to supervise international banks. The committee is an informal group, and adherence to its principles is voluntary. Its members meet several times a year and consist of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

In the United States, the Foreign Bank Supervision Enhancement Act of 1991 (P.L. 102-242) gives the Federal Reserve Board greater supervisory

powers over foreign banks in this country. These new powers include heightened scrutiny of applications by foreign banks establishing U.S. offices and, in particular, a mandate to give greater attention to how regulators in a foreign bank's home country supervise their banks.

Results in Brief

Although bank supervisors, working through the Basle Committee's voluntary approach, have set recognized standards that led to improved bank supervision and increased bank capital, they believe that recent international banking problems demonstrate the need for better assuring adherence to the committee's supervisory standards. The committee is considering options for achieving better adherence, while recognizing and preserving individual nations' sovereignty over their banking systems. Such options include establishing a clearinghouse for national supervisory practices and facilitating peer reviews among national supervisory regimes.

Since GAO found little precedence or support for creating a strong, supranational regulatory body, or for giving the Basle Committee any formal authority, it believes these other options offer important benefits. Complete and consistent information on national supervisory practices would allow national authorities to make better decisions on permitting foreign bank operations in their countries, while avoiding costly duplication of efforts. Such information could also serve to gauge national supervisors' progress toward implementing Basle Committee standards. Peer reviews have, in a variety of settings, provided for more rigorous assessment of regulatory practices through self-monitoring, without creating a separate regulatory authority.

The Foreign Bank Supervision Enhancement Act could be one model of how nations might implement into law the principles espoused by the Basle Committee. While the act was the U.S. response to the real and potential problems of supervising its foreign banks, its provisions address issues addressed by the committee, including reliance on effective consolidated supervision of international banks by their home regulators.

Principal Findings

The Basle Committee's Progress in Improving International Bank Supervision

The Basle Committee has contributed in several ways to improving the standards for international banking. Its 1988 Capital Adequacy Accord provided a framework for strengthening the capital position (i.e., the amount of money banks must hold to back up their assets) of banks worldwide, leaving the banking system better able to withstand potential financial shocks. The accord has been fully implemented by all committee member countries, and nonmember countries with a significant international banking presence have either adopted or are working to adopt the accord. Further, adherence to the accord has resulted in a buildup of banks' capital funds, in many cases in excess of the suggested standard (see pp. 27-8 and 37-8).

In its June 1992 Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishments, the committee provided a framework to improve supervision of international banks. It reinforced the principle that no international bank should operate without being subject to "consolidated supervision"—effectively monitoring the worldwide activities of international banks with a current, complete, and accurate picture of all parts of the bank's operations. Through the standards, the committee in particular (1) addresses the need to designate clearly and assign responsibilities to a lead supervisor over complex entities and (2) reformulates its principles into minimum standards. Of significance is the committee's intent to monitor members' progress in implementing the minimum standards and to assess the standards for further refinements; and its call for bank supervisors to apply Basle Committee principles in practice, including having the capability of performing consolidated supervision (see pp. 32-3).

Need for Greater Adherence to Standards Recognized

While the Basle Committee's informal approach to formulating and presenting its initiatives has worked well, its members recognize a need for greater adherence to the committee's standards. The committee relies on acceptance of common international standards rather than on binding legal authority. It counts on countries to adopt and implement its principles voluntarily. Many countries, beyond those represented on the committee, adopted the 1988 Capital Adequacy Accord, for instance. The informal structure encourages the frank exchange of views, facilitates

consensus, and provides valuable guidance on improving international banking supervision (see pp. 38-40).

However, the recent failure of the Bank of Credit and Commerce International, seized by regulators around the world in July 1991, demonstrates the need for a supervisory framework that better ensures effective bank regulation. This case showed that bank supervisors have not fully implemented Basle Committee calls to ensure that (1) banks are supervised on a consolidated basis, (2) a capable lead supervisor is identified, and (3) information about the bank's potential problems is readily shared among supervisors (see pp. 40-42).

The committee addressed the need for carrying out its initiatives more consistently by reformulating its "best practices" into more forceful Minimum Standards and pledging to monitor their implementation, with room for later refinements. But the committee does face several constraints to improving the quality of supervision through its Minimum Standards: (1) the minimum standards are fairly general; (2) they must not only be adopted but also applied capably; and (3) supervisory practices vary among countries, while supervisors lack adequate information about the extent to which their colleagues follow Basle Committee principles. Basle Committee members believe the committee must continue to rely on moral suasion rather than legal authority to encourage adoption of its standards and monitor their implementation (see pp. 42-7).

Some committee representatives and experts have examined the feasibility of a clearinghouse for worldwide supervisory practices or of peer reviews to assess member countries' progress in adopting Basle committee standards. A clearinghouse could provide supervisors with complete and consistent information on worldwide supervisory practices, help them make better decisions on foreign bank operations within their jurisdictions, and avoid costly duplication of effort. Peer review, whereby teams of experts from member countries assess other member countries, has several advantages, GAO believes. Facilitating exchanges of information would allow countries to see progress in meeting the standards without creating a new regulatory body (see p. 47).

The Foreign Bank Supervision Enhancement Act Is a Possible Model

In the United States, the Foreign Bank Supervision Enhancement Act of 1991 was enacted to improve the supervision of foreign banks. Neither its intent nor the Federal Reserve Board's mandate for its implementation includes improving international supervision worldwide, nor promoting

the Basle Committee's Minimum Standards. However, to the extent that the act's standards are consistent with the Minimum Standards, the act can be seen as one model for how to improve international banking supervision at the national level in a manner consistent with Basle committee principles. (See p. 52.)

The Foreign Bank Supervision Enhancement Act contains a major principle the Basle committee reemphasized in its Minimum Standards—consolidated supervision. The act requires that the Federal Reserve Board base approval for the establishment in the United States of a foreign branch or agency on its determination that the foreign bank applicant is subject to comprehensive, consolidated supervision by its home country supervisor. The Basle Committee's Minimum Standards contain a similar but less stringent requirement, giving the host supervisor limited discretion to approve an applicant not subject to consolidated supervision (see pp. 58-60).

Recommendation

In order to strengthen supervision of international banks worldwide, it is necessary to ensure stricter application of the principles espoused by the Basle Committee on Banking Supervision. Therefore, GAO recommends that the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Chairman of the Federal Deposit Insurance Corporation, in consultation with their colleagues on the Basle Committee, seek an expanded role for the committee without the imposition of a new legal framework or interference with national sovereignty.

For instance, U.S. supervisors could work with other Basle Committee member supervisors to encourage and monitor progress toward adoption of the committee's Minimum Standards by expanding its role as a clearinghouse for information on supervisory practices. In addition, the committee could facilitate a peer review process for bank supervisors desiring such reviews, providing guidance for the conduct of these reviews, and writing guidelines for ensuring the confidentiality of supervisory information. In the peer reviews, the supervisors would be assessed by evaluating their compliance with the Basle Committee's Minimum Standards. Peer review reports could form the basis for bank supervisors to strengthen their procedures. As participants gain experience and refine the process over time, peer review might be instituted as a standard component of supervisors' efforts to strengthen the framework for international bank supervision.

Agency Comments

The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency provided written comments on a draft of this report, which have been presented and evaluated in chapters 3 and 4 (see pp. 49-51, 60-1, and app. III). The comments are reprinted in appendixes II through IV. The Federal Reserve Board and the Federal Deposit Insurance Corporation generally supported the overall conclusions of the report and the recommendation that the Basle Committee seek an expanded role to ensure application of its principles. The Office of the Comptroller of the Currency agreed that more can be done to enhance global bank supervision. However, the Office of the Comptroller of the Currency was concerned that the Basle Committee's limited membership could restrict its effectiveness as the main vehicle for improving coordination of international bank supervision. The Comptroller of the Currency was also concerned that it may be too soon to suggest the Foreign Bank Supervision Act as a model for implementing international standards.

GAO agrees that coordination of international bank supervision should go beyond the Basle Committee's limited membership, but, because the committee's 1988 capital adequacy accord has been widely implemented, GAO continues to believe that the committee currently is the principal forum for coordinating international banking supervision. GAO based its conclusion that the Foreign Bank Supervision Enhancement Act can serve as a model for implementing international standards on the act's shared objectives with the Basle Committee and on their similar criteria in approving foreign bank applications.

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Abbreviations

BCCI	Bank of Credit and Commerce International
BIS	Bank for International Settlements
BNL	Banca Nazionale del Lavoro
EC	European Community
FBSEA	Foreign Bank Supervision Enhancement Act
FDIC	Federal Deposit Insurance Corporation
GAO	General Accounting Office
IML	Institut Monétaire de Luxembourg
IOSCO	International Organization of Securities Commissions
OCC	Office of the Comptroller of the Currency
OECD	Organization for Economic Cooperation and Development

Introduction

The expanding number, changing nature, and increasing complexity of international banks has brought to the forefront the need for effective coordination of international banking supervision. This need is particularly important, because although banking operates worldwide, no supranational regulator exists to monitor all international banks. Banks are locating operations in foreign markets or offering cross-border services whereby the lending bank and the borrower reside in different countries. They are conducting an array of activities that, for some of them, includes providing investment banking, insurance, leasing, mutual funds, and derivatives,[1] as well as traditional commercial banking, through complex organizations known as "financial conglomerates." The resulting linkages among different markets and types of financial services mean that difficulties in one country's banking system can adversely affect the banking systems in other countries and, in the extreme, the worldwide banking system. In addition, because the stringency of national regulation varies and banking is global, problems experienced by a multinational bank in a less-regulated market can affect well-regulated markets.

Concern about the need to improve worldwide banking supervision was heightened with the July 1991 closure by regulators of the Bank of Credit and Commerce International (BCCI) and by problems with the Rome, Italy-based Banca Nazionale del Lavoro's (BNL) Atlanta, Georgia, branch. According to authorities investigating the case, BCCI evaded adequate supervision with a complex organizational structure, and both banks conducted fraudulent accounting and bookkeeping schemes.

In addition, banks are increasingly using new financial instruments to diversify their earnings and enhance their profits. While no consensus exists about the extent to which these activities represent adverse risk, banking regulators generally agree that monitoring these financial instruments will be a challenge requiring close international coordination.

Finally, coordination of international banking supervision promotes a more efficient and active marketplace. It gives market participants and consumers a sense of confidence that, in the absence of a supranational bank regulator, the system can withstand systemic shocks. Banks and other financial institutions are more likely to establish foreign operations and provide cross-border services, and consumers are more likely to utilize them, if both parties can be reasonably assured that supervisory practices and regulations are being coordinated worldwide.

[1]Derivatives are financial contracts whose value depends on the values of one or more underlying assets or indexes of asset values.

The Nature of International Banking

Banks have set up operations outside their own borders and engaged in cross-border banking for various reasons. First, advances in data processing and telecommunications have made it easier for banks to offer global services without establishing a physical presence in several markets. Second, the liberalization of restrictions on capital flows across country borders has increased international lending and deposit-taking activities. Third, the desire to reduce risk has led banks to diversify their earnings sources among several countries so that in any given year, an inadequate investment outcome in one country may be offset by a satisfying investment outcome in another country. Finally, banks' use of innovative financial instruments to diversify their earnings has also increased international banking activity.

Table 1.1 demonstrates the extent to which banks are operating worldwide. Among those banks with over $1 billion in tier 1 capital,[2] table 1.1 shows that, as of December 31, 1990, 15 banks held over 40 percent of their assets outside of their home country of operation.

[2]See chapter 2 for an explanation of tier 1 capital according to the Basle Committee standards. The table is taken from a survey by The Banker of 68 banks with over $1 billion in tier 1 capital. These banks are also at present doing business in at least three cities—London, Tokyo, and New York.

Table 1.1: The 15 Most Active International Banks by Percentage of Overseas Business as of December 31, 1990

Banks	Home country	Percentage of overseas business[a]
Hong Kong and Shanghai Bank Holdings	United Kingdom	78.1
Standard Chartered Bank	United Kingdom	63.7
Union Bank of Switzerland	Switzerland	57.7
Swiss Bank Corporation	Switzerland	53.1
Credit Suisse	Switzerland	52.4
Bankers Trust	United States	50.6
Republic New York	United States	47.7
Bank of China	China	47.1
Paribas	France	45.9
Banque Indosuez	France	45.0
National Westminster Bank	United Kingdom	44.3
Banque Nationale de Paris	France	43.8
J.P. Morgan	United States	43.4
National Australia Bank[b]	Australia	42.5
Citicorp	United States	40.6

[a]"Overseas" business refers to the percent of assets banks hold outside their home country.

[b]Data for the National Australia Bank are as of September 30, 1990.

Source: The Banker (Feb. 1992).

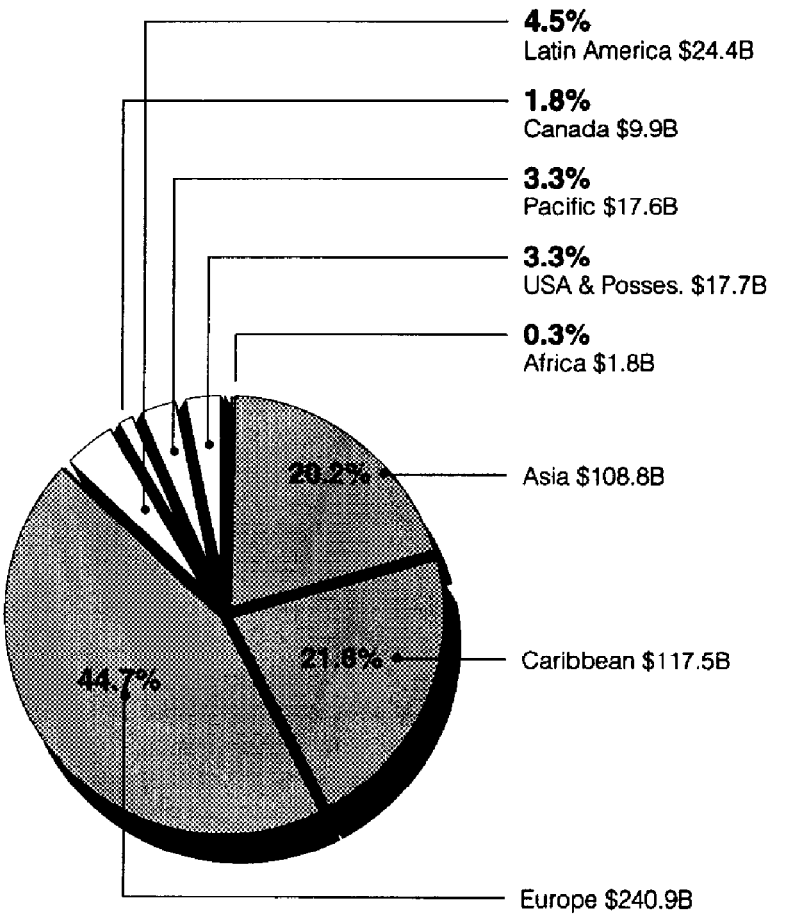
Foreign Banking in the United States

Over the past 6 years, foreign banks, that is, banks whose head offices are located outside of the United States, have increased their U.S. presence. From year-end 1987 through year-end 1992, assets of foreign banks operating in the United States increased by more than 38 percent, from approximately $628 billion to approximately $867 billion, which represented 22 percent of total U.S. banking assets in 1992.[3]

Breaking these foreign assets down by region, figure 1.1 shows that in 1992, banks from Asia and Europe accounted for more than 89 percent of the $867 billion of foreign bank assets in the United States. The assets held by Japanese banks accounted for almost 50 percent of the assets held by foreign banks.

[3]This figure does not include "edge" or "agreement" corporations or U.S. offices of Puerto Rican banks. Edge or agreement corporations are generally limited to international banking and cannot accept deposits from U.S. residents or businesses unless the deposits are directly linked to international trade.

Figure 1.1: Assets Held by Foreign Banks in the United States by Region as of December 31, 1992

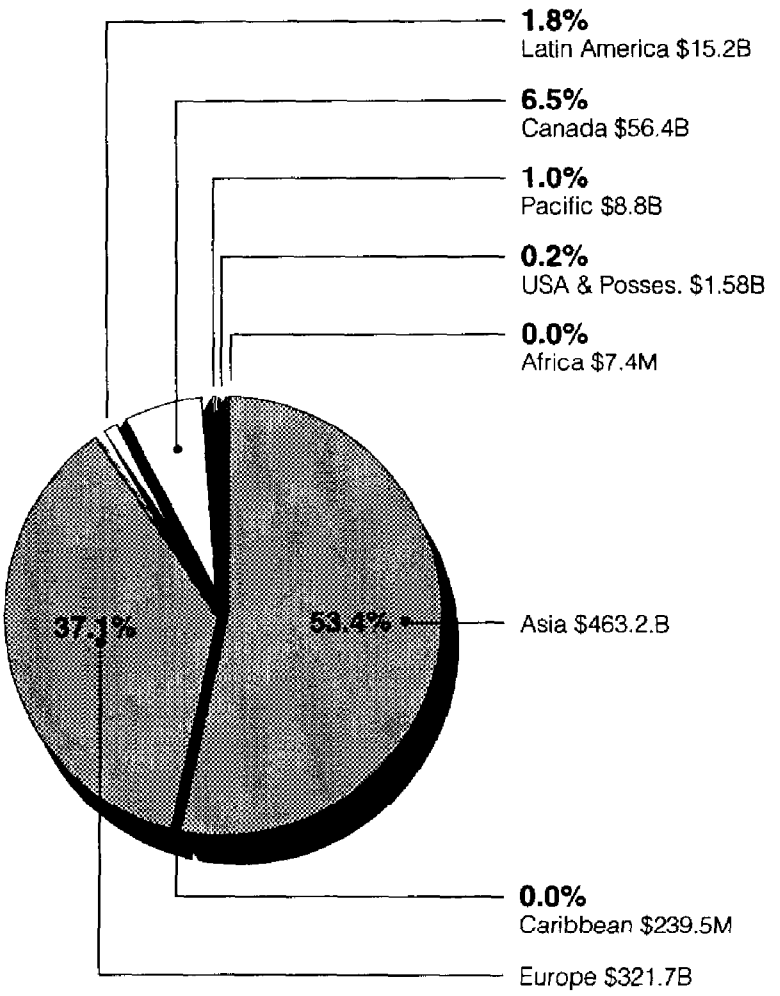


Source: Board of Governors of the Federal Reserve System.

U.S. Banking Abroad

Not only do foreign banks have a significant presence in the United States, but U.S. banks also conduct considerable operations overseas. From year-end 1987 to year-end 1992, U.S. banking assets booked in overseas offices grew steadily from approximately $162.4 billion to approximately $538.5 billion, an increase of almost 232 percent. Delineating these assets by region, figure 1.2 shows that in 1992, overseas offices in Asia, Europe, and the Caribbean accounted for almost 87 percent of the $538.5 billion of U.S. assets held abroad.

Figure 1.2: Assets of U.S. Banks' Overseas Offices by Region as of December 31, 1992



Note: Numbers may not add up due to rounding.

Source: Board of Governors of the Federal Reserve System.

International Banking Institutions Are Complex Organizations

Financial institutions have become increasingly complex organizations that offer a wide array of financial services. This complexity presents a challenge to supervisors, who must oversee not only banking functions but also other activities. Financial conglomerates are integrated groups of companies that offer a broad range of financial services, including traditional banking. Examples of the nonbanking services some financial conglomerates provide include insurance, securities brokerage, and securities underwriting activities and leasing.[4] The potential benefits to these organizations may have been increased market share, diversification of risk through expansion into nonbanking activities, better access to capital markets, and the consolidation of functions for more efficient operations.

While conglomerates offer the benefits of diversified assets, risks, and sources of earnings, their structures pose several problems for supervisors. Banking experts and supervisors with whom we spoke told us that supervision of financial conglomerates is an area of primary concern. One foreign official said that the primary need for studying financial conglomerates is to develop a standard that addresses the degree of transparency within the organization and the placement of overall supervisory responsibility.[5] There are also concerns about the adequacy of the management information systems and controls, particularly whether these are sufficient to warn supervisors and bank management of impending problems. The Federal Deposit Insurance Corporation Improvement Act of 1991 (P.L. 102-242, 105 Stat. 2236, 2286-2305) mandated improvements in these areas for U.S. banks.

One problem with conglomerates is the possibility of encountering "contagion," whereby losses in one activity may reduce the capital available to support other parts of the group or whereby visible difficulties in one area may affect confidence in other areas. Another problem is the risk that the capital of the group may be less than the sum of the capital in the operating affiliates.[6] Other problems include the risk that losses will be allowed to continue in one part, effectively subsidized by profits in other

[4]This discussion is limited to financial conglomerates and does not cover other types of conglomerates that may contain significant commercial or industrial interests in some part of the corporate structure.

[5]"Transparency" is defined as the bank supervisor's ability to obtain information about a financial conglomerate's total operations, including the parent holding company and its subsidiaries.

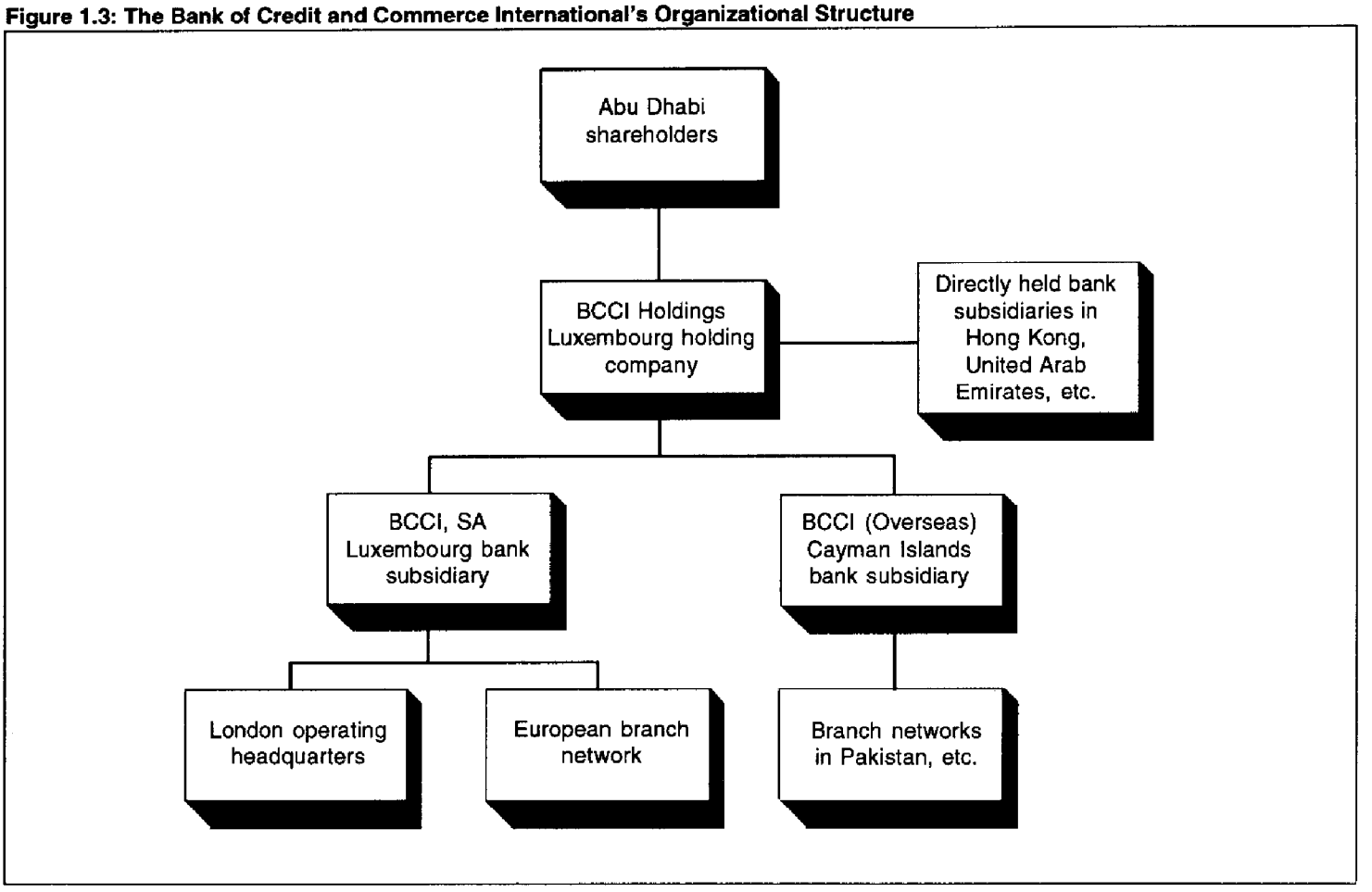
[6]According to a paper drafted by the Basle Committee, it is essential that the parent company in a financial conglomerate and its shareholders be a source of strength to the rest of the group. The capital base of the parent company should be at least as large as the capital required by the supervisors and regulators of each of the companies under the parent. The Basle Committee paper recommended that the group structure should not allow the same capital to be used more than once.

parts of the conglomerate; the risk of intragroup exposures, whereby members of the group have direct or indirect claims on each other; the risk of conflict of interest when the shareholders of the group are also customers of the group, potentially damaging the reputation of the entire group; and the risk of dispersion of control, which can be a deliberate act to conceal from supervisors where the controlling authority of the group resides.

Recent Events Concerning Two International Banks

Based on our review, the problems involving BCCI and BNL reenforce the need for an effective international system for supervising international banks. BCCI, whose organizational structure became increasingly complex, was established as a bank that would compete with banks of the West but serve primarily third-world countries. Throughout the 1970s, BCCI expanded its structure rapidly by adding new corporate members. BCCI was originally incorporated in only one location, Luxembourg. Two years later, a holding company was created, BCCI Holdings. Its subsidiary bank, BCCI S.A., was split into two parts: BCCI S.A., with head offices in Luxembourg; and BCCI Overseas, with head offices in the Grand Cayman Island. Luxembourg was used mostly for BCCI's European and Middle East locations, and the Grand Cayman mostly for third-world countries outside of the Middle East. For the purpose of this report, we will refer to the three BCCI-related entities collectively as "BCCI." The structure is shown in figure 1.3.

Figure 1.3: The Bank of Credit and Commerce International's Organizational Structure



Source: Richard Dale, International Banking Deregulation - The Great Banking Experiment (Cambridge: Blackwell Publishers, 1992) p. 200.

The corporate structure established by BCCI had the effect of minimizing close supervision of the full range of its operations and allegedly enabled it to avoid detection of its true operations and condition for almost 2 decades. For example, BCCI could remove transactions from the accounts of one subsidiary and place them on the accounts of BCCI units in other countries, thereby shielding these activities from supervisory review and external audit.

While BCCI allegedly evaded supervision through its complex organizational structure, BNL-Atlanta allegedly maintained two sets of books to avoid discovery of its illegal activities. BNL, Italy's largest bank—with more than $100 billion in assets worldwide— has offices throughout the world. BNL is 96-percent owned by the Italian government; it maintained an office in Atlanta—BNL-Atlanta. The agency office in Atlanta had no facilities for accepting deposits or conducting cash or checking transactions for customers. It was authorized only to conduct limited financing for large commercial customers located in nine southern states.

The Georgia Department of Banking and Finance handled primary oversight and licensing responsibilities. BNL-Atlanta was also subject to certain federal regulations and federal supervision. Specifically, BNL-Atlanta had to comply with Federal Reserve requirements to report information concerning its assets, liabilities, contingent liabilities, and country risk exposure—or the amount of money the agency was lending to other countries. The Federal Reserve also conducted limited annual examinations at BNL-Atlanta, usually covering portions of its international banking operations not reviewed by the Georgia authorities.

BNL-Atlanta allegedly approved as much as $4 billion in secret and unauthorized financing to Iraq. Some officials of BNL-Atlanta allegedly concealed their unauthorized financing to Iraq by fabricating and falsifying the branch's official accounts; maintaining a secret set of "grey books" that they kept on separate computers and in boxes that they stored outside of the branch; making false reports to the bank's management in New York and Rome; deceiving the bank's internal and external auditors by intercepting audit confirmations and forging responses to them; and lying to the federal and state bank examiners in person and in written reports required to be filed with regulators.

Fraud and deception on the scale alleged in the BCCI and BNL cases are difficult to detect by regulators and supervisors, who depend on the reliability of the records they examine. Nonetheless, the lack of coordinated or thorough oversight in these cases prompted the U.S. Congress to pass legislation that increases Federal Reserve Board oversight of foreign banks operating in the United States and requires greater scrutiny of new foreign bank applications. A full discussion of this legislation can be found in chapter 4.

Systemic Failure: The Ultimate Fear of Supervisors

As banking activities become increasingly global in nature, problems in one bank or banking group can be detrimental to financial entities in multiple countries. "Systemic crisis" is a disruption that severely damages the operation of the financial system either within a country or across country borders and, at the extreme, causes the system to break down completely. A typical form of financial crisis occurs when the sudden failure of a financial institution leads to a lack of confidence not only in the failed firm, but also in any of its other financial institutions thought to have similar vulnerabilities. Investors, in turn, refuse to deal with these other financial institutions. Creditors demand immediate payment, causing a liquidity problem not only with the original firm, but also among its other financial institutions, threatening the entire group's solvency if the situation is not resolved quickly. Several factors have increased the potential for systemic failure in international banking.

Greater linkages exist between various markets as banks interact with nonbank financial institutions, including investment banks and insurance companies domestically and across borders. These linkages increase the potential for problems to spread across a wider range of institutions and countries. Such linkages are evident as banks deal more in off-balance-sheet activities,[7] including derivative instruments. Although derivative instruments are used to reduce risk through hedging,[8] they sometimes involve complex transactions with many other individuals and institutions referred to as "counterparties." Some international finance experts have expressed concern that failure of one counterparty to honor its commitments may affect the ability of the other counterparties to honor their commitments. Opinions differ on whether this action could cause a systemic crisis.

The task of identifying and evaluating the creditworthiness of counterparties has been made more difficult by the complexity of the financial instruments and the multiple markets they affect. Uncertainty about any one of the counterparties' ability to resolve a liquidity crisis can cause other counterparties to refuse to lend to an illiquid but solvent institution, thereby leading to actual insolvency and failure.

[7]"Off-balance-sheet activities" refers to banks' business, often fee based, that does not generally involve booking assets or liabilities (i.e., making loans or taking in deposits, respectively). Examples of off-balance-sheet activities include trading in swaps, options, futures, and foreign exchange forwards, and granting standby commitments and letters of credit.

[8]"Hedging" is a strategy used to reduce risk by making purchases or sales of stocks or currencies that offset existing or anticipated exposure to a change in market rates.

Another trend that potentially increases systemic risk is the greater degree of concentration of off-balance-sheet activities among a few large, highly rated firms. This concentration stems from confidence in the credit standings of these firms, as well as such valid reasons as the high capital and human investment costs of developing complex instruments, performing risk management, and utilizing advanced technological systems. Such concentration also means that the off-balance-sheet activities of one major firm may affect many market participants. Thus, problems experienced by that major firm could entail losses to a greater number of participants than would otherwise have occurred if exposures had been more spread out.

Other factors that may contribute to the possibility of systemic failure include regional economic downturns, rapid movement of problems through automated systems or telecommunication networks, inappropriately managed risk by financial institutions, and ineffective crisis management by regulators or governments.

In 1991, the governors of the central banks of the Group of Ten (G-10)[9] formed a working group to study recent developments in international interbank relations.[10] The working group concluded that lessening the chance for systemic failure involves several actions: ensuring adequate risk management by the individual firm; improving the legal and institutional framework under which firms operate domestically and internationally; and promoting continued communication and cooperation among market participants, central banks, and other supervisory and regulatory bodies. The goal is to educate, create common standards, and devise other means to reduce undue risk to the system. Although there has yet to be a true "meltdown" of the global financial system, regulators have needed to be constantly alert to this possibility.

Efforts to Coordinate International Bank Supervision

As international banking has become more global in scope, banking supervisors have realized the need to coordinate their efforts to improve the safety and soundness of both their own banking systems and those of other financial markets. This coordinated approach to supervising international banks is useful for several reasons. First, coordination allows

[9]These countries actually numbered 11 altogether (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States).

[10]See Recent Developments In International Interbank Relations, Report prepared by a Working Group established by the Central Banks of the Group of Ten countries, Bank for International Settlements (Basle, Switzerland: Oct. 1992).

supervisors from different countries to gain knowledge about the different worldwide supervisory and regulatory approaches. It also facilitates the development of common standards to increase the safety and soundness of worldwide banking. Second, coordination encourages the reduction of competitive inequalities among the various countries by working toward making the degree of stringency of supervision more consistent among countries. Finally, coordination encourages developing effective ways to exchange information and deal with problems in a timely manner.

Coordination of international bank supervision has evolved through the efforts of international and regional organizations, as well as those of national regulators. A principal proponent of this coordination has been the Basle Committee on Banking Supervision.

In 1974, the central bank governors of the G-10 countries established the Basle Committee on Banking Regulation and Supervisory Practices, which is now known as the Basle Committee on Banking Supervision. The committee's members are senior officials of the central banks and supervisory agencies of the G-10 and Luxembourg. The committee operates under the auspices of the Bank for International Settlements (BIS)[11] in Basle, Switzerland, where it meets 3-4 times a year. BIS grants the committee's secretariat.

Four bank regulatory officials represent the United States at Basle Committee meetings—two from the Federal Reserve, and one each from the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). The Federal Reserve has appointed a senior official in its Banking Supervision and Regulation Division as its representative. Given the Federal Reserve Bank of New York's responsibility in money markets, the United States added the New York bank to its representation on the committee in late 1975. The Federal Reserve Bank of New York sends a senior official of its foreign banking department to Basle Committee meetings.

The United States added OCC to its representation in 1978. A senior deputy comptroller has usually been OCC's representative, although on occasion the Comptroller has attended. In 1984, FDIC became the third U.S. bank regulatory agency represented at committee meetings. FDIC is represented

[11]BIS is a bank and an international financial institution headquartered in Basle with three primary roles: it serves as a forum for promoting international monetary cooperation; it assists central banks in managing and investing some of their monetary reserves; and it acts as an agent or trustee for various international financial settlements.

at committee meetings by the Executive Director of its Division of Supervision.

The Basle Committee is an advisory body whose recommendations require consensus agreement of all its representatives. It has no power to require implementation of its agreements in the laws or regulations of its member nations. Instead, it formulates broad supervisory standards and guidelines. It also recommends statements of "best practices," expecting that individual countries will implement them through arrangements that best suit their own national system. However, U.S. federal bank supervisory agencies, as well as bank supervisory agencies of other member countries, have committed themselves to work to implement committee principles.

Various regional organizations have also provided a forum for discussing and analyzing issues involving international bank regulation. These regional organizations represent a wide variety of groups, from country regulators and government officials to private industry members. The Organization for Economic Cooperation and Development (OECD) and other groups have also contributed to the coordination effort but have played a more minor role. These other groups are discussed in appendix I.

In the United States, Congress enacted the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA) to improve the supervision of foreign banks doing business in the United States. The act addresses a number of issues raised in the various international forums. A full discussion of FBSEA is contained in chapter 4.

Objectives, Scope, and Methodology

We initiated this review as part of our basic legislative responsibility to evaluate U.S. and international efforts to strengthen the framework for supervising international banks in the aftermath of the BCCI and BNL cases. Specifically, we

- reviewed the efforts by the Basle Committee on Banking Supervision, the principal mechanism by which regulators have worked to ensure effective worldwide banking supervision;
- assessed the effectiveness of the committee's informal, voluntary approach and the extent to which the committee is pursuing further options to enhance its role; and
- analyzed whether the U.S. Foreign Bank Supervision Enhancement Act of 1991 could serve as one model for implementing into law at the national

level the principles espoused by the Basle Committee to promote adequate international banking supervision.

To address our first two objectives, we reviewed the Basle Committee's publications to obtain a thorough understanding of the committee's goals and initiatives as they relate to coordinating and ensuring effective worldwide banking supervision. We also interviewed officials representing bank regulators, supervisors, bankers associations, and various banking experts in Belgium, Luxembourg, France, Germany, Italy, Japan, the Netherlands, Switzerland, the United Kingdom, and the United States in order to obtain an up-to-date and balanced view of the nature of the committee's activities and its contribution to improving international banking supervision. We also interviewed an official from the Basle Committee Secretariat in Basle, Switzerland. To support the information we obtained in these interviews and from the committee directly, we reviewed documents from international organizations including the OECD and the European Community (EC).

To address our third objective, we reviewed various materials analyzing the Foreign Bank Supervision Enhancement Act of 1991 including correspondence, memoranda of understanding, books and other publications, and the actual banking regulation and legislation. We interviewed the U.S. and foreign banking regulators, international law firms, and consultants to gain a broad view of the intent of the act. We also reviewed legislative testimony from both the U.S. Congress and the houses of Parliament of the United Kingdom. In our overseas interviews, we obtained an international perspective on the U.S. law. In addition, we interviewed officials from a U.S. bank rating agency, U.S. attorneys who specialize in international banking issues, and experts from several U.S. banking associations.

We did our work between April 1992 and October 1993 in accordance with generally accepted government auditing standards.

We sent drafts of this report to the Federal Reserve Board, OCC, and FDIC for comment. Their comments are presented and evaluated in chapters 3 and 4 and are reprinted in appendixes II through IV. Some of OCC's comments are also addressed at the end of appendix III. (See p. 77.) Other technical changes and clarifications provided by the agencies have been incorporated into the chapters.

The Basle Committee and Other Groups Have Enhanced Coordination of International Banking Supervision

For almost 20 years, the Basle Committee on Banking Supervision has been the main forum for improving the supervision of internationally active banks. The committee has contributed to improvements in the safety and soundness of international banking. In 1988, the committee's Capital Adequacy Accord devised a framework for measuring the adequacy of bank capital (that is, the difference between total assets and total liabilities) and created a set of standards for capital levels of international banks worldwide. In June 1992, the committee issued minimum standards for supervising international banks. These standards bolstered the principle that no bank should operate without being subject to consolidated supervision or effective worldwide monitoring of its activities. In addition, the committee is addressing such issues as supervising conglomerates and off-balance-sheet activities, developing standards for measuring and controlling market risk,[1] and measuring interest rate risk.

Although the Basle Committee is the main global forum for enhancing the effectiveness of bank supervision, other international groups contribute to the process. The committee has worked closely with the European Community and other regional groups in formulating its principles (see app. I).

Basle Committee Efforts

The committee's main objective is to help encourage greater coordination among international bank supervisors. It has pursued this objective by (1) facilitating the exchange of information among supervisors on the various national supervisory practices, (2) encouraging safe and sound national regulatory policies and practices, (3) developing general principles for adequately supervising international banks, and (4) developing standards for bank capital and other areas.

Basle Committee Accomplishments

In almost 20 years since its formation, the Basle Committee on Banking Supervision has addressed sensitive bank supervisory issues, especially those that have arisen because of the expansion of foreign bank operations. In the original concordat (1975) and the revised concordat (1983), the committee apportioned responsibility for supervising foreign banking offices between countries in which the offices are located (host countries) and those in which the banks are headquartered (parent countries). The revised concordat also introduced the concept of

[1]Market risk is the potential for loss due to movement in market prices, including interest rates, exchange rates, and equity values.

consolidated supervision. In the 1988 Capital Adequacy Accord, the committee established the minimum capital standard defining how much capital internationally active banks should maintain. The committee's 1990 Supplement to the Concordat encouraged structured collaboration between foreign banking supervisors. The committee, in its 1992 Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishments paper, attempted to ensure that all international banks would be subject to effective consolidated supervision.

1988 Capital Adequacy Accord

Regulators from the major industrial nations had been addressing capital adequacy issues for some time in the Basle Committee. In 1986, the United States and the United Kingdom stimulated attempts to reach an international agreement on minimum capital requirements by issuing a bilateral agreement for comment on a framework to evaluate the adequacy of a bank's capital in relation to its risk.[2] Following negotiations within the Basle Committee, this proposal was amended, resulting in the 1988 capital accord for measuring credit risk,[3] which the committee viewed as the major risk banks face. Credit risk involves the risk of loss from default on a loan or other obligation.

The expressed objective of the capital framework was

- to strengthen the soundness and stability of the international banking system by increasing individual banks' capital levels and
- to level the international playing field because countries' different regulatory requirements were causing some competitive inequality between banks.

An additional objective of the framework was to ensure that banks set aside enough capital to support their off-balance-sheet activities. These activities often were not included in domestic capital requirements.

The Basle framework for measuring capital adequacy includes the following three basic elements:[4]

[2]"Convergence of Capital Adequacy in the United Kingdom and the United States," January 1987.

[3]This framework is outlined in the International Convergence of Capital Measurement and Capital Standards, Committee on Banking Regulations and Supervisory Practices (Basle, Switzerland: July 1988).

[4]For a more detailed discussion of the framework, see International Banking: Implementation of Risk-Based Capital Adequacy Standards (GAO/NSIAD-91-80, Jan. 25, 1991).

- A common definition of capital that emphasizes the importance of core capital (tier 1 capital), which consists of capital elements generally counted in most nations, is one of the elements. The definition also includes tier 2, or supplementary, capital with capital instruments used in some, but not all, member countries.
- A risk-weighting framework that ties capital requirements to the credit risk of assets and off-balance-sheet activities is another element.
- A standard that internationally active banks maintain capital to at least an 8 percent level of their risk-adjusted assets by year-end 1992 is a third element. At least half this capital must be tier 1.

At present, the Basle Committee is monitoring the accord, considering the incorporation of other types of risks, and addressing a number of technical questions in interpreting certain provisions. (See "continuing efforts" later in this chapter.)

The Basle Concordat of 1975

In 1975, the Basle Committee published the Report to the Governors on the Supervision of Banks' Foreign Establishments, known as the Basle Concordat of 1975. The concordat lays out guidelines for cooperation between national authorities in supervising foreign banks. The concordat delineates supervisory responsibility for three types of foreign banking operations: (1) branches, which are integral parts of a foreign parent bank; (2) subsidiaries, which are legally independent institutions incorporated in the country of operation and controlled by one foreign parent bank; and (3) joint ventures, which are legally independent banks incorporated in the country of operation and controlled by two or more parent institutions. In addition, the concordat addresses banking supervision from three aspects: liquidity,[5] solvency,[6] and foreign exchange operations and positions.[7]

The Basle Concordat of 1975 divides the responsibility for supervising foreign banking offices between the host supervisor, meaning the supervisor in which the foreign office is located, and the parent supervisor based on the liquidity, solvency, and foreign exchange positions of foreign bank operations. The committee decided that while the primary responsibility for supervising the liquidity of foreign bank operations rests with the host supervisor, the parent supervisor must be aware of the

[5]Liquidity is the ability to convert assets into cash or cash equivalents without significant loss.

[6]Solvency is the ability to meet current obligations as they come due.

[7]Foreign exchange operations provide customers with foreign exchange services. Banks may also trade on the foreign exchange market, that is, buy and sell stocks and currencies in an effort to earn profits.

foreign branches' demands on the parent banks' resources. In supervising the liquidity of foreign subsidiaries and joint ventures, the host supervisor should inform the parent supervisor of its methods for evaluating liquidity.

In supervising solvency, the committee recommended that the host and parent supervisors share responsibility based on the type of foreign banking operation. For foreign subsidiaries and joint ventures, the host supervisor has the main responsibility, but the parent supervisor must consider the exposure of the offices for which it has a "moral commitment." For foreign branches, the committee decided that since the solvency of a branch is linked to its parent's solvency, the responsibility for monitoring this element rests essentially with the parent supervisor. The division of responsibility for supervising the foreign exchange position of foreign banking operations mirrors those responsibilities established for branches and subsidiaries discussed previously.

Finally, the committee recommended the removal or reduction of any barriers that impede close cooperation between national supervisors. Specifically, the committee recommended the following action: (1) direct transfers of information between national supervisors; (2) direct inspections by the parent supervisor of its domestic banks' foreign offices; and (3) indirect inspections of foreign banking offices by parent supervisors through the agency of the host supervisor.

The Basle Concordat of 1983

In 1983, the Basle Committee published the Principles for the Supervision of Banks' Foreign Establishments. Known as the "revised concordat," this document replaced the 1975 concordat, reformulated some of its provisions, and introduced the principle of consolidated supervision. The Basle Committee intended the principles in the revised concordat to be taken as "best practices," which G-10 member countries have begun implementing.

The revised concordat reemphasized the concept of cooperation between the parent and host supervisors found in the 1975 concordat and also provided more specific guidance on their respective areas of responsibility. It gave primary responsibility for monitoring the liquidity of foreign branches, subsidiaries, and joint ventures to the host supervisor. It also gave the parent supervisor primary responsibility for monitoring the solvency of foreign branches. In addition, it required that the parent and host supervisor share responsibility for monitoring the solvency of foreign

subsidiaries, as well as monitoring the foreign exchange operations and positions of foreign banking offices.

The revised concordat recommended that the host and parent supervisors regularly take certain actions.

- Host and parent supervisors should keep each other informed when serious problems arise in a parent bank that are likely to affect the parent's foreign banking offices.
- The parent supervisor should determine whether the host supervisor can adequately supervise a foreign banking office, and the host supervisor should inform the parent supervisor if it cannot do so.
- The parent supervisor should extend its supervision over the foreign offices or discourage the parent bank from continuing the operations of the foreign offices when the host supervisor's supervision is inadequate. Similarly, the host supervisor should discourage, forbid, or impose restrictions on the operations of the foreign banking office if the parent supervisor's supervision is inadequate.
- The parent supervisor should ensure that holding companies and their subsidiaries are adequately supervised.

Finally, the revised concordat introduced the principle of consolidated supervision, whereby the parent banks and parent supervisory authorities monitor the risk exposure, including the concentration of risks, the asset quality, and the capital adequacy of the banks and banking groups under their responsibility "on the basis of the totality of their business wherever conducted." The revised concordat does allude to the importance of a lead supervisor where "gaps in supervision can arise out of structural features of international banking groups." The concordat places responsibility on the parent authority, stating that "where a bank is the parent company of a group that contains intermediate holding companies, the parent authority should make sure that such holding companies and their subsidiaries are covered by adequate supervision."

Supplement to the Concordat

A supplement to the concordat stemmed from a joint report by the Basle Committee and the Offshore Group of Banking Supervisors[8] issued in August 1987. The Basle Committee recognized the permanent status of the report by reissuing its proposals in April 1990 as a supplement to the 1983 concordat. The supplement was designed to provide practical recommendations for implementing those aspects of the revised concordat

[8]For a full description of the Offshore Group of Banking Supervisors, see appendix I (pp. 66-7).

that required consultation and flows of cross-border information among supervisory authorities. It provided recommendations to parent and host supervisors with regard to the authorization of banking offices, the information needs of the parent and host supervisors, the removal of secrecy constraints, and the need for external audits. The supplement also addressed the committee's belief that, although many supervisors consult when foreign banks first seek to establish operations in the host country, they do not collaborate as closely or as frequently as the concordat advocates.

In authorizing foreign banking offices, the supplement recommended that the host seek a prior endorsement from the parent supervisors. If the parent fails to respond or fails to provide an adequate response, the host should consider denying the application or imposing restrictions on the authorization. If the parent's supervision is inadequate, the authorization should be contingent on the host supervisor's adopting the parent's role. Furthermore, the parent authority should take measures to prevent its bank from establishing operations in unsuitable locations or making inappropriate acquisitions.

In satisfying the informational needs of the host and parent supervisors, the supplement recommended that both host and parent supervisors satisfy themselves that the internal controls of a foreign bank are adequate, including maintaining comprehensive and regular reporting between the bank's foreign operations and its head office. The supplement recommended that the host supervisor consult with the parent supervisor about actual, or suspected, serious problems in a foreign bank's operation, and about its plans to remedy them, or withdraw the foreign bank's authorization. It also recommended that the parent and host supervisors coordinate in other supervisory matters.

In making recommendations about constraints on information exchange, the supplement stated that national secrecy laws designed to protect legitimate interests of bank customers can be an obstacle to information exchange among supervisors and banks. It continued by noting that this legislation does not prevent national authorities from exchanging generalized prudential information, such as information on management competence and internal control systems. The supplement's recommendations were based on the premise that secrecy constraints should be removed to allow supervisors to exchange prudential information freely, subject to certain conditions meant to protect the providers and receivers of the information.

In addressing the need for external audits, the committee recommended that (1) the authorization of foreign banking offices be contingent upon adequate provision for external audits, (2) supervisors appoint internationally qualified auditors and be able to replace inadequate auditors, and (3) external auditors be able both to verify the foreign banking office's data and communicate with the supervisor.

1992 Minimum Standards

In 1992, the Basle Committee on Banking Supervision issued the Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishments. The committee created the Minimum Standards to reinforce the principles espoused in its 1975 concordat, 1983 revised concordat, and 1990 supplement to the concordat. The committee issued the Minimum Standards in an era of growing international banking activities and in the aftermath of events surrounding troubled international banking institutions, such as BCCI. Moreover, the committee designed the Minimum Standards to provide greater assurance that no international bank could operate without being subject to effective consolidated supervision.

The committee emphasized in the introduction to the Minimum Standards that, although the principles of the concordat and its supplement remain sound, "there needs to be a greater effort to ensure that these principles can be applied in practice." According to officials we interviewed, the committee's reformulation of the principles into standards, and its call for practical application versus mere endorsement of those standards, demonstrates that while the committee recognizes that prior agreements address the right issues, the minimum standards reflect the need to address those issues with greater force.

The main features of the minimum standards are as follows:

- A home-country authority that capably performs consolidated supervision should supervise all international banking groups and international banks.
- The creation of a cross-border banking office should receive the prior consent of the host-country's supervisory authority. It should also receive the prior consent of the bank's supervisory authority, and, if different, the banking group's home-country supervisory authority.
- Supervisory authorities should have the right to gather information from the cross-border banking offices of the banks or banking groups for which they are the home-country supervisor.

- A host-country authority that determines that any one of the prior minimum standards is not met can impose restrictions on the bank, including prohibiting the bank from establishing any offices within the host authority's jurisdiction.

Basle Committee representatives told us that the committee deliberately expressed these standards in general terms because the various countries that will be implementing them need flexibility according to their individual legal and structural conditions. As a result, the committee intends to monitor the implementation of the minimum standards in its ongoing collaborative work on the supervision of international banks.

A more in-depth discussion of the minimum standards can be found in chapter 3.

Continuing Efforts

In addition to the major initiatives discussed thus far, at the time of our review the Basle Committee on Banking Supervision was working in several other areas including monitoring the capital accord, market risk, conglomerate supervision, and the management of off-balance-sheet activities. Foreign bank supervisors and international banking experts with whom we spoke indicated that these issues were among the most critical on the Basle Committee's agenda.

Monitoring the 1988 Capital Adequacy Accord

The Basle Committee continues to monitor implementation of the accord and has dealt with a number of technical issues concerning interpretation of certain provisions. The committee amended the capital accord in November 1991, to be effective no later than year-end 1993, to define more clearly to what extent general loan-loss reserves could qualify for inclusion in capital. The committee's intention was to ensure that the reserves banks set aside for both identified loan losses and demonstrable deterioration in the value of particular assets should not be included in the capital base, which is specifically meant to absorb unidentified losses.[9]

Market Risk

The Basle Committee devoted considerable effort to the issue of identifying market risk after the 1988 Capital Adequacy Accord was completed. That accord focused mainly on credit risk. The committee realized that banks were increasingly participating in trading and

[9]For a full description of the amendment, see Report on International Developments in Banking Supervision, Report 8, Basle Committee on Banking Supervision (Basle, Switzerland: Sept. 1992).

off-balance-sheet activities, such as using derivative instruments, that would expose them to greater market risk. The committee also knew that supervisors needed tools to measure and monitor the extent to which banks were exposed to such risk. In attempting to deal with the issue of market risk, the Basle Committee has collaborated with members of the International Organization of Securities Commissions (IOSCO), many of whose members regulate the securities subsidiaries of banks. The Basle Committee and IOSCO share the goal of ensuring that the competitive equality among banks, including banking groups, and nonbank securities houses is maintained. Maintaining this competitive equality would avoid distortions of the market while preserving the effectiveness of both systems of supervision.

For the first time, the Technical Committee of IOSCO and the Basle Committee held a joint meeting in January 1992 to consider proposed minimum capital rules for internationally active banks and securities firms. The IOSCO membership had not agreed on common minimum standards for securities firms. In April 1993, the Basle Committee went ahead and published three consultative proposals on netting,[10] market risk, and interest rate risk, with comments invited by year-end 1993.

Supervising Conglomerates

As discussed in chapter 1 (see pp. 17-8), financial conglomerates present several challenges to bank supervisors. In September 1992, the secretariat of the Basle Committee drafted a working document that presented principles for supervising financial conglomerates. Briefly, those principles call for supervisors to have sufficient formal authority to prohibit corporate structures from being deliberately designed to obstruct effective supervision; require the corporate group to have sufficient capital to support the risk of the entire group and ensure against double counting of capital among group members; require supervisors to perform groupwide supervision by obtaining adequate information about the types of risks faced by group members; ensure that shareholders' interests do not prevail over those of depositors, investors, policyholders, and customers generally; and ensure that management is capable of handling the diverse risks within the group and that appropriate external audits exist.

[10]In dealing with credit risk, the Basle Committee, which supports netting where legally permitted, refers to "netting" as risk weighting the net rather than the gross claims arising out of various off-balance-sheet activities.

Off-Balance-Sheet Activity Management

Reacting to the rapid development of markets for new financial instruments, the Basle Committee at the time of our review was studying the supervisory treatment of off-balance-sheet instruments. Not only have new financial instruments emerged, but once relatively immature markets have also developed in size and sophistication. The committee has stated that it intends to cover the following issues: (1) the present treatment of financial instruments contained in the Capital Adequacy Accord, (2) the treatment of financial instruments not addressed in the accord, and (3) the concentration of counterparty exposure in the financial derivatives market.

The Need for Greater Adherence to Basle Committee Standards Is Recognized

The Basle Committee's collaborative, nonlegalistic approach has been effective in addressing the right issues, providing valuable guidance, and devising solutions to the challenges facing international banking supervisors. Its informal, cooperative approach worked well to create the 1988 Capital Adequacy Accord, for instance. There was little support among the bank supervisors and experts with whom we spoke for giving the Basle Committee the force of law, or for creating a separate supranational regulatory body to enforce supervisory principles. On the other hand, the committee's lack of authority to enforce the adoption of its initiatives has proven to be both advantageous and limiting. The collapse of BCCI was due in part to the failure of any supervisor to perform consolidated supervision, a principle first incorporated in the committee's 1983 revised concordat. Both in response to the BCCI case and previously to the need for increased bank capital levels worldwide, the Basle Committee has been moving toward taking on a more forceful role within its current framework.

Both the 1988 Capital Adequacy Accord and the 1992 Minimum Standards call for the committee to monitor implementation; supervisors consider both agreements to be more rigorous than the previous concordats. Still, the committee faces some constraints to ensuring effective implementation of its Minimum Standards. The standards are necessarily fairly general: Countries must not only adopt the standards but also carry them out capably; supervisors lack complete information on the extent to which their colleagues worldwide apply consolidated supervision and other committee standards; and Basle Committee members believe the committee must continue to rely on moral suasion rather than legal authority to encourage adoption of its standards and monitor their implementation.

Basle Committee representatives are considering ways to better ensure adherence to committee standards while preserving individual nations' sovereignty over their banking systems. These ways include establishing a clearinghouse for worldwide supervisory practices and conducting peer reviews to assess countries' progress in adopting committee standards.

The Basle Committee's Voluntary Approach Worked in Forging the Capital Adequacy Accord

The informal, voluntary system worked in formulating the 1988 Capital Adequacy Accord (discussed in chap. 2). One indication of this reliance on national cooperation rather than formal treaties is that the accord itself was not drafted as a binding legal agreement; instead, it was "endorsed" rather than signed by the membership. The document is essentially a statement of intent by committee representatives to adopt capital adequacy standards that would be based on common definitions of "capital" and "risk." It allows countries flexibility in the way they implement the rules, taking into account their different regulatory systems.

The accord has been incorporated into the supervisory frameworks of all countries that are members of the Basle Committee. Virtually all countries that are not members of the Basle Committee but have large international banks have introduced, or are working on introducing, the standards espoused in the Capital Adequacy Accord, including all of the EC countries. According to a Basle Committee report, since the accord, the capital ratios of larger international banks have increased considerably. At year-end 1991, in most cases they exceeded the accord's minimum capital standard of 8 percent. The committee reported that the increase in capital adequacy ratios is partly due to a decreased rate of growth in the acquisition of risky assets. However, the committee noted that the rise is mostly due to an increased growth in capital reserves.

Despite the fact that a binding structure was absent, several factors motivated national supervisors to reach an agreement on capital levels. For several reasons, regulators were willing to follow the collective approach rather than rely on bilateral or individual efforts. Above all, the Basle Committee was not forcing its own agenda on national regulators, but reflecting their common interests. Regulators shared a common concern in the early 1980s that, due to the international debt crisis, bank safety and soundness were being threatened by depleting worldwide levels of bank capital. At the same time, regulators wanted to ensure a level playing field, recognizing that for one or two countries to adopt capital adequacy standards might only mean banks would flock to the jurisdictions with lesser capital standards and the overall banking system would not be made more safe and sound. These two factors, the concern for safety and soundness and the recognition that individual efforts would be counterproductive, drove supervisors to commit their banking authorities to surrender some of their separate standards in the interests of reaching an agreement.

The implementation of the Capital Adequacy Accord is ongoing. The Basle Committee continues to monitor its progress and refine and expand the capital adequacy standards to ensure that they are implemented and effective. The informal approach comes into play in this monitoring effort as well, since it will likely be carried out by committee representatives and their staff, rather than by either the Secretariat in Basle or a separate internationally sanctioned organization. We believe the expertise and practical experience of the committee members make them uniquely qualified to judge the extent to which their peers are implementing the accord in a consistent manner. Committee representatives also retain the flexibility to recognize and alleviate any unintended side effects.

Supranational Regulatory Body Lacks Support

Supervisors and experts with whom we spoke generally believe a supranational regulatory body with the force of law would threaten national sovereignty, be mired in bureaucracy, and, in order to avoid the possibility of sanctions, would create agreements so general in nature as to be ineffective. Bank supervisors and experts believe that supervisors are more likely to come to a consensus and create substantive agreements if they can propose solutions without the need to gain permission from their respective governments. Thus, supervisors have been able to formulate workable solutions, forge consensus, and create effective agreements. In addition, since laws by their very nature would be slower to amend than principles, giving the committee statutory authority could reduce its flexibility in dealing with an industry that is constantly and rapidly changing as new financial products emerge.

Bank supervisors believe the Basle Committee's informal structure is one key to its success in coordinating international banking supervision. Lacking statutory authority to change national laws and regulations, or to enforce its principles through sanctions or other means, the committee has gained acceptance through cooperation, moral suasion applied among its membership, and the formulation of agreements that reflect market forces and the best interests of the parties involved. In their view, the committee members—central bankers and bank supervisors—have the expertise necessary for dealing with a complex area and the responsibility for improving banking supervision. We believe there is little likelihood of a binding international agreement that would mandate adherence to a meaningful set of international standards for supervision. In fact, international bodies are generally reluctant to impose sanctions.

One academic expert we spoke with, Dr. Richard Dale, favored the formation of a multilateral organization with wider membership beyond the G-10 countries and enforcement powers comparable to the International Monetary Fund. He was concerned that the Basle Committee lacked the broad reach and legal status necessary to provide an international overview beyond the G-10 countries and to cover all aspects of international finance, both banking and nonbanking, necessary in today's essentially borderless international market. Ideally, such a body would have the authority to quickly address specific problems rather than relying on general agreements and the discretion of national authorities to enforce them. However, he admitted the creation of such a body was unrealistic at this time, given the legitimate concerns of supervisors and experts we discussed earlier, and would perhaps function successfully only in an "ideal world."[1]

Expanding Membership Is Questioned

Another issue regarding the Basle Committee's standing as an effective forum is whether the committee should expand its membership. Basle Committee representatives and international banking experts with whom we spoke generally believed that expanding the membership would make the committee less effective. With a larger membership, the danger of slowing down consensus and impeding agreements would be increased. Committee representatives said they consult nonmembers on all their initiatives and give them a chance to comment substantively. Also, they said that Basle Committee-related groups, such as the Offshore Group of Banking Supervisors (see pp. 66-7), are regularly in contact with the committee, as committee members are either members of those groups themselves or attend their meetings on a regular basis as observers. The Basle Committee facilitates contact between supervisors all over the world and circulates technical documents to assist the process of supervision, as well as more policy-oriented documents.

Nevertheless, a few of the foreign bank supervisors and international banking experts with whom we spoke believed that, despite genuine attempts by the committee to include nonmember countries in the review and formulation of committee initiatives, expansion of the committee's formal membership still had some merit. They believed that current

[1]In testimony before the United Kingdom's Treasury and Civil Service Committee of the House of Commons, Dale stated, "The Basle [Committee] arrangements seek to be global but are substantially voluntary and in an ideal world no doubt we would have a legally binding international agreement which would also be global in its scope. I think realistically we are not at that stage yet and I cannot envisage getting such an agreement. Short of that, I would have thought the Basle arrangements are a fair second best, not without their weaknesses of course."

nonmembers may be more likely to comply with Basle principles if they formally participated in their creation and that the unique concerns of the non-G-10 countries might be better aired through full membership. They were not convinced that the special concerns of nonmembers were consistently being addressed, and they believed that nonmember countries may in some cases view the committee as an exclusive club that does not address their particular needs. One foreign bank supervisor with whom we spoke believed the committee could do more to include countries from Asia and the Caribbean.

In summary, bank supervisors generally believe the Basle Committee is the best forum to coordinate international banking supervision. However, in view of the events surrounding BCCI, the bank supervisors, as evidenced by their issuance of the Minimum Standards, and several experts with whom we spoke believe that some further steps could be taken to ensure that proper international bank supervisory standards are adhered to by committee member nations and nonmember nations alike.

BCCI Situation Points up Problems in Applying Basle Principles

Despite the formulation and adoption of the 1988 Capital Adequacy Accord and countries' commitments to the Basle Committee concordats for supervisory principles, problems have continued to occur. In some cases, national implementation of the committee's supervisory principles has not been effective, we believe. In other cases, no supervisory authority was prepared to act as lead supervisor over all of BCCI's operations.

BCCI Evaded Basle Principles

The BCCI case highlights the reality that countries are still not fully committed and consistently able to apply Basle Committee principles when necessary. The Basle Committee's 1983 revised concordat, as described in chapter 2 (pp. 29-30), assigns various supervisory functions to either or both the parent and host supervisors and calls for both to cooperate and exchange information. But significantly, the revised concordat assigns overall responsibility to the parent supervisor for overseeing a bank's entire worldwide operation: "Parent authorities are responsible...where a general supervisory responsibility exists in respect of their worldwide consolidated activities." Complementing this responsibility over a bank's worldwide operations, the revised concordat recommends that the parent authority provide consolidated supervision. Consolidated supervision means monitoring the risk exposure (including the concentrations of risk, the quality of assets, and the capital adequacy) of the banking groups for which the parent authority bears responsibility,

on the basis of the totality of the business, wherever conducted. Finally, the revised concordat states that if a host supervisor believes the home supervision of foreign banks operating within its territories is inadequate, it should prohibit or discourage the banks' continued operation or impose restrictions on their activities within its territory.

BCCI clearly lacked a parent authority[2] capable of performing consolidated supervision over the banking group. BCCI had a complex and unique organizational structure;[3] during most of the 1980s, international bank supervisors struggled to deal with this completely. This complicated structure hampered effective supervision. Since BCCI's main holding company was incorporated in Luxembourg, under the Basle principles the Luxembourg authority, the Institut Monétaire de Luxembourg (IML), was the lead regulator responsible for conducting consolidated supervision. IML, however, testified before the Treasury and Civil Service Committee[4] that it found it difficult to exercise adequate consolidated supervision over "a group 98 percent of whose activities fell outside its jurisdiction." The U.S. accounting firm of Price Waterhouse, which did an audit of BCCI, testified, "The resources available to the Regulators in BCCI's main territories of incorporation—Luxembourg and Cayman—were not commensurate with the fast expanding worldwide operations of the group."

In keeping with the committee's informal approach, the revised concordat states that where situations occur whose circumstances do not fit into the revised concordat's principles, parent and host authorities "should explore together ways of ensuring that adequate supervision of banks' foreign establishments is effected." IML and other supervisors attempted to work together to fashion a solution. In 1985, IML notified BCCI's other regulators that it could not practically fulfill its role as lead regulator. Therefore, it suggested that BCCI incorporate separately in the United Kingdom so that

[2]At least as early as 1976, New York State banking regulators turned down BCCI's attempts to establish a U.S. banking presence because it did not have a suitable primary regulator. The Federal Reserve Board charged, in July 1991, that senior officials of BCCI set up secret arrangements illegally to acquire Independence Bank. Specifically, the Board charged that BCCI was in violation of U.S. law by becoming a bank holding company through its acquisition of 25 percent or more of the shares of Credit and Commerce American Holdings—the parent of First American Bankshares—and Independence Bank, without Federal Reserve Board approval.

[3]BCCI was headed by a holding company incorporated in Luxembourg. Its two main subsidiaries were also incorporated in Luxembourg and Grand Cayman Island. However, neither the holding company nor the subsidiary conducted business in Luxembourg. A worldwide network of branches operated in over 70 countries, including the United Kingdom, where BCCI conducted much of its business.

[4]The Treasury and Civil Service Committee is a committee of the British House of Commons. It conducted a series of hearings during its 1991-92 session following the closure of BCCI. As a result, it issued a report entitled Banking Supervision and BCCI: International and National Regulation.

the Bank of England could take on the role of lead regulator. As a partial solution, in 1987 IML and other regulators established an informal body known as the "College of Regulators,"[5] which served as a mechanism for member nations to share information on BCCI activities. The college first met in June 1988. Although the college was first formed because none of the banking supervisors were prepared to take responsibility as lead regulator, it was not a sufficient solution and was never intended to replace consolidated supervision. The Treasury and Civil Service Committee concluded that "a College of Regulators may be helpful for the dissemination of information but cannot replace the lead regulator's role." The committee further proposed that the Basle revised concordat be changed accordingly.

Although the revised concordat does not specifically refer to a "lead regulator," it does clearly assign responsibility to a "parent authority," especially in cases where "gaps in supervision can arise out of structural features of international banking groups," as was the case with BCCI. The concordat states, "Where a bank is the parent company of a group that contains intermediate holding companies, the parent authority should make sure that such holding companies and their subsidiaries are covered by adequate supervision." The concordat states further that "full implementation of the consolidation principle may well lead to some extension of parental responsibility."

We believe the issue is not the need to add to or change the concordats. They provide adequate guidance. The issue is the assurance that commitment to the principles in the 1983 revised concordat is reflected in actual practice. IML realized that it simply lacked the capability or resources to carry out consolidated supervision over the entire BCCI group. As a nonregulatory body, the Basle Committee can generate commitment to its principles, but national discretion still controls their actual implementation.

The Basle Committee Has Been More Forceful Within Its Current Structure

While the Basle Committee values and wishes to preserve its informal structure, in response to the increasing importance of improving international banking supervision worldwide it has been evolving in recent years from a vehicle meant purely to exchange information and agree upon best practices, into a decision-making body issuing regulatory standards. The crucial question is how far the committee can go in this

[5]The College of Regulators consisted of the original members, the United Kingdom, Switzerland, Spain, and Luxembourg; Hong Kong and the Cayman Islands joined in 1989; France and the United Arab Emirates joined subsequently.

more forceful direction without jeopardizing its nonlegal status. Committee member nations agree that the principles espoused in the concordats are valid. They are now moving more closely into the realm of ensuring that countries actually honor those principles. The difficulty is doing so within the confines of the committee's informal structure.

Compared to its origins, the Basle Committee has taken on a higher profile in recent years. Its original 1975 concordat was not released to the public until more than 5 years after its adoption by central bankers. This practice is in contrast to the almost immediate and wide dissemination of the 1992 Minimum Standards, partially in response to the closure of BCCI a few months earlier. In both the 1988 Capital Adequacy Accord and the 1992 Minimum Standards, the Basle Committee goes beyond providing information and guidance to setting specific standards that all committee member countries are expected to adopt. In both agreements, the committee will monitor that adoption.[6] These relatively new roles are significant and must be carried out carefully in order to preserve the committee's informal, nonlegal structure.[7]

As discussed earlier, the Capital Adequacy Accord was not binding in the legal sense, but countries have been compelled to honor its provisions due to collective interests and incentives. It remains to be seen whether countries will adopt the committee's latest major initiative, the Minimum Standards. However, the paper does appear to reflect the committee's movement toward a more proactive stance, based on experience with the Capital Adequacy Accord.

The Minimum Standards Are More Forceful in Tone

The Basle Committee attributes the necessity for issuing its Minimum Standards to the growth of international banking activities and "experience gained in the supervision of seriously troubled banking institutions, notably Bank of Credit and Commerce International." These standards do not deviate substantively from the principles espoused in the concordats, which have, in fact, been "reformulated as minimum standards," according to the Basle Committee. What is different is the

[6]Writing about the 1988 Capital Adequacy Accord, the former Secretary to the Basle Committee said, "The agreement secures commitments considerably more precise than any of the Committee's previous papers."

[7]The former Secretary continued, "Although not legally enforceable as a treaty, and although the Committee is not a formally constituted international organization, nonetheless the agreement is considered to be binding on the members and the agreement itself states that the Committee will continually monitor its application."

more forceful tone of the new paper, whose standards the "G-10 supervisory authorities expect each other to observe."

This more forceful tone is evident in several areas. The committee pledges to oversee the implementation of the standards, stating that it will take "the necessary steps to ensure that their supervisory authorities meet the standards as soon as possible," and "monitor members' experience in implementing them with a view to determining what further refinements are needed." In addition, the committee brings up the need for a greater effort to ensure that the principles in the concordats "can be applied in practice," and specifies that the bank and banking group must be "subject to the authority of a supervisor with the practical capability of performing consolidated supervision."

The 1983 revised concordat does not urge immediate adoption of its principles but merely "strongly commends the principles set out in this report as being of general validity...and hopes that they will be progressively accepted and implemented by supervisors worldwide." The revised concordat makes no mention of the committee monitoring implementation of its principles and does not specify that supervisors have the capability to carry them out effectively.

The change from principles to minimum standards is another clue to the committee's more forceful role. Bank supervisors and committee representatives we spoke with said that the terms "principles" and "minimum standards" differ in significant ways. "Minimum" signifies a cut-off point anything below which is not acceptable. "Standards" implies something specific and measurable such as in the 1988 capital adequacy accord. For instance, one cannot have "minimum principles." Supervisors further believe that the Minimum Standards paper represents a commitment on the part of regulators to adopt the standards into their respective national laws, as has proven the case with the Capital Adequacy Accord. However, the supervisors recognized that achieving more widespread adoption of its principles through the Minimum Standards would be a challenge to the committee due to the nature of banking supervision, the variation in supervisory practices among nations, and the committee's lack of legal authority to enforce them.

The Basle Committee Faces Constraints to Ensuring Better Adherence to Its Principles

While bank supervisors support the Basle Committee's Minimum Standards, they believe that the committee faces constraints to ensuring that supervisors' commitment to adopting the standards is translated into enhanced bank supervision. The standards are necessarily nonspecific; the standards must be not only adopted but also applied capably; supervisory practices vary among countries, and supervisors lack information on the extent to which their colleagues are following Basle Committee principles; and, due to its lack of formal authority, the committee must be cautious in monitoring and encouraging implementation of the standards.

The Basle Committee intentionally did not provide detailed criteria in its Minimum Standards in order to give supervisors the flexibility to deal with their unique banking and regulatory situations and to allow for the considerable judgment involved in supervision. The supervisors with whom we spoke believed that supervisory standards must be fairly nonspecific and nonquantifiable, defining and ensuring capable supervision while preserving bank supervisors' ability to apply judgment when needed. They did not favor detailed, numerical requirements or check lists. They believed the degree of judgment and discretion involved was due to the variation in banking and regulatory systems and to the sensitive situations they encountered. For example, a supervisor must consider a range of factors to judge whether a bank is "fit and proper," and the conclusion will vary depending upon the circumstances.

While supervisors favored a flexible approach, many of the supervisors and experts with whom we spoke believed that adopting rules and regulations alone would not ensure adequate supervision. For example, they believed that there should be some assurance that supervisors not only collect the proper information, but also verify its accuracy and use it effectively to limit excessive risk. The Minimum Standards state that the host supervisor should assure itself that the parent supervisor has the "practical capability of performing consolidated supervision." Namely, the parent supervisor must "receive consolidated financial and prudential information on the bank's or banking group's global operations" and "have the reliability of this information confirmed to its own satisfaction through on-site examination or other means...." However, monitoring and assuring this capable supervision is difficult due to both the amount of judgment mentioned earlier and to the in-depth knowledge of countries' supervisory practices necessary to address such an issue.

Through the Basle Committee's Minimum Standards and, in the case of the United States, the U.S. Foreign Bank Supervision Enhancement Act (see

chap. 4), countries are increasingly expected not only to meet common supervisory standards, but also to judge the extent to which their counterparts in other countries do so. Yet, supervisors often lack current information about each other's supervisory practices, the extent to which they meet the Basle Minimum Standards, and in particular, whether they are practicing consolidated supervision.

We were told that supervisors generally gained a sense of how well their counterparts in other countries supervised through informal, bilateral contacts or through participation in Basle Committee meetings. Nevertheless, U.S. supervisory authorities believed that not all supervisors communicate equally as effectively or as consistently among their peers, making total reliance on an informal system less than ideal. We believe that this situation may be particularly true for non-Basle Committee member countries that may enjoy fewer informal ties with G-10 and other supervisors. Without some central source of such information, as banking supervisors comply with the Minimum Standards, they will be collecting the same information from multiple countries. This practice is inefficient and neither helps the supervisor to apply a common set of criteria in judging each other's supervisory practices nor facilitates supervisory efforts to monitor each other's progress in meeting Basle Committee standards.

The committee's lack of authority to enforce its standards makes monitoring their implementation difficult and diplomatically sensitive. As discussed earlier, foreign bank supervisors and experts with whom we spoke generally gave the Basle Committee high marks as an effective mechanism to improve the quality of banking supervision worldwide. They did not support creating a supranational regulatory body or giving the committee the legal means to enforce its standards. However, supervisors generally believed that more could be done to prevent problem banks from establishing operations worldwide. A Basle Committee official did not believe the committee could issue a "black list" of banks with unacceptable management or supervision, as it would be too difficult and controversial. Officials with whom we spoke had identified, through their informal channels, at least one "other BCCI" now doing international banking business, whose cross-border expansion banking supervisors agreed to limit. The officials did not name the bank or describe the scope of its international activities. They mentioned the bank to emphasize that situations requiring coordinated international efforts continue to arise. In view of the problems surrounding BCCI, supervisors and experts saw a need for better monitoring the implementation of the Minimum Standards

without the imposition of a legal framework or interference with their national sovereignty over their banking systems.

Some Efforts Being Considered to Better Ensure Quality Supervision

Peer reviews are commonly used in similar settings to ensure that practice meets commitment, and as a basis to judge competence. Supervisors with whom we spoke, as well as the Bingham Report,[8] cited the Financial Action Task Force on money laundering[9] as one example of an effective use of peer review to monitor the implementation of international standards. Like the Basle Committee, the task force lacks the formal authority to enforce its recommendations. The task force is monitoring the performance of its members in two ways. They include an annual self-assessment process using questionnaires, and a mutual evaluation involving on-site visits by a team of experts. The mutual evaluations generate reports for discussion among members. The task force issues an annual report summarizing these reports and its other activities.[10] One official with whom we spoke believed that the Financial Action Task Force could eventually come under the auspices of the Basle Committee.

Some supervisors and experts suggested creation of a centralized database or clearinghouse on supervisory systems so that supervisors could easily check the supervision of other nations before making decisions on authorizing foreign banks. One barrier to creating such a database would be secrecy laws in some countries that prevent supervisors from sharing certain types of information. The Basle Committee is renewing a survey it initiated several years ago to collect information on countries' supervisory systems, including the standards followed.

Conclusions

Despite the Basle Committee's lack of formal authority to enforce its initiatives, bank supervisors and experts believe it remains the best forum to coordinate and promote safe and sound international banking supervision. Through an informal approach, the committee has created

[8]Lord Justice Bingham of the United Kingdom conducted an inquiry into BCCI and issued a report in October 1992.

[9]The Financial Action Task Force on money laundering was established as part of the Paris Economic Summit of 1989 to examine measures to combat money laundering. In April 1990, it issued a report with 40 recommendations. The task force has 28 member jurisdictions and regional organizations, including all OECD countries and major financial centers. OECD has established a secretariat to coordinate the efforts.

[10]For a more detailed discussion of the Financial Action Task Force on money laundering, see Illicit Narcotics: Recent Efforts to Control Chemical Diversion and Money Laundering (GAO/NSIAD-94-34, Dec. 8, 1993).

valuable initiatives and successfully forged agreements such as the 1988 Capital Adequacy Accord. Still, as witnessed by the BCCI case, commitment to Basle Committee principles does not always mean their application in practice. In addition, simply adopting international rules and regulations does not ensure adequate supervision. For instance, while collecting the proper information is important, whether that information has been verified and how it is applied in practice are equally crucial.

There is little support in the international banking community for the creation of a supranational regulatory body with enforcement powers to ensure adoption of the Basle Committee principles. Due to the degree of judgment involved in international banking supervision and the variation in supervisory regimes and banking systems worldwide, supervisors opposed detailed international guidance, such as numerical requirements or check lists specifying how supervisory principles should be implemented.

The Basle Committee has been taking on a more forceful role in ensuring that countries apply its principles in practice as soon as possible. But the committee's informal status and the generally incomplete information on international supervisory practices and the extent to which banks worldwide are subject to consolidated supervision over their global operations make the committee's task of monitoring and ensuring capable banking supervision difficult and diplomatically sensitive.

Peer reviews have been used in similar settings to deal with the gap between commitment to the principles of adequate supervision and their application in practice. They allow countries to more rigorously assess each other's progress toward meeting the Basle Minimum Standards through informal self-monitoring. Peer reviews also help countries learn more about each others' practices and procedures in supervising banks in an informal setting, as opposed to being subjected to the oversight of a supranational regulatory body. Members of the supervisory community have expressed interest in pursuing the peer review route, possibly through informal Basle Committee sponsorship.

Current information about countries' supervisory practices, in particular the extent to which they practice consolidated supervision, is not now readily available. Yet, this information is essential as national regulators begin to enact laws and implement regulations consistent with the Basle Minimum Standards, which are based upon host supervisors judging the parent supervision of foreign banks. A central source of information, such

as a clearinghouse on worldwide supervisory practices, has several advantages. A clearinghouse helps avoid costly and inefficient duplication of effort as multiple supervisors attempt to collect similar information from the same countries. It also assists supervisors who are working toward applying common criteria in making those judgments, and it might serve to gauge worldwide progress toward improving the quality of banking supervision.

Recommendation

In order to strengthen supervision of international banks worldwide, it is necessary to ensure stricter application of the principles espoused by the Basle Committee on Banking Supervision. We recommend that the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Chairman of the FDIC, in consultation with their colleagues on the Basle Committee, seek an expanded role for the committee without the imposition of a new legal framework or interference with national sovereignty. For instance, U.S. supervisors could work with other Basle Committee member supervisors to encourage and monitor progress toward adoption of the committee's Minimum Standards by expanding its role as a clearinghouse for information on supervisory practices. In addition, the committee could facilitate a peer review process for bank supervisors desiring such reviews, providing guidance for the conduct of these reviews, and writing guidelines for ensuring the confidentiality of supervisory information. In the peer reviews, the supervisors would be assessed by evaluating their compliance with the Basle Committee's Minimum Standards. Peer review reports could form the basis for bank supervisors to strengthen their procedures. As participants gain experience and refine the process over time, peer review might be instituted as a standard component of supervisors' efforts to strengthen the framework for international bank supervision.

Agency Comments and Our Evaluation

The Federal Reserve Board and FDIC generally supported the overall conclusions of the report and the recommendation that the Basle Committee seek an expanded role to ensure application of its principles. OCC did not comment on the recommendation but provided written comments on issues discussed in chapter 4.

The Basle Committee Now Serves as a Clearinghouse

In commenting on our recommendation that U.S. bank supervisors seek to expand the role of the Basle Committee, such as promoting its role as a clearinghouse, the Federal Reserve Board and FDIC pointed out that the

Basle Committee now functions as a clearinghouse of information on supervisory practices and regulations. The agencies agreed, however, that the committee's role as a clearinghouse should be expanded and enhanced. OCC did not comment on the clearinghouse concept. We have rephrased our recommendation to clarify that the committee should expand its role as a clearinghouse.

Peer Reviews Generate Some Concerns

In our recommendation, we noted that another way that U.S. bank supervisors could foster greater reliance on the Basle Committee would be to facilitate peer reviews to encourage and monitor progress toward adoption of the committee's Minimum Standards. The Federal Reserve Board and FDIC expressed concerns with this concept. OCC did not comment on peer review.

While the Federal Reserve Board and FDIC believed that some support for peer reviews exists in the supervisory community, they shared two concerns. First, they expressed concern about the problem of maintaining confidentiality of supervisory information. Second, they cautioned that a formal peer review process could jeopardize the cooperative relationships among members of the Basle Committee, whose collaborative approach has thus far successfully dealt with and resolved important supervisory issues.

We have rephrased our recommendation to clarify and further emphasize that we are suggesting voluntary, informal peer reviews. When countries wish to participate in peer reviews, we foresee the Basle Committee facilitating their efforts by providing peer review criteria and guidance, including how to ensure confidentiality of supervisory information.

The Federal Reserve Board was also concerned that peer reviews might generate a "moral hazard" (a term generally referring to the incentive created by insurance, or other protection, that influences those protected to take on greater risk than they would without the protection). The hypothetical example cited by the Federal Reserve Board was of a supervisor receiving a positive rating by a peer review and subsequently having a bank under its jurisdiction encountering difficulties: What, if any, would be the responsibility of the peer reviewers?

We believe that there is potential for a moral hazard in many scenarios in the international banking arena, including aspects of deposit insurance protection, and the perception that certain banks are "too big to fail."

While moral hazard associated with peer review is a theoretical possibility, we believe that the best way to control moral hazard is to ensure safe and sound international banking. Peer reviews would contribute to this goal by promoting improved supervision, adequate capital levels, and effective regulation.

Finally, the Federal Reserve Board noted that countries now submit detailed descriptions of their supervisory systems to the Basle Committee and, in the Board's view, a review of countries' policies and procedures for bank supervision may be accomplished without peer reviews.

We continue to believe that peer reviews would offer unique benefits. Peer reviews would allow bank supervisors to informally review each other's supervisory systems and gain first-hand knowledge of the extent to which they have the practical capability of implementing the Basle Committee's Minimum Standards, for instance, consolidated supervision. We believe that such self-assessments would enhance supervisory coordination and further ensure against problem banks establishing operations worldwide.

A Stronger Case Needed for Basle Committee as Main Forum

OCC agreed with our conclusion that more can be done to enhance global bank supervision. However, it believed that we should present a stronger case for our conclusion that the Basle Committee is the main forum for coordination of international banking supervision.

We concur with OCC's support for going beyond the Basle Committee to coordinate international banking supervision where appropriate. However, we see considerable value in ensuring that international supervisory standards are improved in all nations and believe that, even within its limited scope, the Basle Committee remains the principal forum today for achieving that end. We view the Basle Committee as the main vehicle because of its record of contributing to improved international banking supervision. In particular, the committee's 1988 Capital Adequacy Accord has formed the basis for regulation in most major nations. While other approaches have also contributed to improved supervision, no other has had as far-reaching an impact. For instance, although the International Organization of Securities Commissions has been working with the Basle Committee, it has not yet forged a capital agreement for securities firms or securities related activities. (See app. III, p. 77, for our comments supplementing those in the report text.)

FBSEA Is One Model for Improving International Banking Supervision

In the wake of the BCCI and BNL scandals, the Basle Committee responded to the supervisory gaps highlighted in these cases by issuing its 1992 Minimum Standards, reemphasizing the need for supervisors to follow the principles originally espoused in the concordats. Similarly, the U.S. Congress enacted the Foreign Bank Supervision Enhancement Act of 1991 on December 19, 1991, to strengthen the federal supervision and regulation of foreign banks operating in the United States. While significantly more stringent and directed specifically at improving U.S. domestic banking regulation of foreign banks, FBSEA's provisions enact into law standards that are in some ways consistent with the Basle Minimum Standards. As the U.S.' response to the real and potential problems of supervising its foreign banks, FBSEA is one model of how sovereign nations can implement into law the principles espoused by the Basle Committee, we believe.

Congress Wanted to Improve Foreign Bank Supervision in the United States

In the spring of 1991, following the discovery of unauthorized activities within BCCI and BNL, the U.S. Congress was concerned about the lack of proper federal oversight of foreign banks operating in the United States. The Congress recognized the dramatic increase in the number of foreign banks operating in the United States since the enactment of the International Banking Act of 1978 (P.L. 95-369). In 1978, 94 foreign banks had offices in the United States, versus 299 banks as of December 1992. In addition, today those foreign branches and agencies that hold the vast majority of the total assets are also state licensed. To a large extent, these branches and agencies are state supervised. While the Congress was not faulting state supervision, it believed that the supervision of major foreign banks with operations in more than one state needed to be better coordinated. In the case of BNL, the Federal Reserve was not the primary regulator, and the states had no authority to examine other states' operations. In addition, the Congress was concerned that the existing standards for foreign bank entry into the U.S. market needed to be more stringent, particularly after BCCI had allegedly gained secret control of several U.S. banking institutions.

At the request of the Chairman of the Senate Banking Committee, the Federal Reserve Board submitted a proposal in May 1991 to strengthen the supervision and regulation of foreign banks in the United States. The Board's recommendations basically (1) established uniform federal standards for entry of foreign banks into the United States; and (2) clarified the Board's authority to conduct coordinated, simultaneous

examinations of foreign bank branches and agencies established in the United States.

The Provisions of the Foreign Bank Supervision Enhancement Act of 1991

The Federal Reserve Board of Governors submitted to the Congress proposed legislation in May of 1991 designed to strengthen the supervision and regulation of foreign banks operating in the United States. The legislation was later introduced as FBSEA and enacted on December 19, 1991, as title II, subtitle A, of the Federal Deposit Insurance Corporation Improvement Act of 1991 (P.L. 102-242, 105 stat. 2236, 2286-2305).[1]

FBSEA gives the Federal Reserve Board enhanced supervisory and regulatory authority over foreign banks conducting banking in the United States through branches, agencies, commercial lending companies, and representative offices. The act was largely a response to problems discovered in the U.S. operations of BCCI and BNL and the perceived need for more federal oversight.

In the BCCI case, the Board was concerned about the bank's lack of consolidated supervision over its worldwide operations and BCCI's acquisition, without Board approval, of control of more than 25 percent of the voting shares of First American Bankshares and several other U.S. banking operations.[2] The BNL case involved the discovery that BNL's state-licensed agency in Atlanta allegedly failed to report to bank examiners a large part of its banking business and may have kept this lending secret from the parent bank. As a result, the Board believed that it needed examination authority over BNL-Atlanta to fully investigate the case. The Board also wished to have clear authority to share bank examination information on a confidential basis with foreign bank supervisors.

The Main Provisions of FBSEA

FBSEA's major provisions give the Board authority to approve all branch, agency, or commercial lending company applications; terminate the activities of state banking offices of foreign banks and recommend to OCC that licenses of federal banking offices be terminated; conduct examinations of branches, agencies, and affiliates; and approve the establishment and examine the operations of representative offices.

[1]The legislation made changes to the authority of the Board of Governors of the Federal Reserve System under the International Banking Act of 1978.

[2]See Foreign Bank: Initial Assessment of Certain BCCI Activities in the U.S. (GAO/GGD-92-96, Sept. 30, 1992).

Approval of Foreign Bank Applications

Before the enactment of FBSEA, OCC had authority to review foreign bank applications to establish and obtain licenses for federal branches and agencies, while the applicable state authority did the same for state branches and agencies. FBSEA requires that the Board approve all state and federal applications to open branches, agencies, and commercial lending companies. But the state authorities and OCC are to continue to approve establishment and remain the licensing authorities for state and federal banking offices, respectively. Before FBSEA, states licensed representative offices. The offices were required to register with the U.S. Department of the Treasury, but this activity was more of a record-keeping requirement. Therefore, foreign banks could open representative offices in the United States without approval of any federal regulatory agency.

FBSEA makes mandatory two standards in the Board's determination of whether to approve the establishment of a foreign branch or agency: (1) the foreign bank applicant must be engaged in the business of banking outside of the United States, and the foreign bank applicant must be subject to comprehensive supervision on a consolidated basis by its home country supervisor; and (2) the foreign bank applicant must provide sufficient information required by the Board to assess the application. (Other factors will be discussed in the following sections.)

For foreign banks already operating in the United States, FBSEA gives the Board the authority to terminate, or recommend that OCC terminate, a foreign bank's U.S. offices if the foreign bank is not subject to comprehensive supervision on a consolidated basis by its home country supervisors. FBSEA also requires the Board, in consultation with the Secretary of the U.S. Department of the Treasury, to develop criteria to evaluate the U.S. operations of foreign banks that are determined not to be subject to such home country supervision.

Conduct and Coordination of Examinations

FBSEA authorizes the Board to conduct examinations of branches, agencies, commercial lending companies, and affiliates. The Board may also examine any representative office. FBSEA requires the Board, to the extent possible, to coordinate its examinations with OCC, FDIC, and the appropriate state banking supervisor, and authorizes it to conduct simultaneous examinations of such U.S. offices and U.S. affiliates of a foreign bank. Each branch, agency, or commercial lending company subsidiary of a foreign bank is required to be examined on-site at least

once during each 12-month period.[3] The cost of examinations is to be assessed against and collected from the foreign bank or the foreign bank company that controls the foreign bank.[4]

Other Provisions

FBSEA makes state branches and agencies subject to regulation more consistent with federal regulation by limiting their permissible activities to the permissible activities of federally licensed branches, with some exceptions as specified in the law.

FBSEA required that two formal studies be conducted. First, the Board and the U.S. Department of the Treasury were to conduct a comparative analysis of the capital standards applied to foreign banks conducting banking operations in the United States and those applied to U.S. banks. That study, the Capital Equivalency Report, was completed in June 1992. The second analysis, the Subsidiary Requirement Study, issued in December 1992, assessed whether foreign banks in the United States should be required to operate as separately incorporated subsidiaries and change their current branch operations accordingly.

The Capital Equivalency Report[5] reviewed the capital standards of 22 countries that are the home countries to certain banks. These banks hold approximately 97 percent of the total U.S. assets of foreign banks operating in the United States. The report concluded that most foreign banks are subject to equivalent, although not necessarily identical, capital requirements as U.S. banks.

In the Subsidiary Requirement Study,[6] the Secretary of the Treasury and the Board of Governors of the Federal Reserve System, in consultation with OCC, FDIC, and the Attorney General, after examining the factors contained in FBSEA, "would oppose a subsidiary requirement that would be applied to all foreign bank operations either across-the-board or for purposes of expanded powers." The study concluded further that "subject

[3]Examinations will be conducted by the Board; FDIC, if the foreign bank branch accepts or maintains insured deposits; OCC, if the branch or agency is licensed by OCC; or the state supervisor, if the office of the foreign bank is licensed or chartered by the state.

[4]See Funding Foreign Bank Examinations (GAO/GGD-93-35R, May 4, 1993). The subject of examinations will not be treated further in this report.

[5]See Capital Equivalency Report, U.S. Department of the Treasury and Board of Governors of the Federal Reserve System (Washington D.C.: June 19, 1992).

[6]See Subsidiary Requirement Study, Department of the Treasury and Board of Governors of the Federal Reserve System (Washington, D.C.: Dec. 18, 1992).

to prudential considerations, the guiding policy for foreign bank operations should be the principle of investor choice."

Implementation of FBSEA by the Federal Reserve

Enactment of FBSEA required revisions of both Regulation K (International Banking Operations) and Regulation Y (Bank Holding Companies and Change in Bank Control).[7] The Board issued an interim rule on April 8, 1992, to be effective immediately, but with a 60-day comment period. The Board issued its final rule on January 12, 1993.[8]

FBSEA provides two mandatory standards the Board must apply in determining whether to allow foreign bank applicants to establish offices in the United States. These were adopted in the final rule. The foreign bank must engage directly in the business of banking outside the United States and be subject to comprehensive supervision on a consolidated basis by its home country supervisor. It also must provide sufficient information required by the Board to allow it to assess the application. Regulation K, as amended, provides that a foreign bank is subject to consolidated, comprehensive supervision by its home country supervisor if the foreign bank

> is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation.

Regulation K, as amended, lists five factors the Board is to apply to determine whether the foreign bank applicant is subject to comprehensive supervision on a consolidated basis. The Board emphasizes in the rules that "the factors are simply indicia of comprehensive, consolidated supervision. They are not mandatory standards unto themselves." They include the extent to which the home country supervisor of the foreign bank

- ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;
- obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;

[7] 12 C.F.R. Parts 211, 225, 263, 265, Docket no. R-7054.

[8] The final rule became effective upon publication in the Federal Register.

- obtains information on the dealings and relationships between the foreign bank and its affiliates, both foreign and domestic;
- receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis; and
- evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

FBSEA and Regulation K, as amended, also provide discretionary standards the Board can apply to determining whether to approve the establishment of foreign banks. They include

- a determination of whether the home-country supervisor or the foreign bank has consented to the proposed establishment of a branch, agency, or commercial lending company subsidiary;
- the financial resources of the foreign bank (including the foreign bank's capital position, projected capital position, profitability, level of indebtedness, and future prospects) and the condition of any U.S. office of the foreign bank;
- the managerial resources of the foreign bank, including the competence, experience, and integrity of the officers, directors, and principal shareholders; management's experience and capacity to engage in international banking; and the record of the foreign bank and its management in complying with laws and regulations, and in fulfilling any commitments to, and any conditions imposed by, the Board in connection with any prior application;
- a determination of whether the foreign bank's home-country supervisor and the home-country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;
- a determination of whether the foreign bank has provided the Board with adequate assurances that information will be made available to the Board on the operations or activities of the foreign bank and any of its affiliates;[9]
- a determination of whether the foreign bank and its U.S. affiliates are in compliance with applicable U.S. law, and whether the applicant has established adequate controls and procedures in each of its offices to ensure continuing compliance with U.S. law, including controls directed to detection of money laundering or unsafe or unsound banking practices.

[9]This determination should include information that the Board deems necessary to determine and enforce compliance with the International Banking Act of 1978, the Bank Holding Company Act, and other applicable federal banking statutes. These assurances shall include a statement from the foreign bank describing the laws that would restrict the foreign bank or its parent from providing information to the Board.

Regulation Y was amended to reflect the requirement that a foreign banking organization must file an application with the Board under the Bank Holding Company Act in order to acquire more than 5 percent of the shares of a U.S. bank or bank holding company.

FBSEA Is One Example of Implementing Basle Principles at the National Level

When a major piece of legislation such as FBSEA is enacted by the United States, a leading financial market and a Basle Committee member, it indirectly affects international banking supervision. It sends a message to foreign banks and their bank supervisors that, in order to participate in the U.S. banking system, they must meet certain standards. FBSEA was enacted to improve the supervision of foreign banks in the United States. In our view, neither its intent nor the Board's mandate for its implementation includes improving international banking supervision worldwide or promoting the Basle Minimum Standards. FBSEA standards, however, are consistent with Basle Committee principles, in particular the committee's 1992 Minimum Standards. FBSEA is one model for how to improve international banking supervision at the national level in a manner consistent with the 1992 Basle Minimum Standards, we believe.

The Federal Reserve Board states in its final rules amending Regulation K that "although the United States subscribes to the Basle Minimum Standards, these are only minimum standards, and the FBSEA imposes a higher threshold." That is, FBSEA has a mandatory requirement that foreign offices be subject to comprehensive supervision on a consolidated basis. The Board may not approve an application unless the bank applicant meets that standard. The Basle Committee gives the host-country authority the discretion to approve an applicant not subject to consolidated supervision, subject to certain restrictions and provisos. FBSEA, however, addresses the same issues as the minimum standards by aggressively pressing for the adoption of consolidated supervision, a centerpiece of the Basle Minimum Standards and a principle that originated with the committee's 1983 revised concordat. In its advisory role, the committee is providing a minimum, or baseline, from which countries can begin to improve their international banking supervision. Ideally, countries will, as did the United States, adopt into their own laws standards consistent with, but more rigorous than, the minimum.

Although FBSEA is more rigorous and demanding than the Basle Minimum Standards, its provisions and implementing rules address the same general issues. A detailed analysis of FBSEA and the Minimum Standards will point

out differences in the precise nature in which the issues are addressed, including meaning, emphasis, and tone. What is more important is that both provide a framework for eliminating supervisory gaps, such as a lack of consolidated supervision highlighted in the BCCI case. In fact, a majority of the foreign bank supervisors and experts with whom we spoke believed that the Federal Reserve Board should apply Basle Committee principles in its implementation of FBSEA, wherever possible.

Both FBSEA's mandatory standards and the Minimum Standards address the need for consolidated supervision. Furthermore, both FBSEA's "basis for determining comprehensive supervision or regulation on a consolidated basis" and the Minimum Standards address the extent to which the home supervisor considers the bank's operating procedures, obtains information from the bank's cross-border business, monitors relationships between the bank and its affiliates, receives consolidated financial reports on the bank's worldwide operations, and addresses the bank's capital adequacy.

Turning to FBSEA's discretionary standards, both FBSEA and the Minimum Standards address whether the home-country supervisor has approved the bank's attempt to establish a foreign office, reviewed the managerial and financial resources of the bank, and considered the extent to which the bank's home-and host-country supervisors have arranged to share information about the operations of the bank.

FBSEA's intent is not to limit foreign bank participation in the U.S. market. Its provisions bring supervision of foreign banking facilities more in line with existing levels of domestic bank supervision in the United States. Federal Reserve Board officials admitted that, as required under FBSEA, making determinations about the adequacy of foreign supervision will be diplomatically sensitive. The foreign bank supervisors and experts with whom we spoke generally considered the FBSEA provisions to be reasonable and in keeping with the Basle Minimum Standards. Their only real concern was with FBSEA's mandated study on the advisability of requiring foreign branches in the United States to "roll up" their current branch operations into separately incorporated U.S. bank subsidiaries. Foreign bank supervisors believed that not allowing operations through foreign branches would result in inefficient allocation of capital and seriously limit the types and volumes of loans foreign banks could make, since a subsidiary is limited to its own capital, whereas a branch has access to the parent's capital. One foreign supervisor and an EC official believed such a restriction would cause excessive administrative costs.

On a broader scale, bank supervisors around the world share the U.S.' concerns about gaps in the oversight of international banks, in particular BCCI. This international concern prompted the Basle Committee to introduce its Minimum Standards for supervision of international banks. FBSEA could be one model of how to adopt into law certain rules and regulations consistent with these Basle Minimum Standards and an example of how national bank regulators can begin to apply formally in practice what they have informally committed to in principle through membership and participation in the Basle Committee.

Agency Comments and Our Evaluation

OCC expressed concern about our conclusion that FBSEA could be one model of how nations might implement into law the principles espoused by the Basle Committee. The Federal Reserve Board and FDIC did not comment on this issue.

OCC noted that there are differences between FBSEA and the Basle Committee's Minimum Standards and questioned our contention that national standards more stringent than the Minimum Standards can be consistent with the Minimum Standards. OCC noted that FBSEA was not the only statute, but a piece of the foundation the United States built to supervise foreign banks operating in the United States. OCC also noted that delays have occurred in processing applications under the new law.

Our conclusion that FBSEA can serve as a model is based not only on its shared objectives with the Basle Committee and its greater stringency, but also on the fact that it mandates that the Board consider the same criteria in approving foreign bank applications that the Basle Committee would advance. The principal difference, as the report notes, is that FBSEA requires that countries have a system of consolidated supervision in place, while the committee would accept progress toward that same goal.

We focused on FBSEA in this report because it is the most recent statute dealing with U.S. regulation of foreign banks operating in the United States. As we note in the report, the act was designed to strengthen the supervision and regulation of foreign banks operating in the United States. We also note in the report that the Federal Deposit Insurance Corporation Improvement Act of 1991, of which FBSEA is title II, subtitle A, made changes to the authority of the Board of Governors of the Federal Reserve System under the International Banking Act of 1978.

OCC noted that implementation of FBSEA has led to "long delays in processing foreign bank applications." As we describe in our report, the Board is charged with implementing FBSEA. In our meetings with them, Board officials noted that foreign bank applications were taking longer, in part because the Board staff was being cautious on the initial applications until decisions by the Board provided them with more specific guidance on handling these applications.

Other International Groups That Promote Enhanced International Banking Supervision

The European Community (EC—now called the European Union), the Organization for Economic Cooperation and Development (OECD), and other groups have worked on their own and in conjunction with the Basle Committee on Banking Supervision to coordinate and enhance international banking supervision worldwide.

The European Community

The Treaty of Rome, signed in 1957, laid the foundation for the EC,[1] a common market based on the free movement of goods, persons, services, capital, and banking. Despite some progress toward integration, internal barriers remained, and many Europeans believed that relatively slow European economic recovery from the global recession of the 1970s was, in part, caused by multiple trade barriers and overly protected markets.

In 1985, the EC formally launched its Single Market Program by issuing the White Paper, "Completing the Internal Market," which identified trade barriers and proposed a series of 300 measures (later reduced to 279) necessary to abolish them. The White Paper set forth a regulatory framework to achieve a single European market, proposed a timetable for enactment of each measure, and required the entire program to be in place by the end of 1992. The Single European Act of 1987 reaffirmed the White Paper's objectives and accelerated the market integration process by changing the way EC legislation is passed for most single market initiatives.[2]

The EC bases the regulatory framework for its single market in financial services upon three principles: a single banking license, home-country control, and mutual recognition. The single banking license (or "single passport") allows any bank established and licensed in one member state to provide cross-border banking or establish branches in any other EC member state. Non-EC banks are also eligible for the single banking license, as long as they incorporate an EC subsidiary in any one of the member states. The single license is based on the principle of mutual recognition. This principle requires that member states have a minimum level of harmonization to ensure the safety and soundness of the financial system. For instance, to qualify for the single license, banks must have a minimum capital base, a minimum level of shareholder disclosure, and a

[1]The EC consists of 12 member nations: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

[2]Only a weighted majority of member states is required to approve the adoption of a proposed directive. Known as "qualified majority voting," voting weights are assigned to each state loosely according to its population and economic power. Previously, unanimity was required, and one member state could block legislation. Votes on social and tax matters still require unanimous approval.

maximum limit on the degree of equity participation in nonfinancial firms. Home-country control means that, under the single passport, a bank has the same powers and is subject to the same home-country supervision and regulatory limits regardless of where its services are rendered.[3]

The EC addresses issues similar to those addressed by the Basle Committee and has relied on committee principles in formulating its Single Market Program. Common issues include setting capital adequacy standards for banks and investment firms, requiring supervision on a consolidated basis, and generally establishing common standards for bank supervision to ensure the safety and soundness of the banking system.

The EC model, however, is quite different from that of the Basle Committee. The Basle Committee is an informal body with no legal basis or enforcement authority. The EC is a formal, regulatory body consisting of four supranational institutions: the EC Commission, the executive body that drafts and proposes legislation and enforces the implementation of EC law; the Council of Ministers, which for financial decision-making consists of the finance ministers of each member state; the European Parliament, a primarily advisory body directly elected by EC citizens; and the European Court of Justice, which ensures that EC legislation is interpreted and applied according to the principles of EC law.[4]

The EC's single passport may conflict somewhat with the Basle Committee's 1992 Minimum Standards. The Basle Committee assigns the host supervisor a fair amount of discretion in its dealings with foreign banks. The committee states in its Minimum Standards that if the host-country supervisor determines that any of the minimum standards is not met by the supervisor of the foreign bank seeking to establish a banking operation within its jurisdiction, the host supervisor can impose "restrictive measures necessary to satisfy its prudential concerns consistent with these minimum standards, including the prohibition of the creation of banking establishments." In contrast, under the EC Single Market Program, the host-country supervisor must accept the bank's home-country supervision as broadly equivalent to its own according to the principles of the single market and mutual recognition. EC member

[3]The host supervisor retains primary responsibility for the supervision of liquidity and exclusive responsibility for monetary policy. It also may retain some control over advertising of banking services in its territories. The host supervisor has the broad authority to apply some restrictions on the grounds of public policy or general public interest.

[4]For a full discussion of the Single Market Program and EC institutions and their functions, see European Community: U.S. Financial Services' Competitiveness Under the Single Market Program (GAO/NSIAD-90-99, May 21, 1990).

supervisory authorities with whom we spoke said that, in practice, host and home supervisors will cooperate closely in overseeing the opening of bank branches across EC country borders and in ensuring that those branches are supervised adequately. Some EC countries, including France and Germany, have drawn up Memoranda of Understanding between bank supervisors concerning cooperation between the home and host authorities to agree on how to address the specifics of managing these situations.

The EC coordinates its efforts with the Basle Committee, whose membership includes 7 of the 12 EC member nations. At the time of our review, the Basle Committee was working with the International Organization of Securities Commissions (IOSCO)[5] to reach agreement on capital adequacy standards for financial firms that conduct securities-related activities, including "universal"[6] banks, and those that do not. The EC has adopted the Directive on the Capital Adequacy of Investment Firms and Credit Institutions, but included a provision in the directive requiring a review in 3 years to ensure that its provisions take into account developments such as the Basle Committee's and IOSCO's eventual initiative.

The EC Banking Advisory Committee, established in 1979 pursuant to article 11 of the First Banking Coordination Directive, is composed of up to three representatives from each member state, and from the EC Commission, which also provides its Secretariat. One task of the committee is to ensure the proper implementation of EC directives in the banking field.

Organization for Economic Cooperation and Development (OECD)

OECD, part of the system of western international institutions developed after World War II, is the main forum for monitoring economic trends in its 24 member countries[7]—free market democracies of North America, Western Europe, and the Pacific. OECD is the largest source of comparative data on the industrial economies in the world. It produces economic

[5]IOSCO is made up of securities regulators from more than 40 countries. The organization's primary purposes are providing coordination, exchanging information, establishing standards and effective surveillance, and giving mutual assistance to ensure the integrity of the markets.

[6]Under "universal" banking, banks can underwrite debt and equity securities and conduct other nonbanking activities.

[7]OECD member countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The former Yugoslavia was granted special status in 1961.

surveys, statistical analyses, and policy recommendations on trade, banking, and financial markets; employment; social policies; the environment; agriculture; energy; industry; development aid; science and technology; research and development; taxation; education; transportation issues; and more.

OECD uses a "common approach" to public policy, which means that its discussions generally yield consensus. As a result, it can establish "codes of behavior" to which the participants formally bind themselves. For example, OECD has several agreements, including a code on the liberalization of capital movements.

The objectives of OECD include (1) achieving the highest sustainable economic growth and employment, (2) promoting economic and social welfare throughout OECD by coordinating the policies of its member countries, and (3) stimulating and harmonizing its members' efforts in favor of developing countries. OECD attempts to achieve its objectives in the banking and financial sectors through its Directorate for Financial, Fiscal, and Enterprise Affairs. This OECD directorate is responsible for the following banking-related activities:

- encouraging structural reforms in the financial sector (including insurance) and developing international cooperation in financial regulation and financial system management;
- reinforcing and implementing guidelines of international economic and financial cooperation, especially in the liberalization of capital movements, trade in services, and foreign direct investment;
- identifying policies to create the conditions for a mutually beneficial investment climate for investors as well as home and host countries; and
- developing competition and consumer policies that enhance economic efficiency and consumer information and welfare.

In 1980, the OECD's Committee on Financial Markets created an Expert Group on Banking to identify and assess significant changes in its member countries' banking structures and regulations. This group consists of bank supervisory, central bank, and finance ministry officials from 23 of the 24 OECD countries, including all the Basle Committee nations plus 11 other countries.

Unlike the Basle Committee, the Expert Group on Banking, according to its secretary, has a mandate to assess the policy implications raised by

contemporary developments in banking. The group has issued reports on the internationalization of banking and on electronic funds transfer.

Other Regional Groups

The Basle Committee on Banking Supervision routinely coordinates its efforts with at least eight other regional supervisory groups.

Nordic Supervisory Group

This group was organized in 1925, reflecting the close collaboration that has long existed among the Nordic countries. Consisting of representatives of the supervisory authorities of Denmark, Finland, Iceland, Norway, and Sweden, its meetings initially were formal and almost diplomatic in nature. More recently, it has emphasized more frequent, less formal sessions. Its primary aim has been to exchange information regarding experiences in supervising each nation's banks, not to harmonize the national banking legislation of its members.

Offshore Group of Banking Supervisors

This group was formed in 1980 because of concern about the level of banking supervision existing in offshore banking centers; 19 centers are represented in the group—Aruba, the Bahamas, Bahrain, Barbados, Bermuda, the Cayman Islands, Cyprus, Gibraltar, Guernsey, Hong Kong, the Isle of Man, Jersey, Lebanon, Malta, Mauritius, the Netherlands Antilles, Panama, Singapore, and Vanuatu. Since its creation, it has seen its role as building relationships among the supervisors of these offshore centers as well as between them and other supervisory authorities. Since its inception, this group has developed a close dialogue the Basle Committee.

In 1982, the group and the Basle Committee agreed on a number of principles designed to promote supervisory cooperation. In particular, the offshore centers represented in the group agreed not to obstruct the flow of information from offices in their countries to parent banks, thereby facilitating consolidated supervision by parent authorities. In 1987, the group met to discuss several issues. The issues included using external auditors in supervising banks; obtaining access to parent banks' internal audit reports; reviewing banks' internal control systems and documentation; reviewing the relevance of parent bank guarantees, or loan take-over agreements as a substitute for capital; implementing the recommendations in the Basle Committee and Offshore Group joint paper on information flows; and supervising branches when the parent seeks to limit its responsibility. In 1988 and 1989, the group addressed the following

issues: (1) authorization procedures for cross-border banks, (2) information needs of parent authorities, (3) information needs of host authorities, (4) banking secrecy, (5) the role of the external auditor, (6) capital adequacy, and (7) criminal use of the banking system. In 1991, the group concluded that the BCCI affair indicated that the principles in the 1983 revised concordat and recommendations in the 1990 supplement were not being implemented fully and effectively. In addition, the group reviewed the recommendations of the Financial Action Task Force's 1990 report on money laundering. Finally, the group agreed to enhance its profile as an organization actively promoting effective supervision of banks in accordance with international standards.

Commission of Latin American and Caribbean Banking Supervisory and Inspection Organizations

All national agencies in the Latin American and Caribbean area responsible for the supervision and inspection of banks are eligible for membership in this group, created in 1981. As of September 1990, the group consisted of 23 member organizations.

The purpose of this group is to promote close relationships among these bank supervisory agencies; to discuss mutual problems; and to encourage research, training, and technical assistance related to bank supervision. It has invited representatives from the Basle Committee and other supervisory authorities to attend its annual meetings as observers. In 1987, the commission met separately and with representatives from several other countries, including Basle Committee representatives, to discuss several issues. The following issues were discussed: the role of external auditors, the classification of assets and credit concentration; and capital adequacy, capital and asset valuations, powers to intervene in banks' operations, foreign exchange risk and capitalization of external debt, information exchanges, and training. The commission also addressed the supervision of bank agencies, branches, and subsidiaries outside the home-country; the criteria for determining capital provisions; the supervision of financial groups; and operations associated with buying and selling public and private external debt and their effects on financial statements. From 1988 through February 1990, the commission held three meetings, which included representatives from the United States (the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Treasury Department), the World Bank, and the Basle Committee. The issues covered in these meetings included capital adequacy and its relation to asset quality, risk concentration and the establishment of regulations, basic information for bank supervision and surveillance, risk analysis regarding economic conglomerates; assessment of financial investment,

and safety mechanisms such as deposit insurance. In 1991, the commission issued the Proposal for the Classification of Credit Assets of Financial Institutions, which contains generally accepted minimal standards that reconcile the differences in the classification of credit assets.

Southeast Asia, New Zealand, and Australia Forum of Banking Supervisors

This group held its initial meeting in November 1984, with representatives present from supervisory agencies throughout Southeast Asia and the Pacific Basin. Japan, a member of the Basle Committee, is also a member of this group, thus providing a link between the two bodies.

In 1988, the forum met to discuss several issues, including capital convergence, off-balance-sheet instruments, liquidity management, large exposures, risk management, overseas branch supervision, and internal and external auditors' roles. The forum's 1990 meeting included representatives from the United Kingdom, the United States, Hong Kong, and the Basle Committee. The meeting addressed (1) supervising banks in a deregulated environment and the resulting integration of financial markets, (2) developing sound internal controls by commercial banks, and (3) assessing the roles of supervisors and external auditors.

Gulf Co-operation Council Committee of Banking Supervisors

Instituted in 1981, the Gulf Co-operation Council promotes coordination between the Gulf States, which include Bahrain, Kuwait, Saudi Arabia, Oman, Qatar, and the United Arab Emirates. In addition, a permanent committee of the governors of the central monetary authorities was formed to foster closer monetary harmonization. This committee subsequently established a Committee of Banking Supervisors, whose responsibilities included reviewing and coordinating the different banking laws and supervision procedures, studying banking supervision issues and problems, and acting as a liaison with other supervisory bodies.

In 1990, the council held a joint meeting with the Basle Committee and addressed topics such as capital adequacy, information flows between banking supervisors, large risk exposures, and international accounting standards. In 1991, the council began implementing a risk-based capital adequacy scheme, which resembles the Basle Committee capital accord adjusted for local conditions.

Group of Banking Supervision Officials in Arab Countries

This group was established pursuant to a resolution adopted in 1991 by the Council of Governors of Arab Central Banks and Monetary Agencies. It consists of representatives of virtually all Arab central banks and

monetary agencies and the Arab Monetary Fund. The group is charged with studying the decisions of the Basle Committee on Banking Supervision, particularly those concerning international convergence of capital measurement and capital adequacy requirements. Its goal is to determine and assess both the short- and long-term impact of their implementation on the Arab banking sector and to recommend a coordinated, pragmatic, Arab approach toward the issues involved.

The Caribbean Banking Supervisors Group

Representatives from 21 countries, including visitors from the United States, the United Kingdom, Canada, and the Basle Committee on Banking Supervision attended this group's 1990 meeting. The meeting focused on preventing the banking system from being used for criminal purposes.

The group's 1991 and 1992 meetings were attended by representatives from Antigua, Aruba, the Bahamas, Barbados, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, the Netherlands Antilles, Puerto Rico, St. Kitts, St. Lucia, Surinam, and Trinidad. The topics discussed at this meeting included supervisory challenges in the 1990s; banks' supervision of a monetary union; establishment of an effective legislative and regulatory framework for managing problem institutions; liberalization of the financial system; capital adequacy; the role of regional central banks in supervising credit unions and insurance companies; and harmonization of supervisory practices and policies, loan classification criteria, and loan-loss provisions.

Group of Banking Supervisors From Central and Eastern European Countries

The main purpose of this group is to facilitate the exchange of information on supervisory policies and practices and to further practical cooperation, not only among members but also with other regional groups and international organizations. The group's goal is to ensure that policy responses by supervisory authorities in Eastern Europe experiencing common problems are consistent with practices within and outside of Western Europe.

Representatives from Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia, and the former Soviet Union attended the group's 1991 and 1992 meetings. The topics discussed in these meetings included developing supervisory skills, preparing new banking acts in Eastern Europe, regulating foreign exchange activities, identifying and managing bad loans inherited from the past, assessing and making provisions for

loan portfolios, supervising banks' information systems, and preventing money laundering. The group has solicited the Basle Committee secretariat's assistance in organizing its efforts.

Comments From the Board of Governors of the Federal Reserve System

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

December 3, 1993

Mr. Allan I. Mendelowitz
Director, International Trade, Finance
and Competitive Issues
United States General Accounting Office
Washington, D.C. 20548

RE: International Banking: Strengthening the Framework for Supervising International Banks (GAO/GGD-94-XX International Banking)

Dear Mr. Mendelowitz:

As requested, we have reviewed the recently completed draft report from the GAO on the framework for supervision for international banks. We support the overall conclusion that the Basle Committee on Banking Supervision is the best forum to coordinate and promote safe and sound international banking supervision and that the creation of a supranational regulatory authority with enforcement powers is not warranted.

The report argues that the Basle Committee's informal status as well as its lack of complete information on international supervisory practices have the potential to be an impediment to effective implementation of principles of international supervision adopted by the Committee. Concern is also expressed that there needs to be stricter application of the agreed upon principles worldwide. Two recommendations are discussed which seek to address these concerns.

The first recommendation is that a clearinghouse for worldwide supervisory practices be established under the auspices of the Basle Committee. We support the recommendation as a means to improve worldwide knowledge of supervisory practices and as a means of identifying those countries where practices appear to not yet meet Basle Committee standards for supervision. The Secretariat already functions as a clearinghouse of information on supervisory regulations and practices in a broad range of countries; an update of this information is currently being prepared.

The Secretariat maintains and has recently distributed to supervisors around the world a list of contacts in case of a

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December 3, 1993
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problem. In addition, the Secretariat distributes papers for comment to countries beyond the Committee's membership, and it provides background papers for meetings of regional supervisors. Representatives of the Secretariat attend regional meetings as speakers and participants, as do individual Basle Committee members. Thus, the Secretariat now functions as a clearinghouse for bank supervisors worldwide; however, its reach could and should continue to be extended.

The second recommendation is to expand the role of the Basle Committee to help ensure stricter application of agreed upon standards through peer group reviews. These reviews would have the stated purpose to assess more rigorously the progress of all Basle Committee member countries in implementing the approved supervisory standards. The GAO staff states that this recommendation is proposed as an alternative to the creation of a supranational regulatory body with enforcement powers, an idea that has no support in the international supervisory community. While we are aware that there has been interest expressed in pursuing the concept of peer group reviews by supervisors in at least one of the G-10 countries, we along with supervisors in many of the other G-10 countries have not been enthusiastic about the idea.

There are several concerns with the peer review approach. First is the problem of confidentiality of supervisory information. If the exercise were to be in depth, and involve individual banks, serious questions of maintaining confidentiality arise both with respect to information on individual institutions and to the recommendations of the review team. Second is the problem of moral hazard, particularly when a country is given a satisfactory rating. If difficulties were then to arise with respect to one or more banks from that country, the supervisors who had participated in the review might be held responsible, at least partially, for the problem. More generally, distinct problems exist in making comparisons among supervisory systems in various countries due to significant differences in institutional settings and historical practices and traditions.

If the purpose of the review were to cover policies and procedures alone, that can be accomplished without peer review by requesting that all countries submit detailed descriptions of their supervisory systems to the Basle Committee as is now being done. A review of the adequacy and scope of policies and procedures should be possible based on information being supplied to the Committee, and this should better enable member countries

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to determine their positions with regard to another country's adoption of the Basle standards.

Finally, and of critical importance, a program of peer review runs the risk of altering the cooperative working relationships that currently exist among supervisors in the various countries due to the nature of the process, no matter how general the review. These relationships work quite well and should not be altered by imposing a new review process.

Of course, should an individual country wish to pursue a peer review on its own, it should certainly be free to do so and to organize the review as it sees fit, but without any expectation that similar reviews will necessarily occur in other countries.

Sincerely,

Comments From the Comptroller of the Currency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Comptroller of the Currency
Administrator of National Banks
Washington, D.C. 20219

November 22, 1993

Mr. Allan I. Mendelowitz
Director, International Trade, Finance, and Competitiveness Issues
General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Mendelowitz:

We have reviewed your draft audit report titled **INTERNATIONAL BANKING: Strengthening the Framework for Supervising International Banks**. Your review was conducted in the aftermath of cases involving the Bank of Credit and Commerce (BCCI) and the Banca Nazionale del Lavoro. Your review focused on the function and activities of the Basle Committee on Banking Supervision (Basle Committee).

The report found that the Basle Committee has set recognized standards for bank supervision, but that there needs to be greater adherence to those standards. It recommends that, in the absence of a supranational bank supervisory body, the U.S. bank supervisors seek an expanded role for the Basle Committee. For instance, the Basle Committee could use peer reviews and create a clearinghouse for information on supervisory practices. The report also finds that the Foreign Bank Supervision Enhancement Act (FBSEA) could be a model for implementing the Basle Committee's standards at a national level.

We recognize that the report deals with complex concepts and issues that cannot be always discussed at length. However, we believe the report would be more helpful and persuasive if it were to expand the discussion of pros and cons of some of its premises and conclusions.

The role of the Basle Committee

While the Committee is an important tool for U.S. and other G-10 country bank supervisors, it is by no means the only international bank supervisory group (as the report notes). Therefore, and because the Committee's membership is limited, it is not clear why the report assumes that the Basle Committee is the main vehicle for worldwide coordination on bank supervision. Nor is it clear how enhanced, worldwide adherence to the Basle Committee's standards would be achieved through the Committee. To illustrate other approaches, the report could discuss the

successes and failures of current regional efforts and those of such groups as the International Organization of Securities Commissions.

Supranational bank supervision

See comment 1.

While globally harmonized standards in many areas of bank supervision would have apparent merit, it is not obvious why common standards would in every respect be necessary to increase the banks' safety and soundness, or to enhance the attractiveness of banking services to consumers. Although the report discusses briefly the lack of support for a supranational bank supervision body, it seems to imply that in an ideal world this would be the preferred approach to coordination. In view of the intellectually and politically complex nature of the proposition, it would be warranted to include more of the analysis and underlying reasons for this assumption.

The rationale for suggesting that the FBSEA serve as an implementation model is that its objective is the same as the Basle Committee's Minimum Standards for Supervision of International Banking Groups in that both want to promote the idea of consolidated supervision of international banking groups. However, there are also important differences in their provisions. The report should also recognize that the federal and state framework for supervising foreign banks in the U.S. has laid a foundation on which the FBSEA built additional control features. The report appears to give the impression that the FBSEA is the only statute that provides U.S. bank supervisors with necessary tools. One of the effects of implementing FBSEA in the U.S. has been to create long delays in processing foreign bank applications. Such disadvantages may indicate that it is too soon to suggest FBSEA as an implementation model for other countries. Finally, it is not clear why the report concludes that, as a general rule, all national standards that are more stringent than the Basle Minimum Standards would be consistent with the Standards. While this may be true in some respects, it does not seem to us that it would be true for all potential supervisory measures.

Now on p. 46.
See comment 2.

The report refers (on page 74) to "one other BCCI." This conclusive statement raises a number of questions. Without appropriate context and qualifications, such a statement is likely to be misunderstood and have unintended negative effects.

Recommendation

The report recommends that OCC and other regulators seek an expanded role for the Basle Committee to ensure stricter application of its principles. While OCC is in full agreement with, and continues to actively seek, increased international cooperation and harmonization of supervisory approaches to financial institutions, we believe more can be done to enhance global bank supervision. Because the Basle Committee's membership is limited, we could explore coordination through other international bodies and fora, as well as through bilateral contacts where necessary or appropriate.

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Thank you for the opportunity to review and comment on the draft report. We would be happy to discuss these and any additional thoughts with you.

Sincerely,

Judith A. Walter
Senior Deputy Comptroller for Administration

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The following are GAO's comments on the Comptroller of the Currency's letter dated November 22, 1993.

GAO Comments

1. OCC interpreted the draft as proposing that a supranational regulatory body would be the preferred approach to coordination and believed that we should provide additional analysis to support this contention. We have changed the report to clarify that we are reporting the views of one prominent academic expert, and have explicitly referenced his writings and testimony to emphasize that the concept of supranational supervision is his view, not one that we are advancing.

2. OCC expressed concern that our reference to "one other BCCI" which was identified as doing international banking business, could raise questions and have "unintended negative effects." We have revised that section of the report to clarify that the "other BCCI" was mentioned by supervisory officials with whom we spoke and that the officials did not identify either the name or the scope of the bank's international activities. Our reference to the bank was meant to emphasize that supervisory officials continue to find situations that warrant a coordinated international response.

Comments From the Federal Deposit Insurance Corporation

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

Office of the Director
Division of Supervision

November 8, 1993

Mr. Allan I. Mendelowitz
Director, International Trade, Finance,
and Competitiveness Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. Mendelowitz:

Acting Chairman Hove asked me to respond to your letter of October 8, 1993, requesting review and comment on the draft report, International Banking: Strengthening the Framework for Supervising International Banks. We appreciate the opportunity to provide comment.

We found the report to be an informative document outlining the historical efforts undertaken by international banking supervisors to improve the quality of bank supervision worldwide. We agree with the report's conclusion that further steps to better assure adherence to the Basle Committee's supervisory standards would strengthen supervision on international banks.

The Basle Committee's June 1992 Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishments was a significant stride in establishing a framework to improve international bank supervision. Several constraints, however, have impeded the Committee's effectiveness at monitoring implementation of the minimum standards, including, as the report indicates, the variety of supervisory practices among countries and a lack of adequate information about the extent to which countries follow the Basle Committee principles.

The concept of a clearinghouse for worldwide supervisory practices, as suggested in the report as a step toward improving the exchange of information between international bank supervisors, has been a focus of the Basle Committee. The Committee is engaged in an ongoing effort to gather and disseminate information on supervisory

practices. In July 1993, it invited member and nonmember countries to participate in a survey of international supervisory practices in different countries for the benefit of supervisory authorities around the world. It is envisioned that the Committee's Secretariat will act as a central store of information and as a clearinghouse for the distribution, where necessary, of individual country responses to participating supervisory authorities. Further discussion of these initiatives with respect to the role of the Committee as a clearinghouse is appropriate.

Establishment of a peer review system among international bank supervisors has also been a subject of discussion by the Committee. A number of challenges present themselves to the establishment of a formal review system. To be effective, such a review would likely require a labor intensive effort over and above the review of general policies and practices. The level of detail of such a review raises concern over the confidentiality of information, particularly with respect to information related to specific institutions. Another concern is that formalization of such a review program could jeopardize the present harmonious relationship between members of the Committee, which has been successful in fostering a collaborative approach to resolving issues.

While there may be some merit in the concept of a peer review system, we view the implementation of a formal review program as problematic. We do not have the same level of concern with respect to efforts that may be undertaken on an informal ad hoc basis by individual countries. Such informal efforts could lay important groundwork toward future discussion of this issue at the Committee level.

The FDIC is committed to the Committee's minimum standards and has incorporated these standards into its supervisory system. We will continue work with our colleagues on the Basle Committee to encourage further adherence to the Committee's standards and support the Committee's efforts at seeking a more active role in this regard, without imposition of a new legal framework or interference with national sovereignty.

We appreciate the opportunity to review the draft report.

Sincerely,

John W. Stone
Executive Director

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