



**Bank of Albania**  
**Regional Financial Market and**  
**Financial Stability Conference**  
**Tirana 30-31 October 2006**

# Regional Host Supervisor Cooperation

Why Is It Desirable and How To Make It Happen?

**Franco Bruni, Peter Nicholl & Luigi Passamonti**  
**“Convergence” Program**

# International coordination in European banking supervision

- Second Banking Directive (1988): *host-home/branch-subsidiary, with exceptions and the general good clause*
- *further steps* with the Banking Consolidation Directive (1992) and with
- CAD: 1993, 1998, 2005: *consolidated supervisor*
- Recently: *strengthening the consolidating supervisor approach* (see over)

# Strengthening the consolidating supervisor approach

- Lead supervisor model
- Lead supervisor with an EU mandate
- Single European super-national supervisor
- Harmonisation (from Lamfalussy to CEBS, in particular with CAD)
- European Company Statute

# The limits of a within-EU approach

- Trying to tackle supervisory coordination issues in a purely within-EU manner...
- ... contrasts with the wide ***extra-EU activity of several EU banks*** and underestimates the ***interests of extra-EU countries*** and of the valuable contribution that can be offered by ***their authorities*** in improving the stability, the efficiency and the correctness of international banking
- A unified EU internal supervisory structure is needed...
- ... but success depends also on integration with, say, US, China and ... SEE (all the “still” non-EU Europe)!
- EU coordination to be conceived in an ***“open fashion”***

# Special issues

*(here, there and everywhere!)*

- The role of central banks
- Anti-trust
- Stability vs transparency and correctness
- Burden-sharing and fiscal authorities in bailouts (with and without explicit deposit insurance)

# Three actors in home-host relationships

- *Multinational banks, home authorities and host supervisors*
- A triangular relationship
- But ***host-host*** relations should also be considered, and will end up to be a crucial step in the solution of triangular problems!
- Each actor has ***legitimate claims*** (assets) and ***possible sins*** (liabilities) in the ideal balance-sheet of the triangular relationship
- The following is an ***“a-priory” list of claims*** and sins, a check list of issues to be researched in a ***case-by-case*** fashion (as the “Convergence” project has started to do) and ***proposed for consideration to an indispensable host-host cooperation programme***

# Multinational Banks

## *Legitimate claims*

- “one-stop preference”
- centralisation of strategic risk management and economies of scale and scope in their international organisation

## *“Possible Sins”*

- potential disregard towards the information needs of host authorities
- potential disregard of the quality (and nationality) of the subsidiary’s corporate governance
- moral-hazard, risk shifting and regulatory arbitrage (host-host contagion risks to be evaluated and monitored)

# Home Supervisor

## Legitimate claims

- all the information required to the *consolidating supervisor* ...
- ... preferably via the subsidiaries via the home headquarters
- cooperation of host supervisors with sufficient *confidentiality* and secrecy on the jointly collected information
- Final say in Basel II model validation

## “Possible Sins”

- tries to minimise the information released on the parent bank to the host supervisor
- potential disregard of the systemic risk in the host country when the subsidiary is small in the group, even if large in the host country
- resist the creation of central supra-national supervisors that could facilitate the solution of home-host issues (often the cause is the burden sharing problem in case of crisis: “he who pays the piper calls the tune”)

# Host Supervisor

## Legitimate claims

- *systemic risk in the host financial system* taken into account internationally even when of limited international relevance
- transparency of information for *licensing*
- transparency of multi-country *ownership chains*
- Information on *other subsidiaries* hosted elsewhere
- local availability of information on the banking group *overall risk strategy*
- *corporate governance* requirements
- a role in *Basel II validation* process

## “Possible Sins”

- suspected *hostility towards foreign ownership* of banks
- suspected insufficient *independence from local political pressures* in favour of special interests
- suspected unreliability in keeping pieces of *confidential information* released by home authorities
- suspected insufficient *technical competence* and efficiency
- inability to be clear and precise in *asking information* to the parent bank and to the home authorities
- tendency to confuse the instruments of prudential policy with those of monetary policy in a general tendency of using *non-market-friendly* methods of interference with bank management
- suspected resistance and inability in setting up the ***host-host cooperation*** needed to effectively present their legitimate claims to the international authorities and multinational banks

# Key Host Supervisor Issues

- How can it enforce its “legitimate claims” vis-à-vis home supervisors and multinational banks?
  - Very asymmetric relationships
- How can it be forgiven of its “possible sins”?
  - To build up reputational capital

➤ A collaborative host approach could help

# Regional Host Supervisor Cooperation

Vienna September 13 Technical Seminar

## Participants

- Bosnia and Herzegovina
- Macedonia
- Montenegro
- Romania
- Serbia

## Secretariat

- Convergence Program  
(Franco Bruni, Peter Nicholl & Luigi Passamonti)

## Apologies

- Albania
- Bulgaria
- Croatia

## Agenda

- Review of “Convergence” survey of regional supervisory practices and concerns
- Harmonizing Host-Home-Head Office reporting requirements – Romania’s example
- Discussion of headline policy issues
  - Market concentration
  - Profitability trends
  - Group risk management

# An Overarching Conclusion

- Host supervisors believe that a common understanding of regional activities of international banks could be beneficial
  - To reduce informational asymmetries with international banks and home supervisors
    - Legal entity activities framed in group context
  - To calibrate prudential actions given regional context developments
  - To exercise proportionate supervisory activities over local subsidiaries

# How To Frame Host Cooperation

Two possible sets of criteria

- What could the focus of host cooperation be?
  - Non-traditional policy goals
  - Choice of instruments
  - Implementation challenges
- How could host cooperation be organized?
  - “Quick wins”
    - Building longer-term momentum
    - External support and recognition
  - Through a co-operative structure
    - Regular working meetings

# Priority Policy Issues of Regional Interest

Vienna September 13 Technical Seminar

- Governance and management arrangements
  - ***Board composition***
  - ***HQ outsourcing***
- Competition and concentration issues
  - ***Assessment and possible remedial measures***
- Risk profiles and contagion scenarios
  - ***Household lending and interest spread compression***
- Consumer protection
  - ***Bank Ombudsman***
- Prudential information sharing
  - ***Qualitative and quantitative comparable data***

# Instrument Choice

Vienna September 13 Technical Seminar

## Cooperation could help with instrument choice

- Peer review of nature and implications of issue to address
- Benchmarking with international and regional experiences
- Use of international norms and practices
- Analysis of suitable legal and regulatory approaches

# Implementation Options

Vienna September 13 Technical Seminar

## Cooperation could help with implementation challenges

- Sharing of experiences on:
  - Enforcement challenges
  - Coordination with other domestic institutions
  - Role of self-regulation
  - Influence over bank HQs
  - Support from home supervisors

# Longer-Term Momentum

- Progress on “quick wins” could trigger larger-scale technical work to develop a comparable approach to prudential and market-building regulatory approaches
- Working groups may evolve into a regional discussion and coordination forum

Next Regional Technical Seminar: November 29, 2006

# Regional Host Supervisor Cooperation

## Broader Public Benefits

- Regional financial stability
- More meaningful home supervisor dialogue
- More standardized bank products and services for clients
- Better operating conditions for financial institutions
- Early phased integration with EU procedures
  - CEBS

# External Support Needed

- Home supervisors
  - could encourage better host preparedness to form a common supervisory approach
- International organizations and fora
  - Sharing of collaboration templates
- International banks
  - More understanding for host supervisor needs may result into lower compliance costs

# Convergence Program Support

- Acts as catalyst for regional cooperation
- Provides technical support on new market-building prudential challenges
- Makes an analytical person available to support a regional co-ordination leader
- Helps shape a common interface with home supervisors

# “Convergence”

**“Convergence”**<sup>1/</sup> is a financial sector development program for South-East Europe focused on:

- Undertaking, as an “honest broker”, analytical tasks of micro-institutional issues as a basis for identifying solutions tailored to country circumstances
- Taking EU integration as a strategic perspective
- Building awareness of market participants, involving them in the search of market-building solutions, and fostering their dialogue with authorities
- Using the experience of regional former policy makers and local experts whenever possible
- Working in partnership with other institutions