Perspective on International Cooperation in Financial Supervision

Comments for the Conference "The US Interest in International Financial Cooperation"

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The Major Financial Firms are Global; Many Markets They Compete in are Global, too

- Origin of the Basel Committee on Banking Supervision (BCBS) in 1974
- Recognition then that the roles and responsibilities for supervision of global institutions were not clearly stated. What is the role of the home and of the host jurisdictions?
- Concern for the safety of the overall system and for competitive equality
- Recognition of the absence of consistency
  - In regulation
  - In the application of regulation and enforcement of the rules
  - In the transparency of reporting by financial institutions
- The beginnings of regulatory arbitrage by financial institutions and customers/investors

Five Benefits of International Supervisory Cooperation

- Ensuring that troubled financial institutions with cross-border activities and periods of general market distress are handled constructively
- Ensuring that financial stability is supported by consistent safe and sound practice at financial institutions
- Addressing new risks and financial innovation
- Reducing regulatory burden and redundant supervisory activity
- Advancing supervisory practice and developing supervisory approaches to new activities

Easy to Forget: Supervision Has Developed Rapidly Since 1975

- The development of capital standards beyond leverage ratios dates back only to the 1980s
  - Many revisions over the years
- The Basel Committee's first principle was about consolidated supervision of financial institutions. The goal was to avoid gaps in regulatory coverage.
  - Several restatements of the roles and responsibilities assigned to home and host jurisdictions since the 1970s
- *The Core Principles of Effective Banking Supervision* were published in 1997; revised 2012; also a guide to its interpretation

Complication: As Financial Institutions Globalized, They Centralized Key Functions

- Once international operations were run as largely stand-alone organizations.
- Over time, financial firms developed internal infrastructure (communications, information technology) to centralize key decision-making and risk management and internal control functions.
- Host supervisors found an absence of local decision-makers and local risk management and control personnel.
- For the largest financial firms, their operations span many jurisdictions.

Another Complication: Barriers to Supervisory Information-Sharing

- Information is essential to good international cooperation. Supervisory information must be safeguarded, since it generally has legal protections
- Laws can limit the ability to share information and the scope of sharing—e.g., sharing banking information with a foreign securities agency
- The securities laws restrict the early disclosure of material nonpublic information
- Basic idea was that host banks would share with the home supervisor, but not clear what obligation the home supervisor would have to share with host jurisdictions.

Sharing Supervisory Experiences, Tools and Techniques Over Time

- Professionalization of the Examiner and Supervisory Forces
  - Certifications
  - Workshops for examiners across the BCBS
- Joint Examinations—largely overseas operations
- BCBS: Sound practice papers on risk management, foreign exchange settlement, liquidity management
- By the time of the 2007-09 financial crisis, the development of supervisory colleges

The 2007-09 Financial Crisis Provided New Insights Into Supervisory Cooperation

- Liquidity provision to host country operations of international banks
  - Involves secured credit extension
  - How much credit from a host country is appropriate?
- What was the true condition of financial institutions and of the industry as a whole?
  - Needed: A systematic look at certain risk exposures of banks
  - Assessing the size of the problem
  - A lot of information based on trust
- Dealing with institutions that could fail
  - E.g., mergers, Fortis, Lehman Brothers Holding

Developments Since The Crisis

- Identification of key supervisory problems shaped the post-crisis Basel III, Financial Stability Board agenda
- Example: Work on Resolution on the Supervisory Side
  - Formation of "Crisis Management Groups" (CMG) for each designated G-SIFI—major jurisdictions for the specific G-SIFI
  - Broke new ground in MOUs for sharing information
  - Enlisting the firms in a dialogue about resolvability
  - Identifying and solving problems, developing guidance
    - Recapitalization, e.g.
  - Development by CMGs of resolution plans
  - Periodic resolvability assessments with sign-off by

Expanding Efforts to Ensure Consistency and Good Practice

- The BCBS has had longstanding regional outreach meetings.
- Formed a working group of non-G10 supervisors.
- Since the crisis, the BCBS has stepped up peer review on the implementation of key standards, with published reports.
- The IMF-World Bank FSAPs: published reviews of the degree of compliance with global standards by individual countries.