

Supervising Multinational Banking Organizations:
RESPONSIBILITIES OF THE HOME COUNTRY

Alain Hirsch

MR. MUNDHEIM: Let us follow through with our hypothetical. Assume that the foreign bank with the U.S. branch or subsidiary is a Swiss bank. Alain Hirsch, a member of the Swiss Banking Commission, will tell us the view of the home country as to its regulatory and supervisory responsibility. After you have done that, Alain, perhaps you will want to raise some questions as to whether or not the demands of the host country for information strike you as reasonable and practical.

MR. HIRSCH: Well, if you will allow me, Bob, I think it would be better for the discussion if I begin with the second part of what you have just described and discuss the problem exposed by Neal Petersen a minute ago. Then, in the second part of my remarks I will consider the responsibilities of the home country, that is, of the parent bank.

1. RESPONDING TO THE DEMANDS OF THE HOST COUNTRY

I think, Neal, that everybody agrees, or could agree in principle, that a parent bank has to be a source of strength to the whole of the banking organization. The problem is, who has to supervise it and how much? I suppose that you would also agree that the branches and subsidiaries of a bank should not be a source of weakness for the parent and accordingly that the parent supervisory authorities have some responsibility over them.

A. U.S. Requirements

Now, let us begin very concretely--with your new regulations. One can start with your form F.R. Y-8f covering transactions between a subsidiary or branch in the U.S. and the foreign parent bank. I think that nobody could object to this form and I understand that nobody has, although it requests a great deal of information from the bank. Of course, it requires the foreign bank to give its whole organizational chart to the U.S. authorities; but that is necessary to see what relationship the U.S. branch or subsidiary has to the whole banking group. So, the whole of Y-8f is, I think, fully pertinent to your supervisory task. It has not been challenged, nor should it be. Perhaps it is a good example, if I may begin with a compliment, for other countries to consider.

The second form you have put out is F.R. Y-7 in its new incarnation. In the workshop we could discuss in some detail, perhaps, whether the entire form is necessary and reasonable; but on the whole, I think that this is not a very hot topic.

The hot topic is quite evidently the third form, this pink colored form F.R. 2068, in which you definitely want to know details of the financial situation of the whole international group. You

want to determine for yourself whether it is really sound and whether it is really a source of strength for the U.S. branch or subsidiary.

B. Criticisms of the New U.S. Requirements

As I have had the occasion to tell you already, I must candidly say that I think this is going just too far. I emphasize the fact that I am not speaking from the foreign bank's point of view; but rather, it is too far from the point of view of foreign sovereignty. The main concern is that this path, which the American authorities have followed in a modest way, challenges the basic principle that it is primarily the responsibility of the home country to supervise an international banking group. I suggest to you that if this approach were taken by a number of other countries in the world, the supervision of international banks would become impossible.

My main thesis is that what the American authorities have done, they could have done only on the assumption that no other country in the world would be bold enough to do the same. I think it is not rude--I hope it is not--to say that it is a form of legal imperialism to do something which you suppose no other country will do, because if four or five others should do it, it would be unacceptable. This is really the problem, and it is a pity that apparently the American banks do not fully understand it. If you really have not received many objections from the members of your American banking community, it is probably because they do not understand the implications of the form. This could be a bad example for foreign authorities; and foreign states could possibly go further, showing less respect for confidentiality than the U.S. has. This is my first point.

The second point is that this form, and this way of supervision, is probably not a very efficient method for the U.S. because, as you said a minute ago, you have very few means of verifying the accuracy of these figures. Let us not discuss the possibility of taking action toward the international group, if you feel it is going in an unsound direction. Of course, at the end of the day you may close the subsidiary or the branch in the U.S., but this is only if the situation is very serious. If something is wrong, the best answer is to ask the authority of the home country for a discussion. In my opinion, this could have been done without the pink form.

Last, but not least, you have said yourself that the confidentiality of this report is intended, but is not certain. This may be quite disturbing, especially when you said that you would not *automatically* give information to other agencies. Nobody reading the report would understand it that way. I am sure you will try your best not to give out information, but as you said, nobody knows.

2. HOME COUNTRY SUPERVISORY RESPONSIBILITIES

We come now to the point of asking, what would and what could the home country or the home supervisory authority do? If I suggest that you should rely on that home authority, or go to it when something is wrong, it must be on the assumption that the home authority takes its responsibility seriously. Admittedly, this responsibility of the home country is not assumed in the same way in all countries today.

A few years ago it was quite normal to think that the authority which supervised a parent bank was entirely responsible for supervising all its direct activities abroad--lending directly abroad, and so on. To a certain extent, it also supervised foreign branches, although there were some exceptions, because branches were already being supervised in the host countries. It was admitted, however, that subsidiaries were the concern of the local authorities only, and not the concern of the parent.

It is only a relatively recent development to admit--and quite rightly, of course--that economically a subsidiary is very similar to a branch. It does not make sense for the parent's authority to supervise a branch and to forget about the subsidiary. I do not speak now about some special kinds of subsidiaries which, of course, raise special problems. For instance, there are subsidiaries in which the bank has only a minority holding but where, in fact, it controls the bank; or there are joint ventures where two or three banks together own one bank. Problems arise especially when such joint ventures become important.

But, for a minute, let us forget about these exceptions and think about the normal subsidiary: the wholly-owned or majority-owned foreign subsidiary. Surely, the principle of supervision of these entities by the parent's authority is not universally acknowledged today. In some countries there is still a lack of legal basis for consolidated worldwide supervision by the parent. I understand that this is still the case in France, where they lack any authority to supervise subsidiaries. To a certain extent this is also true of Germany. But in more and more countries, the legal basis exists and the will of the supervisory body is also present.

There are, of course, technical difficulties in supervising foreign operations. The host country also provides supervision--local supervision--for the branch or subsidiary. Certainly, the aim is not just to have additional, competitive, and excessive supervision of the same banking operation. Rather, the idea is to develop rational cooperation between two institutions to verify the condition of these subsidiaries. I think that submission to the supervisory authority of the parent country is necessary in order to have an overall view of the whole banking group. Being able to see it in a comprehensive form, the parent country can apply at least some control to the whole of the banking group.

Again, the rules may be very different in different countries. I understand, for instance, that the American authorities receive rather good consolidated statements from their American banks with foreign subsidiaries; but the authorities do not impose the capital requirement of the American law to all the entities covered by this consolidated balance sheet. In Switzerland we content ourselves with a relatively simple method of consolidation. We think that the capital requirements of the Swiss law should not be weakened by the fact that a bank has subsidiaries in some places where the capital requirements are lower. Indeed, in the case of Switzerland, almost all countries of the world have lower capital requirements. For several years in practice--and formally since January 1, 1981--we have applied to subsidiaries the capital requirements of the Swiss law, which are fairly high (between seven and eight percent of the assets of all the worldwide operations of a bank). This kind of rule has not led, if I am correct, but could lead, to some duplication of regulation. I strongly suggest that the only way to reconcile both governments' legitimate concerns is through cooperation between the home authority and the local authority.

3. NEED FOR MULTINATIONAL COOPERATION

Let me make one more point about the problem of supervision, worldwide supervision. If the home country is to undertake its responsibilities effectively, it has to have the means, not only to get information, but also to verify this information on a worldwide basis. Here, of course, the problem is how to verify information in a foreign country, and here the difference between supervisory procedures in the U.S. and in Switzerland is interesting.

The U.S. has a system of direct supervision with American officials examining the banks directly, while we in Switzerland, as in other European countries, use private auditors appointed by the banks. These are not completely private auditors. They are chosen from a list established by the federal banking commission, and they are very closely supervised by the authority. These auditors really act in many ways as if they had some public authority: they function through the delegation of public authority to a private company. We are very happy, I must say, with this system. I suggest that this method is the most practicable for controlling banks on a worldwide basis. For an official body to go into a foreign country and inspect on site is generally considered unacceptable by the host state; but private auditing companies may have either subsidiaries or correspondent companies in many other countries. They may even send their own people to examine the subsidiaries of the bank. This would not normally be considered as an act of state and would usually be accepted by the bank and the host government. Worldwide verifying--the examining process in your terminology--is more easily accomplished this way.

Now, two words about cooperation, although I do not want to overlap what Peter Cooke will say. To begin with, if cooperation has to take place, the big problem starts with the initial establishment of branches or subsidiaries. This involves questions of competition and of public benefits. A very important condition for allowing the entry of a foreign bank should be the international standard under which it operates and the fact that it has proper worldwide supervision in its home country. If not, I suggest that it is not possible to replace that lack of home-country control by any form of confidential pink report.

If a bank wants to enter the U.S. or any country, it should be customary to make sure that its supervisory authority controls and supervises it in an accepted international way. This need not mean exactly following the American standard or the Swiss standard or the English standard; but supervision must be provided at an acceptable level and on an international basis. That would solve a great many problems. If we consider offshore subsidiaries, offshore banks, and parent banks in offshore countries, the host supervisory authorities readily admit that they normally do not control the whole group on an international basis. So, without any detriment, I think this requirement would solve a great part of our problem.

I believe the second condition for entry should be that the supervisory authority of the parent country must be ready to cooperate fully with the host authority. Especially, it must be willing to alert the supervisory authority of the subsidiary or branch if the whole of the banking group gets into some kind of trouble or if there is an improper transaction between the subsidiary and the

parent bank. If we could approach this goal, I think it would create an effective and efficient system of supervision for international banking. Benefits would be realized both from the point of view of the supervisory bodies and also from the point of view of the banks, because duplication and excessive regulations would be avoided. I will end with a question: Do you think that the kind of regulation you have recently adopted in the U.S. is helping or is hindering efforts in this direction?

MR. MUNDHEIM: Before I give Neal Petersen a chance to answer that, I want to be sure I understand the point. You are saying, Alain, that before allowing entry of a branch or subsidiary into Switzerland, you would look at the adequacy of the supervisory regime in the home country of that bank?

MR. HIRSCH: This approach is now developing. We have just begun to discuss it in the Banking Commission in some specific instances. Our law does not provide that foreign worldwide supervision of the international group is a condition for entry; but what is required in our law is that a bank should have proper organization. Now, it seems clear to me that having proper organization for a subsidiary means being properly controlled by the parent and by the supervisory authority of the parent. I am confident that if we make this point we would be supported by the court. Indeed, we have considered this factor in many cases where we were convinced that the supervisory authority of the parent bank was quite adequate. True, we have not yet come to a decision to forbid an entry for this reason alone, but I strongly believe that we are moving towards that possibility.

MR. MUNDHEIM: Neal, is that a possible standard for approving or disapproving branches or subsidiaries in the U.S.? If it is not, is that part of the reason for our governmental attitude that we cannot rely on home country supervision? Is there some middle path?

MR. PETERSEN: I do not know if I disagree in principle with what Alain Hirsch is saying--that considerable reliance should be given to the home country supervisor. I think it is something that perhaps over time we might strive for. I have some immediate problems with it in terms of entry into the U.S. at this time and under existing international arrangements; and I am sure Peter Cooke will expand on that theme. First, I think it would be very difficult for the Federal Reserve or the other bank regulatory agencies to be making public judgments on the adequacy of supervision in other countries.

Second, if you go back to the principle of national treatment in the foreign banking area, you should bear in mind that we are not asking the foreign banks for any more information than we require, for example, of a domestic bank holding company filing Form Y-6--even though the form number is a little bit lower. That leads me to the third point which I will give to you in all candor. This is my personal view and not necessarily the view of the Board of Governors or anybody else. Political considerations in this country would not allow us to adopt the system that Alain Hirsch suggests.

We have a very open country in terms of foreign banks coming in at the moment. They had been somewhat restricted by the IBA, but I think the system is still one of great openness and probably as open as any country in the world. Now, that policy has been under some political attack--often in regard to the adequacy of our super-

vision of the entities coming in. To illustrate that point, I can refer you to Congressional hearings where the Board testified about its approval of certain acquisitions by foreign bank holding companies. At those hearings many members of Congress raised serious questions about the adequacy of our supervision of foreign banks in this country. Now, this is not a legal problem. It is a political concern--a major one in terms of adopting any approach such as that Alain Hirsch suggests.

The next point I would make is that foreign banks in the U.S. --foreign subsidiaries and foreign branches--now have the same access as any other domestic institution to the lender-of-last-resort and the adjustment-credit facilities of the Federal Reserve. In some instances insured foreign branches have a potential claim, or their depositors have a potential claim, on the FDIC insurance fund. I think it would be difficult to fulfill these roles without satisfying ourselves as much as we can of the overall strength of the foreign organizations.

Finally, I would disagree with Alain that what we are asking for is all that onerous and difficult for a foreign banking organization to come up with--particularly the modified Y-7 and F.R. 2068. It seems to me that it is not a difficult job to file that report once a year and to file quarterly the form Y-8f. So, I would conclude my remarks by saying: (1) I don't think we are being unreasonable. (2) I think it is a proper concern of the host country to require this kind of information for ongoing supervisory purposes. (3) I think it would be very difficult at this time for us to change our approach in any significant way--given the present climate--even if it would be desirable to do so. (4) I think the lender-of-last-resort function, the claim on the Federal Reserve that these institutions may have from time to time, argues for our treating them the same as we treat domestic institutions.

MR. HAWES: Neal, could you react to Alain's specific suggestion about independent verification by auditors? As a general principle, I think it has some interest.

MR. PETERSEN: I imagine it does. Our banking system, as far as supervision is concerned, has been traditionally grounded not upon independent auditors, but upon actual examination and reporting to the bank supervisory agencies. I do not think that we would be comfortable with an independent audit verification at this time.