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INTERNATIONAL COOPERATION FOR IMPROVED BANKING

Remarks of

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INTERNATIONAL COOPERATION FOR IMPROVED BANKING

Central banks and other government banking regulatory agencies have a variety of responsibilities. First and foremost, central banks are charged with the determination of monetary policy. In addition, many central banks in the world have been given the job of supervising commercial bank behavior and serving as lender-of-last-resort to their depository institutions. There are differences in responsibility and authority in the supervision of bank operations between the central banks of the primary industrial countries of the world. In the United States the Federal Reserve System as a central bank has some regulatory, supervisory and examination authority over the state-chartered member banks of the System. It also has prime responsibility for bank holding companies and their nonbank affiliates, and regulatory rule-writing responsibilities in a number of areas. In contrast, the Bank of Canada does not have supervisory responsibilities. Instead, such responsibilities are assigned to a superintendent or commissioner of banking. This latter approach is often found in many Latin American countries.

All basic responsibilities of central banks are interrelated. Monetary policy, of course, is not developed nor implemented in a vacuum. It must work through the credit-granting institutions of the nation. Only by assuring itself that such institutions are soundly capitalized and well managed can the central bank be certain that its monetary policies are being implemented in the most effective and efficient manner. Of course it is not necessary that the central bank do the direct examination and supervision of banks, providing that those who do, not only fully report the results of their examinations and supervision but also consult with the central bank so that the actions being taken in the field of examination, supervision, and enforcement are compatible with the credit needs of the nation. One way or another it is important that the central bank be thoroughly familiar with the problems of examination and supervision.

Also of considerable importance to the central bank are the regulatory relationships. It would be difficult for a central bank to accept regulatory actions of another agency if these were created and implemented without taking account of the central bank's need for information, requirements for reserves, control over deposits, and utilization of the discount window. Each nation has determined its own pattern for handling regulatory, supervisory and examination functions within its special legal, economic and institutional framework. Thus it is apparent that the job can be done by either a single or multiple agency approach. However, when commercial banks begin to cross national boundaries differences in approach become more important. Thus I welcome the opportunity to participate in this meeting and offer some thoughts on the international aspects of bank supervision and regulation.

There has been an increased emphasis on international aspects of commercial bank supervision in recent years reflecting this rapid expansion in international banking. In the United States, for example, foreign-owned banks which in 1972 accounted for only \$6 billion in deposits now in 1978 account for \$27 billion or roughly 3 percent of the total deposits of the nation. We are seeing many more new agencies, subsidiaries and branches of foreign banks than in prior years. Thus, we welcome the increased emphasis on cooperation among central banks in the supervisory area. Several years ago the central banks of the major industrial nations began sending representatives to the Bank for International Settlement for periodic discussions of these issues. This meeting will emphasize the growing importance of international banking in the Caribbean area and will focus upon the needs for cooperative efforts on the part of the central banks of the Latin American and North American countries or their superintendents of banking in the regulatory area.

There have been a number of differences among authorities around the world in the area of supervisory policy. One issue is to what extent those authorities should provide written guidelines to the commercial banks and to what extent such supervision might take the form of individual consultations. The most obvious example of these alternatives is reflected in the contrasting approaches of the central-banks of the United States and the United Kingdom. The Bank of England largely adopted a policy of informal consultations,whereas the United States has opted for written judgments and regulations, Some of this difference may merely reflect the structure of the banking industry and the diversity of such banking units. In the United States there are almost 15,000 banks whereas in Great Britain there are a limited number of very large banks, but with many "near" banks. A recent "white paper" has suggested a more formal regulatory approach in the U.K.

Another policy issue concerns how much one should rely upon the regulatory or enforcement mechanisms of government as opposed to the market disciplines of a competitive environment. Governmental and central bank philosophies differ on this point. In the United States there has been growing reliance upon the competitive disciplines of the marketplace to ensure equal access to credit at the best terms and conditions. Both methods of control would appear to be moving in tandem to assure ourselves of a safe and sound banking system, but one which is responsive to the needs of the nation to provide credit for sustainable noninflationary growth.

Still another point of difference would seem to be the question of credit allocation. The United States central bank has never sought to allocate credit or to substitute its judgment for the judgment of the marketplace on which sectors of the economy should receive credit. I recognize that in such a diverse and well-organized industrial society as in the United States, such a philosophy is perhaps more effective and even more efficient than in a developing country without the strength of broad industrial components or a widely diverse economic structure. Commercial bank supervision in the United States relies heavily upon the adequacy of management systems and controls and the adequacy of credit information. We are giving increasing emphasis to information systems which will enable regulatory agencies to exercise oversight to assure the nation of the safety and soundness of the banks as opposed to allocating credit to particular areas. In a country with less well-developed capital and credit markets, some direction of credit accommodation may be needed.

In a broader sense, the International Monetary Fund is providing a framework within which an over-all approach to supervisory activities may be achieved in the area of creditworthiness and credit granting in the international area. Unrestrained commercial lending might provide a country with credit in amounts so large as to require no resort to the Fund. This would, of course, mean that that country was free to follow whatever policies it wished without the scrutiny or conditionality of the Fund's credit-granting mechanisms. The Fund is increasingly looked to for indications about the creditworthiness of borrowing countries. Here there is the risk that extensive coordination of private and international lending institutions could result in the latter becoming allocators of credit flows. Both extremes can be avoided if commercial banks are provided with adequate information necessary to make their judgments on the economies and external debts of the potential borrowers and if the bank supervisors insist upon prudent policies. Much of this depends upon the availability of sufficient information on external debts to the commercial banks. The communications responsibilities are therefore of high priority in today's world of international banking.

The Federal Reserve looks at the consolidated position of its banks whether at home or abroad and supervisors in foreign countries often look at the subsidiaries of our banks located in their countries. We both have an interest in the soundness of those subsidiaries as well as in the strength of the over-all organization. Cooperation is increasing among the supervisors of banking in the world but I would not wish to mislead you that we have reached the millennium where central banks are in full cooperation or that bank supervisors are able to obtain all the information they need. There are still laws in some countries and reluctance on the part of some bank regulators to share supervision of foreign banks. Some of this is based upon privacy laws and some on the perceived policies of their governments. Nevertheless, compiling and making available aggregate data on international lending by banks is increasing to a greater extent throughout the world and this information provides hope that commercial banks making loans to other nations or industries within other countries will be in a better position to measure creditworthiness and arrange appropriate terms and conditions for the loans they extend.

Thus far I believe we can say that we are achieving some improved surveillance of multinational banks though there are some significant problems. As international banking grows it is obvious that the control of a bank--where two or more commercial banks of differing countries have an ownership position--creates problems of supervision as well as possibilities of difficulties in management and control. Perhaps this is best illustrated by the problems we have seen in joint venture efforts on the part of commercial banks with diverse home offices in the fields of nonbanking activities. It is well known that certain mortgage banking activities of some commercial bank joint ventures have been in difficulty over the past few years and the problems of achieving control as well as supporting correction in the credit granting facilities to these mortgage banking subsidiaries or joint ventures have been considerable. There is a potential for some increase in this type of problem, partly owing to the insistence of certain countries that the depository institutions of their territory be at least 51 percent owned by nationals. This automatically creates a spreading of management responsibility and perhaps also a spreading of the responsibility for meeting the needs of the particular bank for capital or lendable funds. Perhaps in even greater focus is the effort of those banks to enter into other fields of endeavor, especially if the joint partner is a United States bank where participation of such a bank in the other field of endeavor is limited by Federal Reserve regulations.

None of what I have said should be construed as any criticism of the banking regulations of a foreign nation. We, in the United States, have created our own supervisory program, have laid down specific regulations on our banks and we expect those banks to adhere to the laws and regulations of this nation, whether they are participating at home or abroad. Similarly, if other countries are to accept the responsibility for their home office banks and their subsidiaries worldwide, we must expect them also to maintain some degree of control over those subsidiaries on the basis of their own banking laws. The extent of control and the means of accomplishing it are matters for their determination as long as they do not contravene the laws of the host country.

The United States has been reviewing the activities of foreign banks in our country and within the past month Congress has moved toward acceptance of legislation which creates a pattern of national treatment of banks coming in from other countries to do business in the United States. In the past such banks have largely lived under the laws and regulations of their home office, and United States regulatory activity with regard to such banks has been superficial. Now, however, we are attempting to broaden our controls and place some limits on foreign banking activity so that foreign banks are not in the position of competitive advantage over our domestic institutions. It is our hope that this principle of national treatment will be well accepted by both the foreign and local institutions and by the regulatory agencies in foreign nations.

This new effort on the part of the United States, however, does not in any way substitute for the need for international cooperation among central banks or their superintendents of banking. This cooperation, in my judgment, must move even further than at present, not only to maintain a broad look at banking solvency, liquidity, capital adequacy and other similar measures across national borders, but also to provide the information necessary for the commercial banks to do their jobs even better in the competitive market place of the world. Competition is obviously intensifying throughout the banking industry and such competition must be carefully monitored to assure that safety and soundness of the institutions is maintained. As banks increase their size and spread their responsibilities throughout the world, there must be a careful monitoring and analysis of the degree of risk, and the spreading of that risk to avoid overconcentrations. The larger the banking unit, of course, the more difficult would become a failure of such a unit.

Consequently, in my closing remarks today, I want to emphasize the need for continued cooperation and greater informational exchange on the supervisory responsibilities and analysis work by central banks and the superintendents of banking throughout the free world. I hope you join me in this feeling of urgency of the need to cooperate. I suggest that perhaps this conference can be the first step in a means of cooperative central bank exchange of information on the common commercial banks within our countries.

Thus I propose that CEMLA or the Western Hemisphere Governors Conference sponsor a study to review the present level of cooperative supervisory relationships and recommend new ways of achieving closer ties which might:

1. Analyze and inform all regulators on the laws and regulations governing entry into each country in the banking area.

2. Review, monitor, and coordinate standards of conduct for foreign banking units.

3. Establish means of obtaining early warning of developing problems in foreign banks or major international borrowers.

Our emphasis should be on informal consultation and an ability to discuss problems directly without excessive documentation or formal channels of communications. As we build confidence in our ability to exchange information perhaps an even broader effort might be undertaken.

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