



ASSOCIATION OF SUPERVISORS
OF BANKS OF THE AMERICAS

WORK GROUP NO. 3

Consolidated Supervision



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Working Group Members

Jack P. Jennings II (President)	Federal Reserve Board (United States)
Steve Fritts (President)	Federal Deposit Insurance Corporation (United States)
Rafael Diaz (Technical Secretary)	ASBA
Adriana N. Antonelli	<i>Superintendencia de Entidades Financieras y Cambiarias</i> (Argentina)
Claude Haylock	Central Bank of Bahamas (Bahamas)
Carlos Jose Braz Gomez	<i>Banco Central do Brasil</i> (Brazil)
Luz Ángela Barahona	<i>Superintendencia Financiera de Colombia</i> (Colombia)
Marcelo Herrera	<i>Superintendencia de Bancos y Seguros</i> (Ecuador)
Javier Alfredo Lopez	<i>Superintendencia del Sistema Financiero</i> (El Salvador)
Erika Susana Vargas	<i>Superintendencia de Bancos</i> (Guatemala)
René Menendez	<i>Superintendencia de Bancos</i> (Panama)
Hugo Centurion	<i>Superintendencia de Bancos</i> (Paraguay)
Jose Roberto Effio	<i>Superintendencia de Banca, Seguros y AFP</i> (Peru)
Joaquin Mochon	<i>Banco de España</i> (Spain)

Technical Assistance

Jorge Cayazzo	International Monetary Fund
Constantinos Stephanou	World Bank

Other Representatives

Terry Muckleroy	Federal Reserve Board (United States)
Curtis Wong	Federal Deposit Insurance Corporation (United States)

Document Editing

Rudy Araujo	ASBA
Rafael Diaz	ASBA

Mission

To develop, disseminate, and promote banking supervisory practices throughout the Americas in line with international standards. To support the development of banking supervision expertise and resources in the Americas, through the effective provision of training and technical cooperation services

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SUMMARY

Background on Consolidated Supervision of Financial Groups or Conglomerates

Banking agencies are increasingly faced with very large, internationally active, and widely diversified firms operating across borders and conducting interrelated transactions using the pooled capital and financial resources of multiple corporate components. As firms' corporate structures have become increasingly more complicated, concerns have been raised regarding the possibility that a banking company, or a company controlled by a natural person, may be negatively impacted by losses suffered by other entities within the same financial group or conglomerate structure.

In response to these developments, bank regulators have turned to the potential of consolidated supervision. Under a consolidated supervision regime, a financial group or conglomerate, regardless of where chartered or operating, might be supervised from the top down starting with the ultimate parent company and working collectively through each of the owned or controlled legal entities. The hope is for supervisors to capture as a result, risks that might affect the entire group or conglomerate irrespective of where these risks appear in any one of the individual component companies.

In an effort to help promote effective consolidated supervisory practices in the region, ASBA organized a Working Group on Consolidated Supervision in 2007. The objective of the Working Group, which included representatives from supervisory agencies in twelve ASBA member countries and ASBA's executive team, was to identify current consolidated supervision practices in the Americas, through the implementation of a regional survey, challenges in the application of consolidated supervision, and efforts to address these challenges. The survey was completed by all members of the Working Group. A summary of the Working Group's findings,

key issues, and conclusions regarding consolidated supervision practices in the region are contained in the following paper.

Specifically, the paper identifies some key aspects of consolidated supervision, including those identified by the Basel Committee on Banking Supervision (BCBS). In addition, the paper attempts to examine some of the challenges that might be faced by countries or regions attempting to institute a consolidated supervision framework for financial companies operating within their borders, regardless of ownership. The paper also highlights many of the efforts that have been undertaken and are ongoing in the region to address these challenges.

Based on the results of the survey and given important historical and developmental differences in regional financial systems and supervisory and regulatory regimes, it is clear that much work remains to be done if countries in the region wish to impose a universally accepted consolidated supervision regime. Many questions remain unanswered. Given the Working Group's time constraints, issues for further consideration have been identified in the paper and may be explored by a future ASBA Work Group. However, five conclusions have been drawn by the Working Group, which are summarized below.

Conclusions

First, consistent regulatory reporting and unfettered access to a core matrix of financial information will be crucial for any supervisory regime to be effective.

Consolidated supervision will likely require not just generally accepted financial disclosures but that this financial information is consistent and provides sufficient detail of all components of the financial conglomerate. Even internationally accepted financial disclosures that do not mandate, for example, financial information on special purpose vehicles and other technically "off balance sheet" assets and liabilities, will not provide

supervisors with sufficient information to assess all risks at all levels of the conglomerate. A mandatory regulatory reporting regime that specifies disclosures of legal entity level detail and covers all essential information regarding the financial condition and prospects of a regulated company, will help afford consolidated supervisors with the appropriate access.

Second, full and complete financial and ownership disclosure is key to supervising conglomerated companies operating across borders. All members of the Working Group mandate ownership disclosures but this element of consolidated supervision might be improved by efforts to make these disclosures more consistent and more understandable.

Third, cooperation between both domestic and international supervisors can go a long way toward improving understanding of financial companies. Regular communication has already been initiated between various bank supervisors within the region, and some cooperation and coordination between regional supervisors is already taking place on both a formal and informal level. This type of interagency and cross-border communication and cooperation can provide useful information sharing and supervision, even without further legislative initiatives to strengthen consolidated supervision.

Fourth, two factors may be outside the purview of bank supervisors either individually or collectively: The convergence of accounting standards with regard to consolidation of all legal entities within a

financial group or conglomerate and all assets and liabilities held by that ownership structure; and the establishment of a uniform legislative definition of “financial conglomerate”. The first factor may be crucial in determining not only financial disclosure for financial conglomerates but also how ownership control is defined – what legal entities actually reside within the group or conglomerate for financial purposes. The second factor may be a prerequisite for establishing supervisory enforcement powers relative to the individual components within a financial conglomerate however defined, as legal authorities may ultimately need to draw upon that underlying definition. Banking supervisors may be able to provide some input into the first factor, but are likely to have little influence with regard to the second.

Finally, Working Group members were challenged to reach a consensus on a number of specific issues related to the consolidated supervision of financial groups or conglomerates, including the appropriate scope and depth of the legal and regulatory frameworks of consolidated bank supervisory and regulatory regimes in the region. The inability to reach a consensus on these issues was primarily attributable to (1) the comprehensiveness of the topic of consolidated supervision relative to the time constraints of the Working Group; and (2) differences in the financial and historical development of financial systems in the region. These issues, which are identified in the paper in section 4, may warrant further consideration by a future ASBA Working Group.

INTRODUCTION

Over the past decade, the long-term trends of consolidation, conglomeration, internationalization, and innovation in the global financial system have intensified. Financial liberalization has removed statutory barriers that once prevented banking, securities, and insurance firms from operating within the same financial conglomerate. Consistent with these trends, regulatory obstacles to combining banking and the securities business have fallen in many countries within the Americas region while countries with universal banking have permitted the integration of the securities business with traditional banking for some time. Today banking organizations in the region have a broad product mix and activities that extend well beyond traditional deposit-taking and lending. As a result of these developments, there are a small number of financial and/or banking organizations that are larger and engage in a wider array of financial and non-financial activities than at any time in recent history.

These changes have been driven by deregulation; by improvements in communications and technology that have increased the speed and volume of transactions; and by widespread innovation in markets, organizational structures, and services. Common ownership and close ties among companies of different financial market segments has also generated different kinds of business advantages for economic groups, including cost savings and revenue diversification. Increased penetration by foreign financial institutions in the Americas has contributed to the level of financial conglomeration in the region.

Financial groups or conglomerates¹ have inherent risks and pose certain challenges to bank supervisors. For instance, difficulties in one entity within a group may spill over

into other entities. Bank supervisors have particular concern where a non-bank entity within a group may have an adverse impact on a bank, and possibly make demands on a government's safety net. A group's or conglomerate's size and complexity may also make it difficult for markets and supervisors to obtain an accurate understanding of the group's structure and risk profile. In addition, the management of conglomerates on a group-wide basis can also result in the exploitation of regulatory differences among different entities within the group.

One way that banking supervisors have responded to these developments, is by adapting their approaches so that regulatory supervision is closely aligned with the way financial organizations structure and manage their business activities. This has entailed a shift from a "legal entity" approach to supervision to a more "group wide" or "consolidated" approach to supervision, whereby all risks run by a banking group are taken into account. Consolidated supervision requires a clear understanding about the earnings, practices, governance and risks of each economic unit that belongs to the group and a detailed analysis of the impact of each one of them in the rest of the group. Thus, consolidated supervision entails effective "cross-functional" supervision whereby the financial condition and risks of other domestically regulated firms within the group under a common ownership are considered and effective "cross-border" supervision whereby the financial stability and risks of a financial institution's international operations abroad are understood.

In light of these financial sector related developments, ASBA created a working group to identify the challenges supervisors face in the application of consolidated supervision, as well as the practices undertak-

¹ "Group" includes "financial conglomerates" and other groups that have various holdings in the banking, investment, and insurance sectors and the terms are used interchangeably in the paper.

en by supervisors in the region to overcome them. Specifically, the primary objectives of the Working Group were to:

- > Identify current consolidated supervision practices in the region.
- > Understand the main problems that prevent adequate supervision of financial conglomerates and of economic groups with financial and non-financial activities.
- > Identify practices regional supervisors are undertaking to overcome these challenges.
- > Suggest possible changes in the practices, priorities, schemes and legal framework to strengthen consolidated supervision.

The first step of the Working Group was to conduct a voluntary survey among the group members to understand their countries' (1) legal and regulatory frameworks regarding consolidated supervision; (2) development and presence of financial conglomerates and of economic groups with financial and non-financial activities; (3) consolidated supervision arrangements; (4) supervisory practices; and (5) consolidation techniques (For fur-

ther details, refer to the ASBA Questionnaire on Consolidated Supervision in **Appendix 1.**) In May of 2007 and again in May 2008 the Group Members met to share their experiences and challenges in the application of consolidated supervision in their countries. Data collected from the survey responses and from the Working Group meetings were compiled into this report. The structure of the report is the following:

- > **Chapter 1** describes consolidated supervision of financial conglomerates and summarizes the evolution of consolidated supervision and consolidation, conglomeration, and internationalization developments in the region based on the survey results and member input.
- > **Chapter 2** identifies some of the challenges supervisors face in applying consolidated supervision based on the results of the survey and member input.
- > **Chapter 3** identifies practices undertaken by supervisors in the region to address these challenges based on member input; and
- > **Chapter 4** identifies relevant topics not analyzed in the present document.

Consolidated Supervision of Banks and Financial Groups

1.1. Definition of Consolidated Supervision

Consolidated supervision is a comprehensive approach to banking supervision which endeavors to evaluate the strength of an entire group, taking into account all the risks which may affect a bank (or individual regulated firms within the group), regardless of whether these risks are carried in the books of the bank or related entities. This group-wide approach to supervision, whereby all the risks of a banking group are taken into account, wherever they are booked, goes beyond accounting consolidation.

1.2. Evolution of Consolidated Supervision

Consolidated supervision has evolved over time to become an important tool in banking supervision. A key development in the consolidated supervision of banks can be attributed to the Basel Committee on Banking Supervision (BCBS). In 1979, the BCBS issued a report on the “Consolidated Supervision of Banks’ International Activities” which recommended that supervisory authorities of banks with foreign subsidiaries, joint ventures and branches monitor the risk exposures of these banks on the basis of consolidated reports, reflecting their total business, regardless of the legal entities or countries in which it is conducted. Furthermore, in 1992, the BCBS issued “Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments”, which, among other things, recommended that supervisory authorities should not permit banks from foreign countries to open offices within their jurisdiction unless they are satisfied that the home country su-

pervisor of an applicant bank supervises the new office and the parent bank on a consolidated basis. In September 1997, the BCBS stipulated in the “Core Principles for Effective Bank Supervision” that consolidated supervision of banking groups is an essential element of banking supervision and should be practiced on an on-going basis. **Box 1** below provides a summary of the key developments in consolidated supervision. The Core Principles were subsequently updated in October 2006, including Principle 24 on Consolidated Supervision. For further details on the essential criteria for consolidated supervision included in Principle 24, refer to **Box 2** below.

Similarly, consolidated supervision of financial conglomerates has evolved in recent years due in part to the work undertaken by the Joint Forum on Financial Conglomerates (Joint Forum). Beginning In February 1979 and more recently in 1999, the Joint Forum² released several reports on the principles of supervision of financial conglomerates.³ Not surprisingly there is considerable overlap between the issues relating to the supervision of financial conglomerates and the consolidated supervision of banking groups. As such, many of the principles outlined in the BCBS documents related to consolidated supervision of banks are consistent with the Joint Forum principles related to the supervision of financial conglomerates.

1.3. Types of Financial Groups Subject to Consolidated Supervision

The types of financial groups subject to consolidated supervision in the region vary in terms of their structure, size, range of activities, and complexity. Based on survey re-

² The Joint Forum is comprised of representatives from the BCBS, the International Organizations of Securities Commissioners, and the International Association of Insurance Supervisors.

³ The Supervision of Financial Conglomerates. July 28, 1995. Joint Forum; and The Supervision of Financial Conglomerates. March 28, 1999. Joint Forum.

Key Milestones in the Development of Consolidated Supervision

- > **February 1979** Joint Forum on Supervision of Financial Conglomerates
- > **March 1979** Basle Committee on Banking Supervision (BCBS) report on “Consolidated Supervision of Banks’ International Operations”
- > **May 1983** BCBS: Principles for the Supervision of Banks’ Foreign Establishments.
- > **July 1992** BCBS: Minimum Standards for the Supervision of International Banking Groups and their Cross Border Establishments
- > **October 1996** BCBS: The Supervision of Cross-Border Banking.
- > **September 1997** BCBS: Core Principles for Effective Bank Supervision: BCBS indicated that consolidated supervision of banking groups is an essential element of banking supervision which should be practiced on an on-going basis.
- > **June 2006** BCBS: Home Host Information Sharing for Effective Basel II Implementation at supervisory authorities do not allow banks from foreign countries to open establishments within their jurisdiction unless they are satisfied that the home country supervisor of an applicant.
- > **October 2006** BCBS: Revised Core Principles for Effective Bank Supervision.

sponses, several broad categories of institutions can be identified in the region based on the types of financial activities that they engage in and whether or not the group has a banking presence. For instance, many members have defined “banking groups” or another related term under local laws which are subject to some form of consolidated supervision (Refer to **Table 3** for more details).

For purposes of this paper, a *banking group* is identified when a licensed bank establishes or acquires subsidiary companies or takes a controlling stake⁴ in a company to carry out specific activities. Banks in banking groups tend to invest only in other companies which carry on banking or quasi-banking financial activities domestically and/or in foreign countries through foreign bank subsidiaries or other foreign companies. The group may be headed by a holding company for the purpose of holding shares in the bank and other group companies and to manage the group’s investments. The holding company may raise capital to support the group’s activities and may have intermediate holding companies within the group structure.

A definition of a financial conglomerate is absent in many countries regulatory framework in the region; however, financial con-

glomerates account for a significant portion of financial activity in some countries. For purposes of this paper, a *financial conglomerate* is a group of companies that predominantly engage in financial activities in at least two different sectors (e.g. banking, securities, and insurance). For further information on the definition of a financial conglomerate refer to **Appendix 2**. These activities have traditionally been kept separate by law or regulation in many countries in the region with some countries requiring the presence of a financial holding company to separate the financial and non-financial parts of a group. Banking groups in which banks are permitted to own securities companies are considered financial conglomerates in some countries; however, in many countries in the region banking groups are part of a financial conglomerate. Given the similarities in the different group structures and activities, there is significant overlap between the issues relating to the supervision of financial conglomerates and the consolidated supervision of banking groups in the region. **Diagram 1** below, provides an example of an organization including a financial conglomerate and banking group.

In terms of what companies are determined to be part of a financial conglomerate

⁴ For instance, some member countries indicated that a controlling stake represents a shareholding investment ranging from as low as 20 to 50 or more percent of a voting power in a company or less than 20 percent investment where the parent is able to exert significant influence over the company.

Basel Core Principle 24: Consolidated Supervision

Essential criteria

1. The supervisor is familiar with the overall structure of banking groups and has an understanding of the activities of all material parts of these groups, domestic and cross-border.
2. The supervisor has the power to review the overall activities of a banking group, both domestic and cross-border. The supervisor has the power to supervise the foreign activities of banks incorporated within its jurisdiction.
3. The supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group.
4. The supervisor has the power to impose prudential standards on a consolidated basis for the banking group. The supervisor uses its power to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures, exposures to related parties and lending limits. The supervisor collects consolidated financial information for each banking group.
5. The supervisor has arrangements with other relevant supervisors, domestic and cross-border, to receive information on the financial condition and adequacy of risk management and controls of the different entities of the banking group.
6. The supervisor has the power to limit the range of activities the consolidated group may conduct and the locations in which activities can be conducted; the supervisor uses this power to determine that the activities are properly supervised and that the safety and soundness of the bank are not compromised.
7. The supervisor determines that management is maintaining proper oversight of the bank's foreign operations, including branches, joint ventures and subsidiaries. The supervisor also determines that banks' policies and processes ensure that the local management of any cross-border operations has the necessary expertise to manage those operations in a safe and sound manner and in compliance with supervisory and regulatory requirements.
8. The supervisor determines that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) includes: (i) information reporting on its foreign operations that is adequate in scope and frequency to manage their overall risk profile and is periodically verified; (ii) assessing in an appropriate manner compliance with internal controls; and (iii) ensuring effective local oversight of foreign operations. For the purposes of consolidated risk management and supervision, there should be no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. Transmission of such information is on the understanding that the parent bank itself undertakes to maintain the confidentiality of the data submitted and to make them available only to the parent supervisory authority.
9. The home supervisor has the power to require the closing of foreign offices, or to impose limitations on their activities, if: it determines that oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the office presents; and/or it cannot gain access to the information required for the exercise of supervision on a consolidated basis.
10. The supervisor confirms that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is particularly close when the foreign activities have a higher risk profile or when the operations are conducted in jurisdictions or under supervisory regimes differing fundamentally from those of the bank's home country.

or banking group, national regulations typically define what constitutes a “parent” or “subsidiary” company. Some countries define a parent company as a company that owns more than 50 percent of the shares, while in other countries the concept of “control” is used and various criteria exist to determine whether or not “control” exists. Importantly, subsidiary companies are often owned indirectly through intermediate companies which are usually “shell” holding companies that hold shares in the group’s subsidiaries. In addition, definitions of subsidiary may take into account “partnerships” or “joint ventures”.

1.4. Aspects of Consolidated Supervision⁵

Consolidated supervision of a bank or financial holding company, including the parent company and nonbank subsidiaries, should allow banking supervisors to understand the strengths and risks across an organization and address financial, management, and operational deficiencies before they pose a danger to subsidiary banks. A variation on the latter theme is incorporated in **Box 3**,

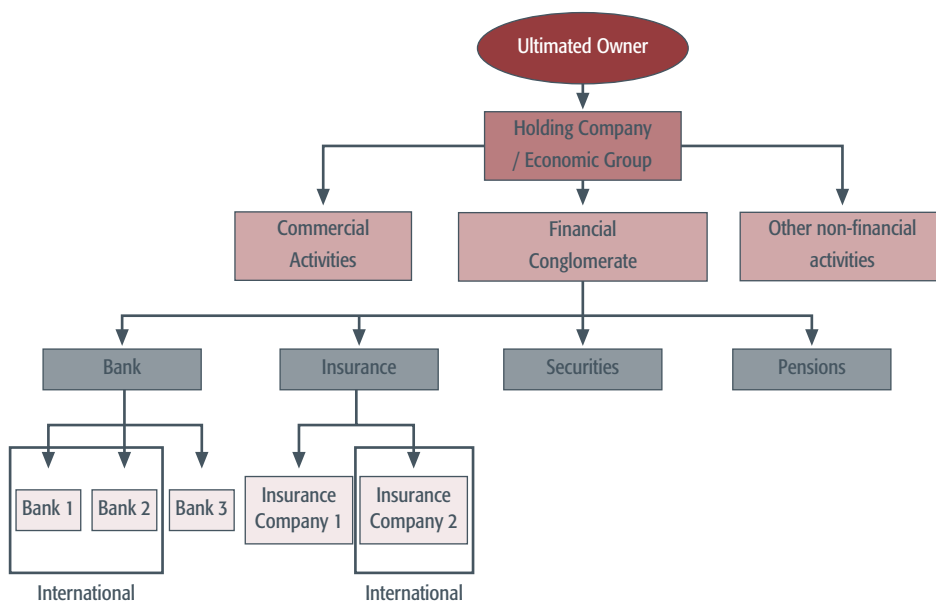
which includes a broad overview of the main elements of Spain’s consolidated supervision regime of financial conglomerates.

1.4.1. Consolidated Reporting

A key component of consolidated supervision is the production of financial reports on a consolidated basis. Generally supervisory authorities may have the legal powers to require banks to submit prudential consolidated reports; however, some do not have legal powers to require some non-bank companies in financial groups to submit reports. Consolidated reports combine the assets, liabilities and off-balance sheet positions of banks and their related companies. These reports enable supervisors to measure the financial risks of banking groups and to ascertain whether or not banks are complying with supervisory standards at the banking group level.

While consolidated prudential reports are important for these supervisory purposes, they are primarily “backwards looking” in terms of providing information on the financial condition of an organization at a given point in time. Thus, it is important that supervisors have available to them for-

Diagram 1: Group Including a Financial Conglomerate and Banking Group



⁵ This section does not address all major elements of consolidated supervision. For a more inclusive overview of the major elements of effective consolidated supervision, refer to the Basel Core Principle No. 24 on Consolidated Supervision which is referenced in Box 2 of the paper.

Elements of Consolidated Supervision in Spain

Since 2005, the regulation for financial conglomerates has been incorporated in the EU, Directive 2002/87/CE, and financial conglomerates are:

Groups of companies whose main activity is financial and in which are integrated simultaneously, banking institutions and/or of investment services institutions together with insurance companies.

This regulation does not substitute the functional/sector supervision that can be in place in affected countries. This regulation creates the figure of the coordinator-supervisor and imposes certain additional supervisory measures to those conglomerates that go beyond certain thresholds of materiality or inter-sector diversification.

Additional supervisory elements:

- > Solvency control of the financial conglomerate (FC)
- > Control of intra-group operations
- > Control of risk concentration
- > Risk management and internal control analysis at the FC level

ward looking indicators of an organization's financial health (e.g. stock prices and financial forecasts), together with financial reports (e.g. audited balance sheet and income statements) and prudential reports. Market data can assist supervisors with analyzing the financial condition of an organization on a real time basis and to take preventative supervisory actions against an organization as needed. Furthermore, unlike prudential supervisory reports, market data and financial reports are publicly available for market participants to analyze as well.

1.4.2. Assessment of Consolidated Financial Condition

Consolidated prudential reports enable supervisors to monitor and evaluate aspects of the group's financial condition⁶ including a group's capital adequacy, concentrations or large exposures, as well as connected-lending exposure. Below is a general description of each of these areas, an observation regarding these requirements in the region, based on survey responses; and a detailed example of each requirement in Spain.

- > **Capital adequacy:** Regulated entities are subject to capital requirements both on an individual and on a group-wide basis.

Capital requirements for different kinds of financial firms exist (e.g. banks vs. insurance companies). While many countries continue to regulate the capital adequacy of their banks in relation to the credit risk and system of risk-weighting and minimum 8 percent capital ratio requirement in the 1988 Capital Accord, some are moving to a more risk sensitive approach to capital allocation under the new Basel II framework.⁷ In general, consolidated capital requirements for banking and/or financial groups vary to some extent across Work Group member countries. As illustrated in **Box 4**, Spain utilizes a solvency calculation for financial conglomerates which has three methods for calculating solvency.

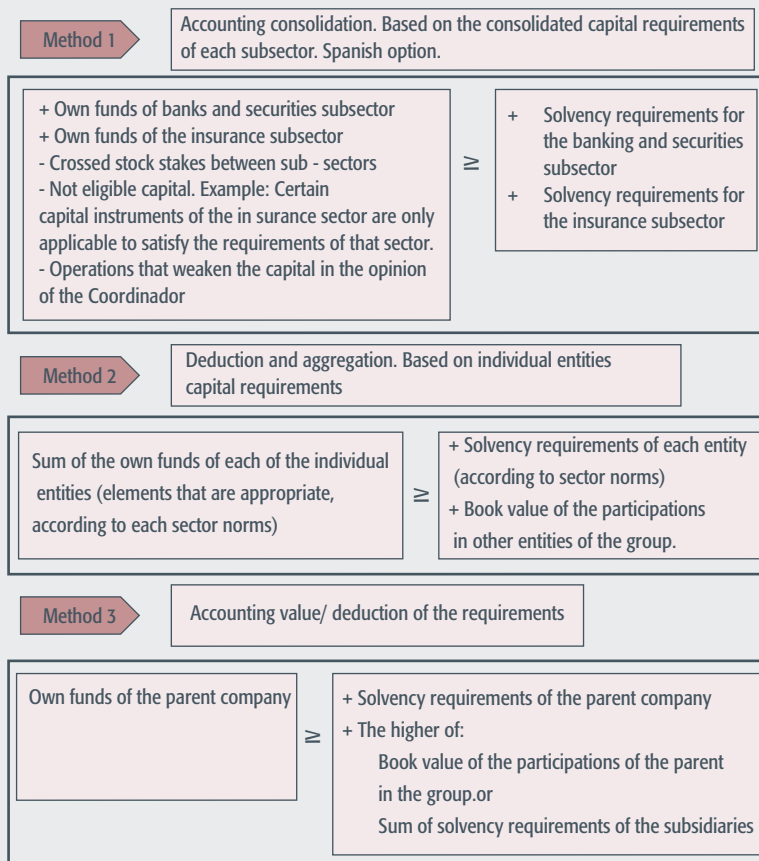
- > **Large exposures:** Monitoring and control of large individual exposures of banking groups is an important function of consolidated supervision. Legislation may be needed to limit the amount of the exposure which a banking group may incur towards a single counterpart or related counter parties, usually as a percentage of the group's capital. These limits vary among Group Members. The Group Members agreed about the importance of

⁶ The items discussed in this section are not exhaustive of the items reported on consolidated prudential reports. Other elements of consolidated supervision include, but are not limited to, assessing the effectiveness of risk management systems and controls over the primary risks inherent in the consolidated organization business activities.

⁷ Many internationally active banks in the region are in the process of implementing advanced methods for allocating capital under the new capital accord (aka: Basel II) over the next ten years.

Solvency Calculation Methods in Spain

Solvency, the regulation offers three alternative methods in line with the joint forum methods:



In Spain, the participations of banking groups or securities groups in insurance companies higher than 20% of the voting rights should be deducted from the own funds for calculation purposes.

establishing limits to large exposures, although they did not reached consensus about the specific limits that should be in place. **Box 5** presents large risks and risks with related entities limits for Spain.

- > **Connected lending exposures:** Limits on exposures by individual banks to “connected” persons (e.g. influential shareholders, directors, and their close relatives) are typically applied to banking groups. These limits vary among Group Members. The Group Members agreed about the importance of establishing lim-

its to connected lending exposures, although they did not reached consensus about the specific limits that should be in place.

1.4.3. Supervision of International Bank Groups

Many banks in the region have international operations. In addition, there is a significant presence of foreign banking organizations in the region. (Refer to **Table 1** and **Table 2** in Section 1 of the report for further details.) In accordance with the Minimum Standards for the Supervision of International Bank-

ing Groups and their Cross-Border Establishments⁸, the supervision of international bank groups should consist of the following:

1. All international banks should be supervised by a home country authority that capably performs consolidated supervision, with the assistance of information provided by host authorities;
2. New cross-border banking establishments should receive the prior consent of both the host country and home country authority;
3. Home country authorities should possess the right to gather information from their cross-border establishments; and
4. If the host country determines that any of the standards is not being met, it could impose restrictive measures or prohibit the establishment of banking offices.

Consistent with these minimum standards, an assessment of the quality of home country supervision would necessarily include (1) ensuring that the home country supervisor receives consolidated prudential

reports that adequately measure a group's capital adequacy, credit concentrations and other key factors⁹; and (2) assessing the ability and record of the home country supervisor to take remedial action when problems arise with a bank's domestic offices.

In order to ensure that home country authorities possess the right to gather information from their cross-border establishments, supervisors should ensure that there will be no legal impediments to the transfer of prudential information before they allow any of their banks to open a subsidiary or other office in another country. Legal impediments to the transfer of information may vary across countries. Agreements among countries should be established regarding the proper use (only for supervision purposes) of any information that is transferred among them.

1.4.4. Information Sharing with Other Supervisors

Cross-Border Information Sharing
The Basel Core Principles for Effective Banking

BOX 5:

Large Risks and Risks with Related Entities in Spain

In the Spanish regulation there are limits to single name concentration and to the aggregated amount of risks with related entities and managers that are established in percentages over the capital base of banking group:

Large risks:

- > The risks with the same person or economic group can not exceed 25% of the capital base.
- > In addition, large risks are those that exceed 10% of the capital base of the entity, and its aggregated value can not exceed 800% of the capital of the entity.

Risks with related entities:

- > It must be understood as non -consolidated group, includes only financial institutions (deposit institutions, specialty lenders, securities broker and dealers, investment companies, assets managers)

For the case of lending to counselors or related entities there is a threshold of 25.000 E. The Bank of Spain makes a detailed follow -up of the credits, using monthly information available in the *Central de Información de Riesgo*, CIR, and the quarterly reports of risks with related persons or companies.

⁸ Basel Committee. June 1992.

⁹ Including, but not limited to market and liquidity risks and asset quality and provisioning requirements.

Basel Core Principle 25: Home-host relationshipsox

Essential criteria

1. Information to be exchanged by home and host supervisors should be adequate for their respective roles and responsibilities.
2. For material cross-border operations of its banks, the supervisor identifies all other relevant supervisors and establishes informal or formal arrangements (such as memoranda of understanding) for appropriate information sharing, on a confidential basis, on the financial condition and performance of such operations in the home or host country. Where formal cooperation arrangements are agreed, their existence should be communicated to the banks and banking groups affected.
3. The home supervisor provides information to host supervisors, on a timely basis, concerning:
 - the overall framework of supervision in which the banking group operates;
 - the bank or banking group, to allow a proper perspective of the activities conducted within the host country's borders;
 - the specific operations in the host country; and
 - where possible and appropriate, significant problems arising in the head office or other parts of the banking group if these are likely to have a material effect on the safety and soundness of subsidiaries or branches in host countries. A minimum level of information on the bank or banking group will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of a bank's or banking group's activities to the financial sector of the host country. In this context, the host supervisor will inform the home supervisor when a local operation is material to the financial sector of the host country.
4. The host supervisor provides information to home supervisors, on a timely basis, concerning:
 - material or persistent non-compliance with relevant supervisory requirements, such as capital ratios or operational limits, specifically applied to a bank's operations in the host country;
 - adverse or potentially adverse developments in the local operations of a bank or banking group regulated by the home supervisor;
 - adverse assessments of such qualitative aspects of a bank's operations as risk management and controls at the offices in the host country; and
 - any material remedial action it takes regarding the operations of a bank regulated by the home supervisor. A minimum level of information on the bank or banking group, including the overall supervisory framework in which they operate, will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of the cross-border operations to the bank or banking group and financial sector of the home country. In this context, the home supervisor will inform the host supervisor when the cross-border operation is material to the bank or banking group and financial sector of the home country.
5. A host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
6. Before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For purposes of the licensing process, as well as ongoing supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision.
7. Home country supervisors are given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with KYC requirements. Home supervisors should inform host supervisors of intended visits to local offices and subsidiaries of banking groups.
8. The host supervisor supervises shell banks, where they still exist, and booking offices in a manner consistent with internationally agreed standards.
9. A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.

Supervision emphasize that cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors¹⁰. For further details on aspects of home-host relationships on information sharing and cooperation refer to **Box 6** below. In addition, **Box 7** below details expectations for home-host information sharing and cooperation.

Cross Sector Information Sharing

The Basel Core Principles for Effective Banking Supervision also emphasize that supervisors have arrangements with other relevant supervisors, including domestic supervisors, to receive information on the financial condition and adequacy of risk management and controls of the different entities of a banking group¹¹. Thus, in an effort to develop a consolidated assessment of a consolidated organization, where applicable¹² supervisors may need to rely on the assessments developed by other “primary bank supervisors”¹³ or “functional regulators”¹⁴ concerning activities under their supervision. In particular, banking supervisors should gather information from functionally regulated firms and, in as much as possible, of unregulated firms, in order to assess group risk profile, risk management, and capital adequacy of the group.

1.5. Overview of Financial Conglomerates in the Region

Financial conglomerates account for a significant portion of the financial and economic activity in many countries in the region. However, as previously indicated, many countries in the region do not have a definition of a financial conglomerate in their reg-

ulatory framework. In addition, the term is used differently across the countries which have a definition of a financial conglomerate in their regulatory framework¹⁵. The lack of a consistent definition or understanding of what constitutes a financial conglomerate makes it difficult to compare financial conglomerates across the region. Nonetheless, to the extent that banking and securities activities are well integrated across many countries in the region, many financial entities in the region effectively form part of a financial conglomerate as per the Joint Forum’s definition of a financial conglomerate¹⁶ as well as the definition used in this report .

1.5.1. Financial Groups or Conglomerates

As illustrated in **Table 1** below, there is a significant number of financial groups, including financial conglomerates, in some countries in the region. The groups participate to varying degrees in the insurance, capital, and pension market sectors. For example, in Argentina, of the 10 major insurance companies that represent 55% of the insurance market, two of them belong to a financial conglomerate. In addition, of the six major pension fund companies that represent 80% of the pension fund market in Argentina, four of them belong to a financial conglomerate. In Brazil, 68% of the insurance market belongs to domestic financial conglomerates. In Spain, the 6 main financial groups control 18% of the insurance market. In the United States,¹⁷ 195 domestic and 14 foreign financial groups participate in the insurance market and 30 domestic and 19 foreign financial groups participate in the capital market sector. Thirty financial conglomerates, representing approximately 55 percent of the banking assets, operate in Central America, Panama, and the Dominican Republic.

10 In particular, principle no. 25 on home-host relationships.

11 BCP No. 24, Essential Criteria No.5, October 2006.

12 Authority to supervise and regulate BHCs and nonbank subsidiaries and to prevent parent companies or non-banks from engaging in unsafe or unsound practice vary across agencies and/or countries in the region.

13 For purposes of this document, a “primary bank supervisor” will refer to a bank supervisor that has primary responsibility for supervising banking operations of a BHC/FHC.

14 For purposes of this document, a “functional regulator” will refer to regulators with primary responsibility for a BHC/FHC’s functionally regulated activities (e.g. securities, insurance).

15 For example, one country defines a financial conglomerate as any group comprising more than one financial institution, irrespective of the sector which varies from the definition of a financial conglomerate used in this paper (refer to page 14 for the definition).

16 Financial conglomerate is a group of companies whose predominant activity consists of providing services in at least two different financial segments (e.g. banking, securities, insurance, and pension funds).

17 Financial conglomerates do not exist in the United States; however, the creation of a financial holding company (FHCs) is permissible by law. FHCs are permitted to engage in a broader array of financial activities, including, for example, securities, insurance, and merchant banking activities.

Key Developments in Home-Host Information Sharing & Coordination

The BCBS recognizes that cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. In addition, the BCBS advocates that banking supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions

- > **May 1983:** BCBS "Principles for the Supervision of Banks' Foreign Establishments" (Concordat)
- > **April 1990:** BCBS Information Flows Between Banking Supervisory Authorities
- > **June 1996:** BCBS Report on Cross-Border Banking Supervision
- > **January 2003:** BCBS "Shell Banks and Booking Offices".
- > **August 2003:** BCBS "High Level Principles for the Cross-Border Implementation of the New Accord".
- > **June 2006:** BCBS "Home-host Information Sharing for Effective Basel II Implementation".

1.5.2. Foreign Financial Groups or Conglomerates

Foreign financial groups or conglomerates have a significant presence in select ASBA member countries both in terms of number (see **Table 1**) and as a percent of total financial system assets (**Table 2**). Many foreign financial groups entered local markets in the

region after banking crises during the late 1990s. Foreign financial institutions have benefited banking sectors in the region by bringing in good administrative practices, technology and innovative products. In addition, foreign banks' relatively strong creditworthiness has contributed to the financial soundness of banking sectors in the region.

Table 1. Number of Domestic vs. Foreign Financial Groups in Select Countries (2005)

Country	Number of domestic financial groups	Number of foreign financial groups	Number of foreign financial groups among the 3 major banks in terms of assets
United States*	5,126	29	0
Brasil	76	30	0
España	76	18	0
Argentina	54	35	0
Panamá	18	54	1
Ecuador	14	0	0
Guatemala	10	3	0
Colombia	8	7	1
Perú	5	11	2
El Salvador	0	9	3
Bahamas	n.a.	4	3

*Figures represent top tier bank holding companies; n.a. = not available.

Table 2. Domestic vs. Foreign Financial Conglomerates as a Percentage of Total Financial System Assets (2005)

Country	Local Participation (%)	Foreign Participation (%)
Ecuador	100.0	0.0
España	89.4	10.6
Estados Unidos*	85.0	15.0
Colombia	78.4	21.6
Brasil	76.8	23.2
Guatemala	76.5	8.0
Argentina	74.0	26.0
Perú	51.6	48.4
Panamá	49.0	51.0
El Salvador	0.0	100.0
Bahamas	n.a.	n.a.

*Figures represent financial or bank holding companies; n.a.= not available.

1.5.3. Financial Groups or Conglomerates with Offshore Banks

In addition, many financial groups or conglomerates in the region have offshore banks. For instance, approximately 22 financial conglomerates with offshore banks operate in Central America, Panama, and the Dominican Republic representing nearly 30 percent of the regional banking system¹⁸. These financial conglomerates have operations in all the countries except for Honduras¹⁹.

1.6. Risks Related to Financial Groups or Conglomerates

Although companies have benefited from consolidation, conglomeration and internationalization of their operations, these processes have exacerbated existing risks and introduced new risks, both for the institutions that have undertaken them and for the financial system as a whole. The impacts of these phenomena are mixed and therefore the net result is difficult to generalize; however, bank consolidation and conglomeration have not necessarily yielded either safer financial firms or more resilient banking systems²⁰.

1.6.1. Parallel Banking

Further in this regard, financial groups or conglomerates conduct financial activities through different types of companies that may be located in different countries through various ownership sub-structures. These companies may operate without the existence of a controlling company that consolidates and manages all the organization's activities (both domestic and international) in a centralized manner, potentially resulting in varying degrees in parallel banking²¹. In addition, financial groups or conglomerates may operate in offshore centers to take advantage of more favorable (less stringent) regulations, to reduce costs, and increase competitive position (For further details regarding this risk, see section 1.6.3, "Regulatory Arbitrage" discussion below). These activities may pose serious challenges and risks to supervisory authorities and financial systems in the region. For instance, offshore banks of financial groups or conglomerates can limit the effectiveness of the consolidated supervision of the organization. First, it can be difficult for bank supervisors to identify offshore banks. In addition, it can be difficult to obtain detailed information on their

18 Source: IMF 2007. These figures maybe underestimated given transparency issues related to these financial conglomerates' offshore operations.

19 The specific analysis of off-shore banks, including its relation with consolidated supervision, should be treated in a separate Working Group.

20 De Nicolo, Bartholomew, Zaman & Zephirin. Bank Consolidation, Internationalization, and Conglomeration: Trends and Implications for Financial Risk. IMF Working Paper. July 2003.

21 However, the domestic activities carried out in each country may be centralized.

activities (For further details regarding these risks, see section 1.6.2., “Lack of Transparency” discussion below). In some instances, supervisors are not given broad legal powers to apply prudential regulations and effective corrective actions to financial groups or conglomerates with offshore banks as local laws may restrict the scope of prudential regulations to the sovereign borders of an individual country. Other challenges or risks posed by these organizations include, but are not limited to “contagion” and “moral hazard”. In addition to lack of transparency and regulatory arbitrage, contagion moral hazard risks are detailed below²².

1.6.2. Lack of Transparency

The group’s size and complexity may make it difficult for market participants and supervisors to obtain an accurate picture of its structure and risk profile. For instance, owners of a complex financial conglomerate may organize the group’s structure and activities in a manner that takes advantage of gaps in laws and regulations across different countries (For further details see section 1.6.3, “Regulatory Arbitrage” below). As such, the legal and managerial structures of a group may vary. Intra-group transactions can be used or abused to transfer assets from one entity to another. Important risks positions may be built up and remain unnoticed because they are distributed across many group entities. Furthermore, a lack of transparency in an overly complex ownership organizational structure of the group can hinder supervisors’ efforts to hold the ultimate controller of the financial conglomerate accountable for managing the group in an unsound manner.

1.6.3. Regulatory Arbitrage

There are important differences in the prudential regulations across the region in terms of capital requirements components and credit limits. These differences can originate regulatory arbitrage, given that conglomerates can establish themselves in jurisdictions with regulatory advantages, in-

stead of taking in to account business criteria for this decision. Thus, transactions may be booked in certain entities and not others to take advantage of regulatory differences. In addition, intra-group transactions can be set up to formally comply with regulatory requirements, but in effect circumvent them. For instance, “multiple gearing” is an example of the latter and refers to the use of the same capital by two or more regulated entities in the group. Regulatory arbitrage can thus hinder supervisors’ ability to monitor and supervise an organization on a consolidated basis.

1.6.4. Contagion

Contagion risk refers to the risk that difficulty in one group entity that may spill over to other ones due to economic links between entities (e.g. capital). It can also refer to a situation whereby problems in a unit of an economic group can be perceived by market participants as problems in the whole economic group, due to common branding. Contagion risk is particularly a concern when it affects regulated entities because of problems occurring in non-regulated entities. “Firewalls” may be established to try to minimize the risk, but they maybe ineffective. Thus, a parent company may be compelled by market forces to support an ailing subsidiary although it has no legal requirement to do so.

1.6.5. Moral Hazard

The risk of moral hazard (or the risk that risk-taking behavior of parties will increase because of the existence of certain arrangement) can exist when a non-regulated entity may try to gain access to a bank’s deposit insurance (or other safety net) by virtue of being associated with the group. The conglomerate or group may also be considered by market participants as “too big to fail” with the expectation that the organization would not be allowed to fail but would be supported by the government, leading to risky behavior either by the group or market participants.

²² This section is not an exhaustive summary of all the risk related to financial conglomerates since different countries may have different types of risks.

Supervisory Challenges in the Application of Consolidated Supervision

Financial supervisors in the region have been in the process of strengthening their consolidated supervisory regimes over the last decade in response to the growing presence of financial groups and conglomerates in the Americas. This process has been accelerated in recent years, due, in part, to an increase in the complexity of the structure and activities of financial groups. These developments have presented supervisors with numerous challenges in the application of consolidated supervision. Below is a summary of some of the challenges which were identified in the survey results.

2.1. Legal and Regulatory Issues

2.1.1. Supervisory Powers

At present, many supervisors in the region do not have access to all information on the activities and business of a financial group or conglomerate (e.g. to nonbank activities, international and/or off-shore activities and businesses). Regulatory gaps exist in some countries regarding the right of the supervisor to require from financial groups or conglomerates relevant information relative to their structure and operations on a consolidated basis and to impose corrective measures or sanctions on the organization, including its' international operations. In order to regulate and supervise financial groups or conglomerates, supervisors should have clear and explicit authority to regulate and supervise their operations and to apply corrective measures and sanctions. In addition, supervisors should have full access to all the relevant information of the organization. This authority should include the international operations of the group or conglomerate and be consistent with supervisors' au-

thority over specific institutions that they currently supervise. These powers may also include the ability of the supervisor to order changes in the structure of the financial group, including the suspension of domestic or international operations, the temporary or final closing of offices or subsidiaries.

2.1.2 Consolidation of Supervisory Agencies

No member country suggests that specific banking regulations or statutes in their country would impede effective supervision of financial companies or financial conglomerates; either on a functional or consolidated supervision basis. Only one member country has substantially consolidated supervision of most financial intermediation firms under a single regulatory agency; and the underlying reasons for doing so included some administrative efficiencies and political considerations. Other member countries are not actively involved in similar supervisory consolidation efforts, although some suggest that such discussions may be taking place. Countries that have not consolidated their banking and other financial firm regulators, suggest that the statutory regimes under which different types of firms operate might first need to be revised. There was some suggestion as well, that regulators of different types of firms operate under different statutory mandates; and that this might make supervisory integration more challenging.

2.1.3. Enforcement Regime

In some cases, supervisors' ability to enforce prudential regulations is hindered by their limited capacity to issue corrective actions and in some cases sanctions²³. The deficiencies in enforcement at the financial group

level are consistent to some extent with supervisors' enforcement efforts at the individual institutions they supervise. In particular, the process of implementing sanctions or corrective measures in many member countries can be slow due to the ability of the affected party to disagree and appeal authorities' decision on sanctions and corrective measures²⁴ to a higher authority or court. As a result, the process can neutralize the deterrent effect of the corrective measures and sanctions and enable supervised institutions to avoid compliance with prudential regulations.

In addition, some supervisors lack adequate legal protection from taking actions in good faith. The ability of supervised institutions to appeal supervisors' decisions on sanctions and corrective actions results in high costs in terms of human resources. As a result, inadequate legal protection may represent an obstacle to the strict application of sanctions and corrective actions against supervised institutions.

2.1.4. Supervision of International Operations

One of the most challenging overall aspects to imposing consolidated supervision over different types of financial firms in a single group or conglomerate is that there does not seem to be a single, successful business model for global operations of a financial group or conglomerate. Some international companies transplant all or as many as possible of their domestic operations to their foreign offices: Banking, brokerage, insurance; whereas other international groups or conglomerates only operate a single arm of their activities in some host countries while partnering with a domestic firm in those countries. This divergence of business strategies will be a fundamental question when any but the home country regulator attempts to conduct supervisory activities. For example, when an international financial group or conglomerate dominated by its banking arm, operates

a small banking company in a host country but also operates a larger or possibly more dominant brokerage company within that same host country, there is not a consensus on whether or not the host country exercises consolidated supervision prerogatives via the host's bank supervisory agency or its brokerage regulator. If or rather when the statutory and regulatory regime is different for a country's bank and brokerage supervisors, applying effective consolidated supervision principles may be significantly more challenging.

2.1.5. Regulatory Capital Requirements

Another challenging aspect of imposing consolidated supervision can be found in the rules governing capital requirements. Basel II capital rules and requirements for example, specifically designed for banks and bank holding companies, cannot be easily applied to non-banking financial firms such as insurance companies. As bank capital occupies a special place in the area of supervisory enforcement and corrective actions, the specific rules and regulations governing this financial arena are extremely important. As any regulatory regime whether banking or insurance hinges on the ability to enforce supervisory findings and judgments, the lack of enforcement clarity is going to present problems. Moreover, existing statutes and regulations have largely been designed to benefit or regulate specific business lines or activities. Even if bank regulators would wish to apply uniform capital standards on financial groups or conglomerates with substantial non-financial components, it is not clear how such standards would affect the diverse, individual businesses.

2.1.6. Exposures to Related Borrowers

Some countries in the region have difficulty in identifying related borrowers. Identification of related borrowers is important to verify compliance with established credit limits, prevent excessive risk exposure to and abuse

²³ One supervisory agency indicated that sanctions are less important as they are not a form of corrective action per se and can be mired down in legal procedures that may presumably undermine the corrective action process.

²⁴ In some instances corrective actions are treated a legal noncompliance by supervised institutions and is therefore processed as a sanction with a legal due process described above.

by related borrowers. Difficulties identifying related borrowers include: (1) lack of legal and regulatory framework for identification of individuals or groups related to owners or managers of a financial conglomerate; (2) lack of a uniform effort by all supervisors in the region, in terms of human, material and technological resources to comprehensively identify all parties related to financial conglomerates.

2.2. Transparency of Financial Organizations

2.2.1 Understanding the Structure and Activities

Consolidated supervision of financial organizations entails an understanding of the overall structure of an organization and the activities of the material parts of the organization, including its domestic and foreign operations²⁵. The structure of financial institutions and conglomerates in the region has become increasingly complex over the last decade and in some cases, has made it more difficult for supervisors to clearly understand which companies belong to certain groups and the material risks of the consolidated organization. Some supervisors indicated that the task of determining the ownership of companies or groups of companies can be complicated by various factors, including: insufficiently detailed regulatory reporting; cross-border ownership when financial information is not readily available to host regulators²⁶; limited transparency in accounting consolidation; and ownership control exercised by minority interests either

through common management or other controlling arrangements.

National laws form the basis for the type of legal entity that directly conducts the financial activity. As indicated in **Table 3** below, many countries in the region²⁷ have defined in their banking or commercial laws or regulation, the terms “banking group,” “financial conglomerate,” or other similar terms. These terms generally include the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. In some cases however, parent companies and non-bank (including non-financial) group entities are not required under local laws to be included in these “group” terms (**Table 3**). In addition, in some cases there is no legal framework to bring companies domiciled abroad (in offshore centers and domiciled in other countries in the region) under consolidated supervision or that imposes prudential requirements on those companies. Thus, the possibility that material activities of the organization may be omitted from reporting requirements and/or the supervisors understanding of the activities of all material parts of a group may exist.

Similar challenges may also exist for groups of companies owned by common shareholders, but outside of a holding company structure. Although this paper is generally directed at corporate or some such limited liability company legal structure, cross-ownership holdings by natural persons or groups of such individuals may present similar complexities as ownership by conglomerates. Application of the recommendations contained in this paper might be relevant in some cases.

25 This element is consistent with the first “Essential Criteria” of Principle 24 on Consolidated Supervision of the BIS Core Principles Methodology for Effective Bank Supervision.

26 In some countries, supervised entities may report about the legal impossibility to inform the home supervisor the name and financial data of the owner, when an entity establishes its structure from a country with legal limitations that impede the access to information considered “confidential or reserved”.

27 Based on a representative sample of countries in the region that participated in the ASBA Work Group on Consolidated Supervision. Refer to Appendix 1 for a list of participant countries.

Table 3: Legal Definitions of Banking and Financial Groups

Country	(1.a.) Legal Definition of "Banking Group" (BG) or "Financial Conglomerate" (FG)? Do terms include the bank and its offices, subsidiaries, affiliates, foreign and domestic (1)	(1.b.) Are Parent Companies and Non-Bank Entities Included?	(1c.) Can supervisor exercise discretion in determining whether particular entities will be considered part of a group?
Argentina	no	yes	yes
Bahamas	no; (parent company)	n.a.	n.a.
Brasil	yes; (FC, economic FC)	yes	yes
Columbia	no; (business group)	yes	yes
Ecuador	yes; (financial group)	no	yes
El Salvador	yes; (BG,FC)	no	yes
Guatemala	yes; (BG, financial groups)	yes	yes
Panama	no; (economic group)	yes	n.a.
Peru	yes; (FC, non-FC, mixed conglomerate)	yes	yes
Paraguay	yes; (financial & economic groups)	n.a.	no
Spain	yes; (BG, FC, mixed-group)	yes	yes+D23
United States	yes; (bank & financial holding companies)	yes	yes

(1) Note: n.a.indicates that a survey response was not provided or not responsive to the question

Furthermore, as indicated in **Table 4** below, in some cases national laws permit commercial or non-financial companies to own banks; however, bank supervisors do not necessarily have the explicit legal authority to review the activities of the commercial parent and affiliates to determine their im-

pact on the banks under their supervision. In some cases, supervisors do not have explicit supervisory frameworks to evaluate the risks that a group's non-bank activities may have on a bank or banking group under their supervision, which hinders the effectiveness of consolidated supervision.

Table 4: Laws Regarding Commercial or Non-financial Companies

Country	(4) Do national laws permit ownership of banks by commercial or nonfinancial companies?	4 (a) Legal authority to review activities of commercial parent and affiliates to determine impact on bank?	4 (b) Legal authority to establish and enforce "fit and proper standards" or other similar standards for owners and senior management of parent companies (under agency's supervision)?
Argentina	not prohibited by law	not formally established	yes
Bahamas	not prohibited by law	no	yes
Brazil	yes	no	yes
Colombia	yes	yes	yes
Ecuador	yes	no	no
El Salvador	yes	yes	yes
Guatemala	yes	no	yes
Panama	yes	yes	yes
Peru	not prohibited by law	yes	no
Paraguay	yes	n.a.	n.a.
Spain	not prohibited by law	no	yes

(1) Note: "yes" responses include countries that effectively have similar requirements or processes in place or that may be subject to some limitations; n.a. indicates that a survey response was not provided or not responsive to the question.

2.2.2. Consolidated Financial Reporting and Information Requirements

Table 5 below illustrates the differences in financial reporting between the member countries that responded to the survey. Unless otherwise indicated, financial statements are published or available to the public on an annual basis. Consolidation rules vary even though most countries indicated that they apply some principles of the international accounting standards. The scope of consolidation for most of the member countries is the same as the permitted controlling ownership of a financial company or fi-

ancial group, with some countries also requiring public reporting at secondary group levels as well as at the ultimate parent level. Some countries also carve out insurance company information from consolidated financial statements even when insurance companies are part of the financial conglomerate. In addition, **Table 6** below illustrates that while most member countries indicated that one supervisor collects consolidated financial information for the wider corporate group, many indicated that they did not have special regulatory reports to identify and assess intra-group operations.

Table 5: Consolidated Financial Statements

Country	(34) Do accounting or supervisory regulations require publication of consolidated financial statements?	(35) How is the scope of consolidation defined in your country? Does it include only those related entities which carry on activities of a banking or financial nature?
Argentina	Consolidation is performed according to standards similar to international norms.	The scope of consolidation includes the parent company, its subsidiaries and offices in the country and abroad
Bahamas	No specific requirement to consolidated financial reporting.	The scope of consolidation is not defined.
Brazil	Consolidation is mandatory when there is significant influence over a subsidiary, for both financial and nonfinancial companies. Brazil uses a national accounting standard similar to International Accounting Standard for consolidation.	Consolidation is by financial institutions or other companies licensed by the Banco Central; and separately for all entities in the conglomerate including both financial and non-financial companies.
Columbia	Consolidation rules are similar but not identical to international standards.	Quarterly consolidation is demanded to the supervised entities and issuers of securities. Additionally, joint financial statements are required for supervised entities with the same stockholders. Insurance companies do not consolidate with banks, but are included in the combined financial statements.
Ecuador	n.a.	n.a.
El Salvador	Consolidation according to domestic regulation. No requirement to publish consolidated financial statements.	Consolidated financial statements are for the financial conglomerate as defined. Excluded are companies that may be part of an economic group.
Guatemala	Consolidated financial statements are not required to be published.	The scope of consideration is banking and financial companies only.
Panama	Banks are allowed to consolidate using NIIF or U.S. GAAP (International or of United States). Audited consolidated annual reports are published on an annual basis.	Consolidation would apply to the domestic definition of economic group, limited only to interrelated judicial or natural persons.
Peru	No requirement for publication of consolidated financial statements.	The scope of the consolidation includes banking companies, microfinance institutions, insurance, securities and pension funds institutions. The inclusion of any other non-financial company will be determined by the Superintendency of Banks.
Paraguay	Consolidation is according to International GAAP. Financial statements are consolidated at both the overall conglomerate and at group levels, with publication required quarterly and annually.	Consolidation is by financial system group, which includes all financial entities other than insurance companies which are consolidated and reported separately.
Spain	Consolidation is per international standards, IAP 27.	Scope of consolidation is all companies within the broadest economic group and is not restricted to financial entities.

United States	Consolidation using US GAAP.	Bank holding companies and financial holding companies provide quarterly and annual consolidated reporting at the parent level. The narrow exception for some commercial entities owning financial companies generally requires consolidated financial statements published at the ultimate parent level, with additional, separate public quarterly financial reports for the bank entity.
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Table 6: Consolidated Financial Information

Country	(24.a.) Does any one supervisor collect consolidated financial information for the wider corporate group?	(24.b.) Are there special regulatory reports in order to identify and assess intra-group operations?
Argentina	No, there is not one unique supervisor that collects consolidated financial information.	There is not a special report. This information is acquired through several reports.
Bahamas	No	No
Brazil	Yes	Intra-group operations are checked, but there is no formal report.
Columbia	Yes	Yes
Ecuador	Yes	n.a.
El Salvador	Yes	There is not a special report. The intra-group operations are revised through auditing.
Guatemala	n.a.	n.a.
Panama	Yes	Yes
Paraguay	n.a.	n.a.
Peru	Yes	Yes
Spain	n.a.	Yes
United States	Yes	Yes

2.3. Information Sharing & Cooperation

2.3.1. Cross Border Information Sharing

Supervisory agencies responsible for supervising a financial institution must gather information on all domestic and international operations of a financial group or conglomerate. Many financial groups have significant international banking and non-bank operations which are licensed and supervised by foreign host country authorities. While home country supervisors may have responsibilities for the consolidated supervision of these global organizations, each host country should be responsible for the supervision of the legal entities in their jurisdictions.

Information sharing among international supervisors is essential to ensure that a financial group's global activities are supervised on a consolidated basis. In order to facilitate cross-border information sharing, some countries have established Memorandums of Understanding (MOU) for establishing bilateral relationships, and they have specifications on cooperation during the licensing process, supervision of ongoing activities, and in the handling of problem institutions. **Table 7** below provides information on how many countries have established formal information sharing agreements with foreign bank supervisory agencies.

Information sharing is generally subject to certain statutory requirements including those relating to the ability of the foreign bank supervisor to maintain the confiden-

tiality of information provided to it. Some banking supervisors indicated that they generally will provide information in response to requests from a foreign home supervisor, including requests relating to verification of information. This assumes that the information will be used for supervisory purposes and the foreign supervisor provides appropriate assurances with respect to the confidential treatment and onward disclosure of such information.

Some countries indicated that there are certain situations in which banking supervisors can be compelled to disclose otherwise confidential information. Such information may be subpoenaed by a court, a grand jury

or a legislative committee. In addition, some banking supervisors notify and provide information to law enforcement authorities if information comes to their attention that indicates a possible violation of criminal law.

In general, supervisors indicated that they currently consider the information they have available to them as sufficient to effectively supervise the entities they regulate and/or the regulated entities within a financial conglomerate or group. However, they also indicated that they must continuously strive to improve their sources of information and to receive information in a manner in which it can be efficiently and effectively used in the supervisory process.

Table 7: Domestic & Cross Border Information Sharing

Country	(17.) Are there any Memorandums of Understanding(MOUs) already signed between bank supervisors and other (relevant) domestic supervisors?	(18) Are there any Memorandums of Understanding (MOUs) already signed between bank supervisors and foreign supervisors?
Argentina	yes; National Commission of Securities, Superintendency of the Administration of Retirement and Pension Funds	yes
Bahamas	yes; Group of Financial Services Regulators	yes
Brazil	yes; supervisor of the securities market CVM	yes
Columbia	yes; including the Superintendency of Companies that supervises non-financial holding companies	yes
Ecuador	yes; Superintendency of Companies; General State Comptroller; IRS; National Counsel for the Control of Narcotic Substances; and others	yes
El Salvador	no; information sharing on local level is stipulated in legislation	yes
Guatemala	no	yes
Panama	yes; Securities National Commission, the Public Ministry, the Financial Unit Analysis, the Superintendency of Insurance and Reinsurance Companies, Panamanian Autonomous Institute of Cooperatives	yes
Peru	yes; Peruvian securities regulator CONASEV	yes
Paraguay	no	no
Spain	yes; Capital Markets National Commission, General Division of Insurance and Pension Funds, Executive Service of the Commission for AML and Financial Crimes	yes
United States	yes; including state banking and insurance supervisors; information sharing among other domestic supervisors is done pursuant to informal agreement, subject to statutory and regulatory limitations	yes

2.3.2. Cross Sector Information Sharing

In order to supervise and analyze the health of a financial group or conglomerate, supervisory agencies must gather information of all the economic units that are part of this group. Thus, banking supervisors may need to gather information from a variety of sources, including functionally regulated organizations²⁸, unregulated organizations and other sources, to assess the group's risk profile, risk management, and capital adequacy. As indicated in **Table 7** above, many bank supervisors have information sharing agreements with other domestic supervisors.

Generally, information exchanges for supervisory purposes among banking supervisors and functional regulators are authorized by law and may not be subject to a general prohibition against disclosure of confidential commercial and financial information by government employees. However, in reality the cooperation among supervisors is still kept at an informal level and there is still lack of coordination among them. Usually there are no detailed protocols or systems for the exchange of information among functional supervisors.

Therefore, the process of analyzing a financial conglomerate can become difficult, because the communication among the rele-

vant supervisors is not regular. Although, in many occasions all the supervision units of the different financial market segments are in one institution, it can not be assumed that communication is fluid and efficient among them.

2.4. Limited Resources to Implement Consolidated Supervision

Many members indicated that the increasing number of domestic and foreign financial organizations in their jurisdictions that are involved in complex financial activities is challenging their existing human, technical, and financial resources. In particular, some supervisors indicated that staff with specialized skills are required to effectively supervise complex organizations on a consolidated basis; however, their agencies' resources to hire technical staff and to provide ongoing specialized training for existing employees remains limited due to budgetary constraints. In addition, some agencies indicated that it is difficult to hire new qualified staff due to a protracted and bureaucratic hiring process and low salary levels. Many supervisory agencies lack budgetary autonomy and are dependent on the government for their annual funding.

28 For purposes of this document, a "functional regulator" will refer to regulators with primary responsibility for a BHC/FHC's functionally regulated activities (e.g. securities, insurance).

Efforts to Address Challenges Identified in the Application of Consolidated Supervision

After identifying specific consolidated supervision practices in the region and some of the challenges supervisors face in the application of consolidated supervision in the region, the Working Group identified specific measures that may assist supervisory agencies with addressing some of the challenges highlighted in the report above. Some of these measures identified below include initiatives currently underway by supervisory agencies in the region.

3.1. Legal and Regulatory Issues

3.1.1. Supervisory Powers

In order to implement an adequate consolidated supervision process, supervisors should have the authority to establish a prudential regulatory framework for financial conglomerates. In addition, regulations to ensure financial conglomerates' compliance with requirements should be established, including the ability of supervisors to apply corrective measures and sanctions, similar to those that are currently in place for banks, including: capital requirements, limits on related and large borrowers, liquidity requirements, accounting standards, and other regulations to ensure the sound operations of the organization.

When compliance with requirements is not met, corrective measures to limit the organization's activities should be implemented, including provisioning for specific risks and changing the organization's structure (closing or relocating operations). Supervisors should have the power to require financial conglomerates to provide regular reports on their structure, corporate governance, business strategies, risks, operations and risk control systems in a timely manner. In addition, supervisors should

have the power to establish cooperation agreements with other relevant supervisors in order to implement adequate consolidated supervision schemes, through a regular flow of relevant information, including information that can be sensitive (For further detailed measures refer to section 3.3., Improvements in Information Sharing & Cooperation).

3.1.2. Management Control Issues

Although convergence of accounting rules might determine the degree of balance sheet consolidation for disclosure purposes, it is unlikely to provide the two things most important for supervision of globally integrated financial conglomerates: A rebuttable presumption of management control and financial reporting for regulatory purposes. These two issues will likely require consistency in the legal framework governing regulation of corporate entities.

Understanding management control is a key component for determining the nature of interrelated or intercompany risks; and perhaps more importantly, may be necessary for taking supervisory action. Unless supervisors have the ability to presume interrelated management control over companies thought to be within a conglomerate for prudential purposes of (1) defining a financial group or conglomerate; (2) applying prudential limits (e.g. connected lending limits; and (3) mandating corrective actions, the ability to take such actions will be impaired. National regulations may establish the presumption of relationships whereby the burden of proof rests with the financial institution and not the supervisor.

The alternative is to establish a "ring-fencing" approach to individual corporate entities; forcing corrective actions on the

individual entity, irrespective of the effect of such actions on the parent or conglomerate. This approach may be appropriate for conglomerates for which a regulated business component is not predominant or for companies whose individual corporate components are subject to disparate levels of government regulation or protections, such as might occur with deposit insurance; but may not be preferable for conglomerates whose business activities are predominantly subject to a single regulatory regime.

3.1.3 Enforcement Regime

Enforcement is the key element of any effective supervisory methodology, including consolidated supervision. Absent the ability to do more than suggest corrective actions, supervisors will have insufficient leverage to change management behavior and ensure compliance.

Corrective actions and sanctions may be graduated such that they are in proportion to the importance and/or seriousness of the problems or violations of the supervised institution. For instance, the measures and sanctions may include fines, suspensions of specific activities, removal of management, among other things. Furthermore, the measures may be applicable to individual institutions and/or to the financial group or conglomerate as warranted. In order to enforce the immediate implementation of corrective actions against supervised institutions in a timely and effective manner to correct existing problems, legislation or regulations may be established to stipulate that the processing of appeals by supervised institutions regarding supervisors' decisions does not constitute grounds for suspension of the supervisor's corrective measures.

In addition, adequate legal protection may be given to supervisors in instances where it may be lacking and representing an obstacle to the effective implementation of corrective actions and sanctions against problem institutions. For instance, be established for supervisors against economic liability and legal expenses stemming from their actions taken in good faith.

3.1.4. Regulatory Reporting, Accounting Consolidation & Convergence

Regulatory reporting should be different than public accounting disclosures. Regulatory reporting is focused on regulated businesses within a wider conglomerate and is used for the purpose of supervising specific aspects of these businesses. Although accounting guidance will require consolidation for financial disclosures, this consolidation may or may not provide sufficient detail on the activities of the regulated entities. Reliance on accounting consolidation – which is typically based on the commercial needs of shareholders – may not be appropriate for protecting the public interests represented by the regulators. Regulatory reporting typically relies on either statutory requirements or regulatory implementation of legal mandates.

In an effort to reduce “regulatory arbitrage” risk in the region, members discussed the desirability and feasibility of having cross jurisdictional consistency in regulatory reporting and accounting rules. To the extent that bank supervisors generally do not have the authority to determine generally accepted accounting principles, members had few suggestions or recommendations regarding either international or regional accounting rules. However, accounting rules have a direct bearing on one of the most important aspects of supervision – financial reporting – and this impact can be substantial.

The most important accounting concepts for the supervision of financial conglomerates are possibly those of consolidation and significance. Consolidation because guidance on this subject will determine which companies within a conglomerate have financial results reported together; and significance because this issue will determine the exceptions to consolidation.

Regardless of supervisory decisions on control or presumptive control, accounting decisions on reflection of consolidated financial results will have a direct bearing on the amount of information publicly available. Practically, while supervisors may request or in some cases even mandate financial re-

porting for relevant companies, the manner in which these companies compile financial information for public disclosure will determine the types of management reports and financial source documentation that is readily available to supervisors. Particularly in countries where supervisors are sensitive or vulnerable to industry complaints of “regulatory burden”, additional requirements for information which is not already collected for purposes of complying with accepted accounting guidance may be made more difficult.

As a result, generally accepted accounting guidance is an important consideration and possibly even a prerequisite for consolidated supervision. Fortunately, the principles of consolidation and significance are somewhat more consistent internationally than some newer paradigms such as fair market accounting. Accounting principles which are consistent internationally but which do not provide individual national supervisors sufficient disclosures for companies operating within their purview, might be problematic. For example, companies or business activities which are significant within a specific country but are not significant to a global conglomerate, may have their financial condition or results either consolidated or otherwise combined with a

larger component of the conglomerate. While this result follows accepted accounting standards and may not be significant for the financial conglomerate as a whole, the detail in these available disclosures might not be sufficient to provide individual national supervisors a clear picture of the activities and risks of the domestic company. Convergence of accounting standards for internationally active conglomerates may need to focus less on internationally consistent rules for consolidation, and more on domestically specific rules for individual company disclosures.

The Caribbean Group of Banking Supervisors (CGBS) recently established a Technical Working Group which put together several proposals regarding the harmonization of specific accounting and regulatory standards, including regulatory reporting requirements, definitions of “capital”. The objectives of the proposals are (1) to encourage consistency in the application of standards for comparability across institutions and jurisdictions; and (2) to reduce regulatory arbitrage. To date, the CGBS proposals have been endorsed by the CARICOM of Central Bank Governors. **Box 8** below describes the CGBS’s initiative to harmonize specific accounting and regulatory standards.

BOX 8:

Caribbean Initiatives on Harmonization of Supervisory Standards

Caribbean Group of Bank Supervisors Technical Working Group Proposals Endorsed by the Group of CARICOM Central Bank Governors

The need to have cross jurisdictional consistency in regulatory reporting and definitions, inclusive of the definitions of what constitutes “capital base” and “acceptable group structures”, in order to avoid regulatory arbitrage

- > The need for regulators to have the ability to prescribe in legislation, the accounting treatment to be used for reporting to the regulator for prudential purposes
- > The need to ensure that the approach taken in amending legislation to conduct consolidated supervision is consistent with the revised Basel Core Principles
- > The development of legislation to address the entry protocols and scope of foreign regulators who wish to perform on-site examinations in member countries.

Source: Opening remarks at the CGBS/FSI seminar on “Conglomerate & Consolidated Supervision”. April 2007.

3.1.5. Adoption of a Single Auditing Firm

Adopting a single auditing firm for an entire financial conglomerate may not be as important as adopting a single auditing *standard*. In practice, a single auditing firm may not be capable of conducting the audit of increasingly global and diverse financial conglomerates. And should a large enough auditing firm be found to assume that responsibility, there is at least some basis for suggesting that occasionally competing audit firms may actually provide better disclosure for ultimate parent company boards of directors. Conglomerates which offer or even promote substantial autonomy to their different business groups, especially internationally, may be better served by using different audit firms that report to individually accountable boards of the domestic legal entities.

However, a single audit standard – international, domestic, or otherwise predetermined – may be an advantage especially if a conglomerate operates predominantly in a single business sphere. The objective would be to obtain internationally uniform and comparable findings, reporting, and disclosures; and while such consistency would not necessarily be difficult to achieve by different auditing firms, a single audit firm applying different standards based on individual domestic requirements might produce results which are not easily comparable.

In either case, an appropriate audit standard may need to make clear that regardless of individual audit responsibilities, any firm attesting to the financial statements of the ultimate parent company should not put any limitation on the scope of that attestation. Such limitations might be used by audit firms to avoid ultimate responsibility for preparing parent company financial statements. Ultimate parent audit firms may make appropriate use of audit work performed by other firms as much as there is some reliance placed on internal audit.

3.1.6. Establishment of Firewalls

Firewalls can be established among companies with a common ownership in order to reduce risks, including contagion risk.

These firewalls can include prudential limits on permissible activities, ownership of other companies, connected lending/investments and prohibitions on shared infrastructure and client bases. It would be advisable that management control is exercised at the level of each entity, subject to an overall group direction dictated by the main controller. The drawbacks of establishing firewalls include limited group-wide operational synergies and inefficiencies in financial conglomerate operations, which can prevent a decrease in the costs of the group. As consolidated supervision over financial conglomerates improves, some firewalls can be removed.

In many cases, firewalls may exist, however in practice they are weak. For instance, in some countries where related parties are not well defined in the regulations, the ability of supervisors to aggregate or monitor related party exposures is compromised. In such cases, existing firewalls may be strengthened by supervisors establishing a general rule or incorporated into legislation. In addition, in some instances where firewalls exist, they are not adequately enforced due concerns regarding a lack of legal protection for supervisors against prosecution for taking actions in good faith. A lack of legal protection for supervisors is common in supervisory authorities that lack legal autonomy from government and/or political influence.

3.1.7. Legal Definition of Financial Conglomerate

A clear, uniform, internationally accepted, definition of financial conglomerate might well be the foundation for a universal consolidated supervisory regime. However, no such definition will be complete without defining three key terms: “Financial”, “ownership control” and what constitutes a “predominant business activity”. Agreement between legislatures of individual countries, including some countries which may not yet have a company operating as a financial conglomerate within their borders, might well be an insurmountable difficulty. The drafters of this paper do not

consider this to be the most likely option; much could be done even without a legislative definition if bank supervisors could themselves all agree to a single, unambiguous definition.

3.2. Increased Transparency of Financial Organizations

In order for supervisors to be familiar with the overall structure of banking groups and the material activities of a group's domestic and cross-border operations, the supervisor should demand transparency from them regarding their organizational and management structure. Supervisors should request and receive detailed reporting from each one of the units that compose a financial group and from the head of the group. Furthermore, the reports should be submitted accurately and in a timely manner. In addition, financial supervisors should have the supervisory authority to alter (e.g. close or relocate) any operation of a group that could hinder the supervision of the group or undermine the financial soundness of the group.

One of the most important things for supervision of globally integrated financial conglomerates is a rebuttable presumption of management control. Understanding management control is a key component for determining the nature of interrelated or intercompany risks; and perhaps more importantly, may be necessary for taking supervisory action. Unless supervisors have the ability to presume interrelated management control over companies thought to be within a conglomerate for prudential purposes of (1) defining a financial group or conglomerate; (2) applying prudential limits (e.g. connected lending limits; and (3) mandating corrective actions, the ability to take such actions will be impaired. National regulations may establish the presumption of relationships whereby the burden of proof rests with the financial institution and not the supervisor.

3.3. Improvements in Information Sharing & Cooperation

3.3.1. Regular Contact with Supervisors

Supervisors should endeavor to have arrangements with other relevant supervisors, both domestic and cross border to receive information on the financial condition and adequacy of risk management and controls of the different entities of financial organizations²⁹. For instance, supervisors should have regular contact with supervisors in countries in which their banking organizations have material operations and share information on the organizations as part of that process. This contact or cooperation might be considered even as early as during the licensing or charter approval processes for new entities or new business activities. Banking supervisors should also endeavor to inform host country supervisors about events that could endanger the stability of cross-border establishments in the host country. Supervisors should inform host country supervisors when administrative penalties have been imposed or any other formal enforcement action has been taken against one of their banking group if the banking supervisors believe such information will be important to the host country supervisor as it may relate to the cross-border operations in that country.

Some members have undertaken measures to facilitate increased information sharing and coordination in the region. In particular, the Caribbean Group of Bank Supervisors recently established a Technical Working Group on consolidated supervision to facilitate information sharing between regional regulatory agencies. In addition, Central American Council has established a Liaison Group to facilitate information sharing among bank supervisory authorities in the region as well as to coordinate annual consolidated and cross-border supervision for regional financial conglomerates. Details regarding these recent initiatives are outlined in **Box 9 - 10** below.

²⁹ Essential criteria number five of Basel Core Principle number twenty-four on consolidated supervision.

Caribbean Initiative³⁰ on Information Sharing

The Caribbean Group of Bank Supervisors (CGBS): Technical Working Group on Consolidated Supervision

Against the background of regional integration of financial markets in the region, and recognizing that the effective implementation of consolidated supervision cannot be the responsibility of one Caribbean Island but must be collectively assumed by the region – the CGBS adopted a collaborative approach to address issues of concern, including:

1. Information sharing between regional regulatory agencies;
2. The necessary harmonization of laws and supervisory standards across the region;
3. A harmonized approach to the restructuring of financial groups;
4. A standardized accounting and reporting framework; and
5. Critical training of bank examiners in the region.

3.3.2. Memorandum of Understanding (MOU's)

Members indicated that there should be an integral effort to establish explicit Memorandum of Understanding (MOUs), among home and host supervisors and among functional supervisors. MOU's might have specifications on the following items:

- > Specific reports that should be delivered, with specific time framework.
- > Clear commitment regarding the use of the information delivered.
- > Agenda of regular meeting to discuss relevant issues.
- > Regular update of list of institutions that participate in the markets of both parties.
- > Home and host supervisor responsibilities.
- > Internships of officials to a supervisory agency to understand the supervision and regulation environment of the supervisory agency.
- > Consultation on policy changes.
- > Problem resolution: procedures during normal and emergency situations

Debe decir: Most of the members have established bilateral MoUs with other supervisory agencies; however, the scope of these MoUs does not necessarily correspond to specifications listed above. The Central Ame-

rican Council recently established a Multilateral Memorandum of exchange of Information and Mutual Cooperation for Consolidated and Cross-border supervision. Supervisors from Central America, Panama, and the Dominican Republic are signatories on this MoU and the framework for the MoU is very detailed, including specific arrangements for institutional coordination, and exchange and protection of information. Further details regarding this and another related initiative are included in Box 11-12 below. Similarly, the CGBs recently signed a regional MoU with other bank supervisory agencies in the region. Further details regarding this initiative are included in Box 13 below. In Appendix 3 other examples of MOU's are shown.

3.3.3. Confidential Information

Members indicated that in general, banking supervisors should endeavor to accord the same level of protection to confidential information received from foreign supervisors as they do to information they collect in the supervisory process and receive from other domestic supervisors and regulators. In this regard, each bank supervisor should have regulations and policies that should strictly restrict disclosure of confidential information.

30 The Caribbean Initiative is part of a broader initiative, namely Caricom's Caribbean Single Market and Economy initiative to integrate their financial markets.

3.3.4. Creation of a Supervisors Committee

In order to achieve a better communication and understanding among supervisors of each financial market, a Committee can be formed to discuss the main problems and barriers that obstruct consolidated supervision and to strengthen cooperation liaisons among them. This group can contribute to improve information flow among them. A Committee can also be created on a cross-border basis. Among other activities, the Committee can:

- > Exchange experiences
- > Discuss and measure the impact of new legislation
- > Joint inspection of financial groups
- > Exchange technical skills

- > Set Working Groups to investigate topics of common interest: harmonization of rules, monitoring and minimizing regulatory arbitrage or other distortions³¹.
- > Consultation and exchange of information / views between regulators in “fit and proper” assessments concerning new licensee applications or change of ownership situation³²
- > Develop “what if” contagion scenarios involving the collapse of a financial conglomerate for assessing policy implications, setting priorities and deriving appropriate and well coordinated contingency plans.

The Caribbean Group of Bank Supervisors and the Central American Council are examples of two regional organizations that have

BOX 10:

Central American Initiative on Information Sharing

The Central American Council of Banking, Insurance and Other Financial Institutions Superintendents, through a Multilateral Memorandum of Information Exchange and Cooperation for Consolidated and Cross-Border Supervision established a Liaison Group, to perform effective and joint consolidated supervision to act in a coordinated way regarding financial conglomerates.

In November 2007, the first meeting of the Liaison Group of the Central American Council of Banking, Insurance and Other Financial Institutions Superintendents was held in Guatemala. This committee is composed by each one of the Banking Supervision Directors of each one of the Banking Superintendence of the countries that are part of the Council.

The functions of the Liaison Group are to:

- a) Establish plan, identify material risks and coordinate annual consolidated and cross-border supervision for regional financial conglomerates, which should be presented for approval by the supervision authorities in the last ordinary meeting of the year before the “consolidated and cross-border supervision” program.
- b) Share relevant information regarding important events or questions regarding operations of groups that have cross-border activities, including relevant changes in stock ownership.
- c) Request to the relevant supervisor (when needed) a short explanation of the performance of a financial conglomerate under its jurisdiction, including the main aspects of its management and the way how they comply with their obligations and requirements of the supervisor and other aspects the supervisor consider relevant.
- d) Exchanges information in a timely way regarding any event that can have a negative impact on the stability of the cross-border groups.

31 FSAP: Chile. “Technical Note: Consolidated Supervision of Financial Conglomerates.” IMF and World Bank. June 2004.
32 Ibid.

Central American Initiative on Multilateral Information Exchange

The Central American Council of Banking, Insurance and Other Financial Institutions Superintendents: Memorandum of Understanding

Among the cooperation efforts in the region to improve consolidated supervision it is important to highlight the cooperation of the Central American Council of Banking, Insurance and Other Financial Institutions Superintendents ("Council"). The members of this council, which include all the Central American countries, Panama and Dominican Republic, signed in Panama on September 12, 2007, a Multilateral Memorandum of Exchange of Information and Mutual Cooperation for Consolidated and Cross-Border Supervision (MOU).

There are guidelines in the MOU to collect enough information from financial conglomerates and to share this information among the members of the Council, which will contribute to have a better understanding of their structure, given that it asks for information of all the companies or economic units that belong to each one of these groups.

The topics of the memorandum include among others:

- a) General Framework
- b) General Principles and Goals
- c) Definitions
- d) Arrangements for Institutional Coordination
- e) Creation of a Liaison Committee
- f) Exchange of Information
- g) Protection of Information
- h) Suspicious or Irregular Activities
- i) Continuous Cooperation

The definitions include among others:

Control: Control exists when the majority of the votes of the general stockholders meetings can be assured or that the majority of the directors can be elected by:

- a) Direct or indirect participation
- b) In a complementary way: When it can be presumed that one person or a group of persons can have a significant influence in a direct way or through third parties.

Holding Company: An entity that possesses a majority of stock of certain company which controls.

Central American Initiative on Meetings with Supervised Entities

The Central American Council of Banking, Insurance and Other Financial Institutions Superintendents: Meetings with Supervised Entities

During 2007, The Central American Council of Banking, Insurance and Other Financial Institutions Superintendents ("Council") has organized meetings ("reuniones colegiadas") with three financial conglomerates that maintain operations in the region and that maintain parallel operations and incorporated entities for which were not consolidating their operations.

The Council requested these groups to consolidate all of their operations, without exceptions, through organizational structures easy to understand, that may allow supervisors to know their composition and the volume of their operations at a global and consolidated level and the companies that are part of the groups.

Caribbean Initiatives on Memorandum of Understandings

The Caribbean Group of Bank Supervisors' MOU Initiatives

- > Members of the CGBS signed a Memorandum of Understanding initially involving 8 jurisdictions in which the FirstCaribbean International Bank operates; additional jurisdictions have since become signatories to the MOU;
- > Several CGBS members have bi-lateral agreements in place within and outside the Caribbean region
- > MOU information sharing agreements in some cases have facilitated the conduct of joint examinations of some entities

established “committees” or “Technical Work Groups” to facilitate better communication and understanding among supervisory authorities on specific aspects of the consolidated supervision of financial organizations in their jurisdictions. **Boxes 9-13** provide additional details on these groups’ recent activities and initiatives.

In addition, last year Argentina, Brazil, Chile, and Uruguay implemented a regular schedule of meetings or technical exchanges of information every six months to discuss important supervisory issues in the region. Each meeting includes four working sessions and is held over a two day period. One country is responsible for making a presentation on a technical topic based on their supervisory experience in each session. The topic is subsequently discussed by all the participants. These meetings have facilitated the exchange of information and coordination regarding technical matters and supervised entities and are consistent with the current regulatory framework in each country.

3.4. Human Resources for Implementation of Consolidated Supervision

Supervisory agencies that would like to augment their human, technical or financial resources dedicated to consolidated supervisory responsibilities may reevaluate current approaches to supervision to determine ways to better utilize existing resources. For example, enhanced coordination among functional supervisors and among home and host supervisors, as demonstrated by the Central American Council and the CGBS initiatives described above, can reduce resource needs at individual supervisory agencies. Establishing clear and distinct responsibilities among supervisory agencies may also reduce resource demands for hiring new personnel by eliminating any redundancies.

In addition, supervisory agencies that have budgetary autonomy may be better positioned to address their human resources needs for implementing consolidated supervision. Further in this regard, supervisory agencies that have budgetary independence are more likely to implement “pay for performance” schemes and to increase salaries to attract and retain skilled staff.

Outstanding Issues Regarding Consolidated Supervision of Banks and Financial Groups

As previously indicated, Working Group members were challenged to reach a consensus on a number of specific issues given (1) the comprehensive nature of consolidated supervision; (2) the time constraints of the Working Group; and (3) differences in the financial and historical development of financial systems in the region. The outstanding issues regarding the appropriate scope and depth of the legal and regulatory frameworks of consolidated bank supervisory in the region are identified below and may warrant further consideration by a future ASBA

Working Group related to specific aspects of consolidated supervision.

- > Legal frameworks for information sharing (e.g. private customer information with host country supervisors, etc...).
- > Incorporation of an analysis of off-shore banks in relation to consolidated supervision.
- > Regulatory capital requirements for financial conglomerates, including insurance companies, pension funds, and securities intermediaries.

Members of Work Group on Consolidated Supervision

Country	Institution	Name	Position
Members			
USA Co-Chair	Federal Reserve Board	Jack P. Jennings II	Associate Director –Board of Governors
USA Co-Chair	FDIC	Steve Fritts	Associate Director –Division of Supervision and Consumer Protection
Argentina	<i>Superintendencia de Entidades Financieras y Cambiarias</i>	Adriana N. Antonelli	<i>Gerente de Supervisión de Entidades Financieras –Grupo II</i>
Bahamas	The Central Bank of Bahamas	Claude Haylock	Deputy Manager – Bank Supervision
Brazil	<i>Banco Central do Brasil</i>	Carlos José Braz Gómez	<i>Gerente Técnico Regional. Departamento de Sup. de Bancos e Cong. Bancarios</i>
Colombia	<i>Superintendencia Financiera de Colombia</i>	Luz Angela Barahona	<i>Directora de Riesgos de Conglomerados</i>
Ecuador	<i>Superintendencia de Bancos y Seguros</i>	Marcelo Herrera	<i>Intendencia Nacional de Instituciones Financieras</i>
El Salvador	<i>Superintendencia del Sistema Financiero</i>	Javier Alfredo López	<i>Jefe de Riesgo Operativo</i>
Guatemala	<i>Superintendencia de Bancos</i>	Erika Susana Vargas	<i>Asistente – Intendencia de Análisis y Supervisión</i>
Panama	<i>Superintendencia de Bancos</i>	René Menendez	<i>Director de Supervisión Bancaria</i>
Paraguay	<i>Superintendencia de Bancos</i>	Hugo Centurión	<i>Encargado de Despacho de la Sección de Bancos</i>
Peru	<i>Superintendencia de Banca, Seguros y AFP</i>	José Roberto Effio	<i>Intendente de Riesgos de Supervisión</i>
Spain	<i>Banco de España</i>	Joaquín Mochón	<i>Inspector Senior – Grupo Latinoamérica</i>
Technical Asistense			
	International Monetary Fund	Jorge Cayazzo	Senior Financial Sector Expert Banking Supervision and Regulation Division
	World Bank	Constantinos Stephanou	Finance, Private Sector and Infrastructure Group, Latin America & Caribbean Region
ASBA Coordinators			
	ASBA	Rudy Araujo Medinacelli	Secretary General
	ASBA	Rafael Díaz Wild	Research and Implementation Specialist
Other Representatives			
USA	Federal Reserve Board	Terry Muckleroy	Senior Supervisory Financial Analyst – International Supervision
USA	FDIC	Curtis Wong	Capital Markets Specialist, Division of Supervision

APPENDIX 1

QUESTIONNAIRE ON CONSOLIDATED SUPERVISION

I. Legal Framework / Scope and Structure

1. Describe the term “banking group” (BG) or “financial conglomerate” (FC) as defined under local laws, noting:
 - a. whether the terms include the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign;
 - b. the extent to which parent companies and non-bank (including non-financial) group entities are included;
 - c. whether supervisor(s) may exercise discretion in determining whether particular entities will be considered part of the group.
2. Does your agency have legal capacity and enforcement to determine which companies form part of a BG/FC? Is there a registry of economic groups and who is responsible for maintaining/ updating it?
3. For those entities that form part of a BG/FC, is there a requirement to create a financial holding company (FHC) to control all of their financial sector activities? If so, are there restrictions on the FHC (e.g. that the group bank should be a FHC, that the FHC cannot be established outside the country etc.)? Please provide a copy of the relevant legislation/regulation.
4. Indicate whether national laws permit ownership of banks by commercial or non-financial companies. Discuss the extent to which relevant supervisors:
 - a. have the authority to review the activities of commercial parent companies and of companies affiliated with the parent companies and uses the power in practice to determine the safety and soundness of the bank; and
 - b. has the authority to establish and enforce “fit and proper standards” (include revised BCP definition) or similar standards for owners and senior supervise management of parent companies.
5. BG/FCs frequently have highly complex structures, which may obstruct effective consolidated supervision. To what extent is the supervisory agency empowered to require transparency of legal and managerial group structures?
6. Discuss the supervisor’s authority to review and direct changes to legal, managerial, operational, and ownership structures of the bank and its wider group to ensure that they will not hinder effective supervision on both a solo and a consolidated basis or expose the bank to undue risks. Also, describe the supervisor’s authority to limit the activities of the bank or the group and the locations in which activities can be conducted to ensure that activities are properly supervised and that the safety and soundness of the bank is not compromised.
7. Please describe the main regulatory firewalls between the bank and the rest of the BG/FC or economic group (e.g. ownership limits, permissible activities, related party and large exposure limits, limits and disclosure requirements on intra-group transactions, limitations on co-participation in senior management and/or Board of Directors as well as on external auditing firms, prohibitions on common branding/marketing, IT systems, front- and back-office staff, distribution networks etc.).

II. Importance of Financial Conglomerates in Domestic Financial System

8. What proportion of banking sector assets at end-2005 belong to domestic BG/FCs and what proportion to foreign BG/FCs?
9. How many domestic BG/FCs and how many foreign BG/FCs operate in the domestic banking system? Of the three biggest banks (in assets), how many belong to domestic BG/FCs and how many to foreign BG/FCs?
10. How many domestic and how many foreign BG/FCs form part of bigger economic groups that also have non-financial (i.e. commercial) activities? Of the three biggest banks (in assets), how many belong to domestic BG/FCs and how many to foreign BG/FCs that form part of broader mixed-activity economic groups?
11. Please provide market shares of domestic and foreign BG/FCs in other market segments (e.g. securities, insurance, and pensions) based on whatever

metric you use (e.g. assets, trading volumes, insurance premiums, assets under management etc).

12. Do the BG/FCs have offshore activities – what type (e.g. banking, asset management etc.) and how important are they in terms of size? Are these activities located in offshore centers or in other countries? Are the offshore entities subsidiaries of the group bank or are they located parallel to/above it?

III. Consolidated Supervision Arrangements

13. Which agency is responsible for the regulation and which entity is responsible for the supervision (if they are different) of the financial system (banking, insurance, securities and pensions) in your country?

14. Is there a 'lead regulator' with legal capacity and enforcement to undertake consolidated supervision of BG/FCs? If so, please provide a copy of the relevant mandate. If not, is there an informal arrangement in place between supervisors?

15. How is the supervisor structured to handle consolidated supervision? Are supervisors organized in individual units that cover an entire FC? Is there a specific unit supervising systemically important BG/FCs?

16. Describe any arrangements (formal or informal) the bank supervisor has with other relevant supervisors, domestic and cross-border, to receive information on the different entities within the BG/FC, including regarding financial condition, legal compliance, and the adequacy of risk management and controls. Discuss if there are legal obstacles to sharing information between supervisors in your country (e.g. bank secrecy)? Indicate whether the supervisor informs or coordinates with other relevant supervisors when taking formal remedial action in relation to a bank or any other component of the BG/FC.

17. Are there any Memorandums of Understanding (MOUs) already signed between bank supervisors and other domestic supervisors? Are these MOUs publicly disclosed? Please provide a copy of a MOU that is currently used.

18. Are there any MOUs already signed between bank supervisors and foreign supervisors? Do these MOUs cover all relevant countries? – If not, why not? Are these MOUs publicly disclosed? Please provide a model of a MOU that is currently used.

19. What are the main responsibilities of the domestic bank supervisory agency acting as a home and as a host supervisor?

20. To what extent MOUs clearly define rights and obligations of each supervisor involved, regarding:

- > information gathering and exchange
- > consultation and mutual assistance on policy changes
- > monitoring of markets and entities
- > on-site supervisory activities
- > problem resolution, including a definition of procedures during normal and emergency situations

IV. Supervisory Practices

21. Discuss the bank supervisor's authority to review the overall activities of a bank holding company or financial holding company (both domestic and cross-border) and to obtain information from the bank and banking group in the form and frequency it deems necessary. Discuss the supervisor's methods (e.g., on-site examinations, off-site surveillance, and/or reliance on external auditors) for maintaining a current understanding of the overall structure of the banking group, including the activities, operations, and risks presented by all material parts of the group, domestic and cross-border.

22. Describe the bank supervisor's policy for assessing the need for and frequency of on-site examinations of a bank's direct or indirect foreign operations or additional reporting. Please explain the on-site supervisory approach for a BG/FC. Discuss whether the supervisor actually visits the foreign operations of local banks and meets with the host supervisors during these visits.

23. Discuss the extent to which the bank supervisor applies and monitors compliance with prudential standards (including those governing capital adequacy, asset quality and provisioning, affiliate transactions, large exposures, exposures to related parties, and risk management requirements) on a consolidated basis for the BG/FC and/or the FHC.

a. Describe the nature and scope of any such standards, defining all relevant terms (e.g., "related parties," "affiliates," connected parties to which large exposure limits apply).

- b. In the case of risk management, identify all risks covered (e.g., country, transfer, credit, market, liquidity, operational, and legal risks, and interest rate risk in the banking book).
 - c. Discuss whether and, if so, how the bank supervisor evaluates the risks non-banking activities conducted by a BG/FC/FHC may pose to the bank, and describe measures the supervisor may take to mitigate those risks.
24. Describe any internal controls, internal audit, corporate governance, and accounting, auditing, and disclosure requirements to which the bank and its wider corporate group are subject, and discuss how the relevant supervisor(s) monitors and enforces compliance. Does any one supervisor collect consolidated financial information for the wider corporate group? Are there special regulatory reports in order to identify and assess intra-group operations? Please explain and provide a copy of the reports.
 25. Indicate risk transfer activities (e.g. loan sales/securitization), or shared credit activities (e.g. mortgages, credit cards, leasing etc.), between different financial entities belonging to the same BG/FC currently used in your country. Could these activities potentially create regulatory arbitrage problems?
 26. Is there a common (unique) valuation framework for assets and financial instruments (e.g. bonds, derivatives) held by different financial entities belonging to the same BG/FC? Discuss current rules.
 27. If unregulated financial companies, or commercial companies undertaking financial activities, integrate of a BG/FC, how are they monitored?
 28. Is the supervisor empowered to request, following domestic prudential regulations, additional provisions or capital for activities carried out by a BG/FC through banks established abroad? If so, where is the accounting made?
 29. Discuss whether and how the bank supervisor determines that:
 - a. management (of the parent bank or head office and, where relevant, the holding company) is maintaining proper oversight of the bank's direct and indirect foreign operations; and
 - b. the local management of any cross-border operations has the necessary expertise to manage those operations in a safe and sound manner and in compliance with supervisory and regulatory requirements.
 30. Discuss the extent to which the bank supervisor has the authority to prohibit the establishment, require the closing, or impose limitations on the activities of foreign operations, if it determines that:
 - a. oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the operations present.; and/or
 - b. it cannot gain access to the information required for the exercise of supervision on a consolidated basis.
 31. Describe any restrictions that apply under national law to parent bank access to material information on direct and indirect local operations. Indicate whether and how the national bank supervisor verifies that there is no hindrance in host countries to parent bank access to material information on operations in the host country.
 32. Indicate whether the national bank supervisor subjects the local operations of foreign banks to prudential, inspection, and regulatory reporting requirements similar to those applicable to domestic banks. Indicate whether the national bank supervisor establishes that no objection (or a statement of no objection) has been received from the home country supervisor of a foreign bank seeking to establish operations in its jurisdiction.
 33. Describe the scope and manner of supervision of shell banks and booking offices operating in the supervisor's jurisdiction.

V. Consolidation

34. Do accounting or supervisory regulations require BG/FC to publish consolidated financial statements? To what extent is International Accounting Standard 27 ("Consolidated Financial Statements and Accounting for Investments in Subsidiaries") used in country accounting practices?
35. How is the *scope of consolidation* defined in your country (i.e. specifying the types of entity that should be included in consolidated prudential reports)? Does it include only those related entities which carry on activities of a banking or financial nature?
36. What are the *methods of consolidation* used in your country (i.e. the accounting techniques that banks use when reporting on a consolidated basis)?
37. What are the consolidation rules for FHCs, including the treatment of subsidiaries and equity participations? Please explain in detail and provide a copy of the consolidation regulation in place.

APPENDIX 2

FINANCIAL CONGLOMERATE & FACTORS INFLUENCING DEVELOPMENTS OF FINANCIAL CONGLOMERATES

Definition

A definition of a financial conglomerate is absent in most countries' regulatory framework. This paper does not attempt to provide a universally applicable definition for "financial conglomerate" as even terms like "financial holding company" and "banking group" are used differently in different countries. However, the concept of a financial conglomerate is generally well-enough understood, to the extent that a discussion of the many issues surrounding regulation and supervision of such firms can be undertaken. Even those members of the working group who feel strongly that no definitive regulatory requirements can be enacted without acceptance of an unambiguous definition of financial conglomerate, agree that the supervisory concerns surrounding some of these issues need to be brought into open debate. Thus, for purposes of this document a financial conglomerate will mean:

"Any group of companies under common control whose exclusive or predominant activities consist of providing services in at least two different financial segments (e.g. Banking, securities, insurance, pension funds)."³³

This simple definition itself has some shortcomings. For example, the concept of "control" can be interpreted as either an entirely legal construct or it can be viewed in more functional terms. Countries do not view the definition of control in the same manner, with some favoring reliance on a legal construct; some favoring specific regulatory interpretation; and some preferring broad supervisory purview. The definition also leaves unclear the meaning of "predominant". However, for the purpose of this report, the definition only tries to obtain a common understanding of what is broadly meant by a financial conglomerate, with no intention of excluding certain economic groups from the analysis.

Factors influencing development of financial conglomerates: Internationalization, conglomeration, and consolidation

- > **Internationalization** is the entrance of a financial group or conglomerate in the financial market of other country.
- > **Consolidation** is the process of combining companies with the same line of business; for example the consolidation of two banking organizations. The trend of consolidation has resulted in "concentrated" banking systems, whereby a small number of large institutions, representing the majority of domestic financial system assets.
- > **Conglomeration**: Conglomeration is the process of combining companies from different financial market segments or from seemingly unrelated businesses. Each of a conglomerate's subsidiary businesses runs independently of the other business divisions, but the subsidiaries' management reports to senior management at the parent company.

The increase in the internationalization, consolidation, and conglomeration of financial companies over the last decade have been driven, in part, by management pursuit of cost savings through economies of scale and revenue enhancement through a wider base of clients and markets, the search for a more efficient allocation of resources, and the drive for increased market share. In addition, these trends have increased over time due to financial deregulation which has eliminated legal and regulatory barriers and provided new business opportunities for businesses that were not previously available. The trend in conglomeration has also been driven by management desire to diversify business risk by participating in different markets and by the ability to offer clientele one-stop shopping. Important advances in information technology, has fueled the increase in these trends as well. First, the speed and quality of communications and information processing have made it possible for financial groups to offer a broad array of products and services to a larger number of clients over wider geographic ar-

33 Source: World Bank and Joint Forum Reports.

eas. With this technology, it is efficient for financial groups to expand their business operations to other market segments and to other regions. Second, the purchase of this first tier technology represents an

important investment, which encourages financial groups to share this investment with other business partners and to spread the high fixed costs this technology represents across a large customer base.

APPENDIX 3

MEMORANDUM OF UNDERSTANDING MODELS

MEMORANDUM OF UNDERSTANDING

BETWEEN THE

CENTRAL BANK OF THE BAHAMAS

AND THE

[OVERSEAS SUPERVISORY AUTHORITY]

REGARDING COOPERATION ON BANK SUPERVISION MATTERS

The Central Bank of The Bahamas and the [Overseas Supervisory Authority] hereafter referred to as “the Parties”, guided by principles for the effective consolidated supervision of banking organizations and by principles for cooperation between banking supervisors as established in the Basel Committee’s Core Principles for Effective Banking Supervision, have agreed as follows:

1. For the purposes of this Memorandum of Understanding:

- > “banking organization” is a bank or trust company which carries on banking business or trust business and whose activities are subject to licensing and bank supervision by the Parties;
- > “bank supervision” includes the supervision of the activities of both banks and trust companies, as defined by the national laws of the respective countries;
- > “supervisory information” is the information received or obtained during the process of performing bank supervision functions, as well as through the exchange of information and the conduct of on-site inspections pursuant to this Memorandum of Understanding, by either of the bank supervision authorities. Supervisory information shall not generally include information on assets under management and individual customer deposit accounts and transactions; and,
- > “cross border establishment” means a branch, subsidiary, representative office, or any other business activity of a banking organization within either of the countries which, by common agreement, gives rise to the need for consolidated supervision.

- > “home country” is the country of licensing of a banking organization which has established a branch, subsidiary, or representative office in another country, the “host country”.
- > The “requesting party” means the party making a request under this Memorandum.
- > The “requested party” means the party receiving a request under this Memorandum.

2. The parties agree to cooperate in supervising cross-border establishments as follows:

Provision of Supervisory Information

2.1 In connection with the supervision of banking organizations licensed in one country that have cross-border establishments in the other country, the Parties agree to provide, on a reciprocal basis, supervisory information on any material changes pertaining to banking organizations under their supervision, such as restrictions on the range of permitted business activities, suspension or modification or revocation of a license, appointment of a provisional administrator, and reorganization or liquidation.

Off-site Supervision

2.2 In exercising on-going off-site supervision through collecting, examining, and analyzing information and financial and statistical reports submitted by cross-border establishments in host countries, the Parties agree that:

- > the host country Party will exercise prudential supervision over the activities of cross-border

establishments in accordance with its national legislation and regulations and its established supervisory programs;

- > the host country Party will not prevent the cross-border establishments from submitting, to their parent banking organizations, information and other reports necessary to complete consolidated reports or specific reports in accordance with the requirements of the home country Party, provided that such information will not generally include the names of depositors; and,
- > the Parties undertake to use their best endeavors to provide timely, relevant information to their counterpart on material developments or material supervisory concerns affecting cross-border establishments, their directors, management, or staff, as well as any material administrative penalties or other formal enforcement action affecting the cross-border establishment.

On-site Inspections

2.3 In effecting the conduct of on-site inspections of cross-border establishments for the purpose of consolidated supervision:

- > the Requested Party will not prevent the Requesting Party from carrying out on-site inspections for bank supervision purposes (either directly or through delegated third-party agents on its behalf), subject to the requirements and limitations of the Requested Party's national legislation;
- > the Requesting Party will notify the Requested Party of its intention to inspect a cross-border establishment, indicating the purpose and the planned scope of the inspection, which may include the review of the loans and investment portfolio for the purpose of consolidated supervision;
- > the Requested Party agrees to provide, at the request of the Requesting Party, access to any available supervisory information relevant to the conduct of the on-site inspection, subject to the limitations and requirements of the Requested Party's national legislation;
- > representatives of the Requested Party have the right to be present during the on-site inspections and related meetings conducted by representatives of the Requesting Party; and,
- > following the on-site inspection, the representatives of the Requesting Party will discuss the results of the inspection with the Requested Party.

Execution of Requests and Responses

3. The Parties agree that a request for assistance or supervisory information shall generally be made in writing but, when a need for expeditious action is identified, an oral request, subsequently confirmed in writing, within 3 days of the request will be adequate.
4. The Parties agree to take all necessary measures to provide as prompt and as complete a response as possible. The Requested party will notify the Requesting Party regarding any circumstances preventing or delaying the fulfillment of a request for information or assistance.
5. The Parties agree to independently bear the expenses involved in the implementation of this Memorandum of Understanding, unless an alternative procedure is agreed upon in writing, signed by both parties.

Confidentiality of Information

6. The Parties agree that, within the framework of this Memorandum of Understanding, supervisory information and documents shall be provided to the extent reasonable and subject to national statutory provisions including those restricting disclosure. A request for information, documents, or assistance may be denied wholly or partially if the Requested Party determines that the fulfillment of the request will violate its national legislation, or that it may harm significant national interests, or on grounds of public interest, or when disclosure would interfere with an ongoing investigation. In such cases, the Requesting Party will be notified about the denial and provided reasons for the denial in writing, where appropriate.
7. The Parties agree that each Party will always ensure the confidentiality of supervisory and other information and documents received from the other Party pursuant to the requirements and restrictions of their relevant national law.
8. The Parties agree that supervisory information that is received by either Party will not be used, without the consent of the Party that provided it, for any purposes other than for the purposes for which it was requested and provided.
9. The Parties agree that, unless disclosure is legally compelled, supervisory and other information and documents received by either party pursuant to this Memorandum of Understanding will not be passed to a third Party or otherwise released from the control of the receiving Party without the prior

extent reasonable and subject to any relevant statutory provisions, including those restricting disclosure. In addition, the provision of or request for information under this understanding may be denied on the grounds of national security or when disclosure would interfere with an ongoing investigation. Where a request for assistance is denied, or where assistance is not available under domestic law, the requested supervisor will provide the reasons for not granting the assistance.

8. Requests for assistance will be made in writing by designated employees of the supervisor and will be addressed to the requested supervisor's contact persons. However, where the Authorities perceive a need for expedited action, requests may be initiated in any form but should be confirmed subsequently in writing.

Sharing of information

9. The Authorities recognise that information should be shared between them in order to facilitate effective consolidated supervision of financial institutions operating across their national borders. Information sharing should include contact during the authorisation and licensing process, in the supervision of the on-going activities of such entities and in the handling of problem institutions.

10. In connection with the authorisation process, and in accordance with the Core Principles:

- (a) the host supervisor should notify the home supervisor, without delay, of applications for approval to establish offices or make acquisitions in the host jurisdiction;
- (b) upon request, the home supervisor should inform the host supervisor whether the applicant bank is in substantial compliance with banking laws and regulations and whether the bank may be expected, given its administrative structure and internal controls, to manage the cross-border establishment in an orderly manner. The home supervisor should also, upon request, assist the host supervisor by verifying or supplementing any information submitted by the applicant bank;
- (c) the home supervisor should inform the host supervisor about the nature of its regulatory system and the extent to which it will conduct consolidated supervision over the applicant bank. Similarly, the host supervisor should indicate the

scope of its supervision and indicate any specific features that might give rise to the need for special arrangements; and

- (d) to the extent permitted by law, the home and host supervisors should share information on the fitness and properness of prospective directors, managers and relevant shareholders of a cross-border establishment.

11. In connection with the ongoing supervision of their cross-border establishments, the two supervisors should:

- (a) provide relevant information to their counterpart regarding material developments or supervisory concerns in respect of the operations of a cross-border establishment;
- (b) respond to requests for information on their respective national regulatory systems and inform each other about major changes, in particular those which have a significant bearing on the activities of cross-border establishments;
- (c) inform their counterpart of material administrative penalties imposed, or other formal enforcement action taken, against a cross-border establishment. Prior notification shall be made, as far as practicable and subject to applicable laws; and
- (d) facilitate the transmission of any other relevant information that might be required to assist with the supervisory process.

12. Requests for information should normally be made in writing. However, where the supervisory authorities perceive a need for expedited action, requests may be initiated in any form but should be confirmed subsequently in writing.

On-site inspections

13. The Authorities recognise that cooperation is particularly useful in assisting each other in carrying out on-site inspections of cross-border establishments in the host country. Prior to commencing an on-site inspection, the home supervisor may review relevant examination or other supervisory reports or information provided by the host supervisor. The home supervisor should notify the host supervisor of plans to examine a cross-border establishment or to appoint a third party to conduct an examination on its behalf, and to indicate the purposes and scope of the visit. The host supervisor should allow the home supervisor or its delegated agent to conduct on-site inspections. As may be mutually agreed be-

tween the parties, examinations may be carried out by the home supervisor alone, or accompanied by the host supervisor. Following the inspection, an exchange of views should take place between the examination team and the host supervisor.

Protection of information

14. The Authorities recognise that mutual trust between supervisory authorities can only be achieved if exchanges of information can flow with confidence in both directions. Both supervisors hereby pledge that all possible steps will be taken to preserve the confidentiality of confidential information received. In this regard, employees of both supervisory authorities are bound to hold confidential all information obtained in the course of their duties. Any confidential information received from the other supervisor should be used exclusively for lawful supervisory purposes.
15. A supervisor in one jurisdiction that has received confidential information from a supervisor in another jurisdiction may subsequently receive a request for that information from a third party, including a third party supervisory authority, who has a legitimate common interest in the matter. Prior to passing information to the third party, the supervisor should consult with and seek agreement from the supervisor that originated the information, who may attach conditions to the release of information, including whether the recipient is or can be bound to hold the information confidential.
16. In the event that a supervisor is legally compelled to disclose to a third party, including a third party supervisory authority, information that has been provided in accordance with a statement of mutual cooperation, this supervisor should promptly notify the supervisor that originated the information, indicating what information it is compelled to release and the circumstances surrounding its release. If so required by the originating supervisor, the supervisor will use its best endeavours to preserve the confidentiality of the information to the extent permitted by law. Authorities should inform their counterparts of the circumstances in which they may be subject to legal compulsion to release information obtained.

Financial Crime

17. The Authorities intend to co-operate closely when they identify suspected financial crime activities in supervised banks and financial transactions. For the purposes of this agreement, financial crimes are in particular: money laundering, unauthorised banking, investment or insurance business and all other violations of law on financial markets.

Modifications and Term

18. This understanding shall continue indefinitely subject to modification by the mutual consent of the Authorities or termination by either party with 30 days advance notice in writing. After termination, the confidentiality provisions shall continue to apply to any information provided under this understanding prior to termination.
19. Annexes will be reviewed at least annually and reconfirmed or amended as necessary to ensure that the information therein remains current.

Ongoing Coordination

20. The Authorities recognise that visits for information purposes and exchanges of staff may promote cooperation between them. In addition, the supervisors in the two countries should pursue areas where the training of staff at either agency would benefit from input and support by the other agency in order to reinforce sound banking supervisory practices in both countries.
21. The Authorities should conduct meetings as often as appropriate to discuss issues concerning banks that maintain cross-border establishments in the respective countries.
22. (optional) This document has been prepared in [language] and translated into [language].

On behalf of:

[Authority A]

By:
[Name & title]

Dated:

[Authority B]

By:
[Name & title]

Dated:

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