



A “Convergence” Review of Cross-Border Supervision Arrangements in South-East Europe

Issues Note

Background

The financial systems in South-East European countries¹ are characterized by a high degree of foreign ownership, with most foreign-owned banks originating from EU countries.

In this situation, supervisory authorities face in most cases only the end-results of strategic decisions affecting the banking system under their purview, unlike home country authorities which can monitor the full decision-making process. Their limited understanding of the strategic drivers that underpin the operational choices of international banks complicates the calibration of effective host supervisory approaches. The result is a prudential framework with aspects, as suggested by anecdotal information, that are sub-optimally in part market-unfriendly and in part crisis-“unproof”. While improved support from home authorities would undoubtedly help host country supervisors, this alone may not be sufficient to put the latter in a situation comparable to the one of the former when it assesses the activities of a bank active in its own domestic market.

Foreign operations represent a significant and growing share of activities of most international banks in the region. These operations bear more resemblance with each other than with those in the respective home markets. Host country supervisors in the region may find the understanding of activities conducted by an international bank in other countries, through *host-host* collaboration, to be as relevant as their understanding of its home activities. Arguably, effective host-host collaboration and coordination may become, in the future, a pre-requisite to create a better level-playing field between host country supervisors and their EU home counterparts in the consolidated supervision of international banks.

Content

We feel that the development of a pertinent approach for this review would greatly benefit from an early involvement of selected host country authorities. Their views are essential to sharpen our understanding of the issues at stake and to focus our efforts on those approaches that are most likely to contribute to improved collaboration between financial sector stakeholders in South-East Europe.

We would like to receive guidance from host country authorities on the following issues:

- How best to examine the current status of cross-border supervision collaborative efforts?
- How could host country supervisory regulations and standards be put on a convergence path to EU practices?
- What are the most frequent impediments to effective consolidated cross-border supervision?
- Which instruments could be developed to improve consolidated supervision?
- What are the other important issues that a host country supervisor deals with?

Objective of the Review

The “Convergence” review will be designed in order to generate the following benefits:

¹ The targeted countries are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, Serbia and Montenegro.



(a) to help host country authorities refine their collective view of common regional issues faced in relation with home country authorities and of practical policy constraints faced as a result of an imperfect collaboration;

(b) to establish a comparative basis that will encourage host country authorities to increase coordination amongst themselves and with home country counterparts, including harmonization of reporting and supervisory practices – as a first step towards a “single rule book” for large EU banks;

(c) to provide a third-party assessment of these issues as a basis for an informal bilateral engagement with selected home country authorities by a neutral entity, such as “Convergence”.

Approach

The review will be conducted by seeking the confidential perspectives of senior host country authorities on cross-border supervision issues.

The review will be undertaken in four phases:

- First: To gather information, based on a structured questionnaire, via confidential one-on-one meetings with senior local authorities.
- Second: To create a platform of issues for discussion among host country authorities.
- Third: To sketch proposals on potential harmonization of reporting obligations of individual banks and host country authorities converging towards EU practices. .
- Fourth: To approach informally one or two home country authorities and relevant international institutions with a “no paper” describing the issues as seen from the perspectives of host country authorities. Be ready to play a low-key facilitation role should a dialogue be possible.

“Convergence” Team

The review will be jointly led by Prof. Franco Bruni of Bocconi University, Milan and Mr. Peter Nicholl, formerly Governor of the Central Bank of Bosnia and Herzegovina and deputy Governor of Reserve bank of New Zealand. Prof. Dr. Shkelqim Cani, former Governor of Bank of Albania, will represent “Convergence”.

Next Steps

The preliminary interviews will help us formulate a structured questionnaire as a basis for the more in-depth discussions that will take in the first phase of the review as outlined above.

The first phase of the review is scheduled to take place in September-October 2005. The first draft report, at the conclusion of the second phase, should be available in November 2005.