



**TECHNICAL WORKSHOP ON**  
**“REGIONAL HOST SUPERVISION ISSUES”**

September 13 2006

NH Vienna Airport Hotel

London Room  
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10.00 Welcome and coffee

10.30 [Questionnaire Results – Findings and Implications](#)  
(Prof. Franco Bruni and Peter Nicholl)

11.30 Discussion

*13.00 Working Lunch*

13.30 [Host Reporting Requirements](#)  
(Luigi Passamonti)

14.00 [Host Supervisor Coordination](#)  
(Introduced by Peter Nicholl)

16.00 Conclusions

Conference on: “Designing Financial Supervision Institutions: Independence, Accountability and Governance. Economics and Law”, Bocconi University, Milan, May 29-30, 2006

## **Supervisory Issues in South Eastern European Countries: A Host Country Perspective**

Franco Bruni and Peter Nicholl

### ***1. Introduction***

Issues of international coordination in European banking supervision have been with us for a long time. A major step in tackling them was made with the Second Banking Directive (1988) which developed for the banking sector the principles of a single licence, home country control and mutual recognition, the building blocks on which the single market for financial services relies. A financial firm operating (with a branch) in a *host* member state is supervised by the *home* authority. This is not the case when its foreign operations take place via a subsidiary, even if fully owned. Moreover certain areas, in particular those relating to consumer protection, competition and other conduct-of-business-rules, continue to be covered under the responsibility of the host country, which is also allowed to exceptionally apply its own rules “for imperative reasons relating to the general good”.

Further steps have been made within the EU with the Banking Consolidation Directive (1992) and with the three successive Capital Adequacy directives (CAD: 1993, 1998, 2005), coming to the definition of the “consolidating supervisor” which accounts also for the activities of foreign subsidiaries.

In spite of this long story, the issue is still unsettled, controversial and rather “hot” in the international debate on financial regulation. Conceptually this is a consequence of the fact that the various imperfections of the solutions that have been adopted up to now are magnified by the rapid increase in the “de facto” internationalisation of banking<sup>1</sup>. This process pushes towards a rethinking of the whole issue in a spirit akin to the wording of the title of this Conference on the “design of supervision”. Internationalisation is taking place both within the Union and across its borders. The most important and delicate across-the-border case is the growing dominance of EU banks in the financial sectors of all the countries of South Eastern Europe (SEE<sup>2</sup>), the case to which this paper and our project are devoted.

Within the EU the discussion has recently advocated the consideration of the strengthening of the consolidating supervisor approach<sup>3</sup>, moving towards the so called *lead supervisor model* or, one step further, the *lead supervisor with an EU mandate* or, even further, the *single European supernational supervisor*. Moreover, new efforts are being made to attack the issue from a different side, pushing towards a strong harmonisation of the supervisory rules and styles of the various EU national supervisors. This development is benefiting, in particular, from the valuable work of CEBS in the Lamfalussy procedure. CEBS efforts<sup>4</sup> are now stressed, in particular, by the need to deal with the supervisory aspects of the application of the last version of the CAD. The recent creation of the

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<sup>1</sup> See, for instance, Dermine (2005).

<sup>2</sup> By SEE we mean the following group of countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, Serbia and Montenegro.

<sup>3</sup> See Oosterloo and Schoenmaker (2004).

<sup>4</sup> Committee of European Banking Supervisors, (2005).

*European company statute*, which facilitates cross-border branch banking, is an additional step towards the evolution of the EU approach to the issues of international coordination of supervision.

The moves towards these EU –wide approaches is motivated in part by the realisation that major banks no longer recognise national borders as the limits of their operations. But we believe that trying to tackle supervisory coordination issues in a purely within-EU manner would be a mistake because many EU banks do not recognise the EU borders as the limit of their operations either. This is especially true in the SEE region, which is now dominated by subsidiaries of EU banks. The EU banking system urgently needs, to be sure, a well functioning unified internal supervisory structure. But its global success also depends on its readiness to become increasingly integrated with the global capital market, i.e., say, with US and Chinese banks and, in particular, with the banking system of the non-EU Europe, from Russia down to the SEE region. The EU solution for supervisory coordination must therefore be conceived in an “open fashion”, paying attention to the interests and to the developments of the non-EU international banking operations. While European non-EU countries are of special interest for us, some non-European examples (like the Australian-New Zealand case: see Appendixes 2 and 3) can be very instructive.

Having in mind especially the peculiarities of the EU-SEE relationship, Section 2 describes the different interests and preoccupations of the three protagonists of home-host problems: home authorities, host authorities and international banks. Section 3 contains a brief description of SEE banking. Section 4 summarises some findings of a research conducted by the authors within the *Convergence* project of the World Bank. Section 5 concludes with some recommendations and suggestions for discussion amongst SEE countries supervisors.

Two aspects that, always and everywhere, complicate the solution of multinational supervision are: the role of central banks in supervision and the fact that international supervisory cooperation can be hindered by the uncertainty on how home and host countries share the potential financial burden of bail-outs in an international banking crisis. That these aspects are very relevant also in the EU-SEE case will clearly result from this paper (Appendix 1, in particular, deals with central banking and supervision in the process of setting up Bosnian monetary and supervisory authorities).

## **2. Three actors**

Home-host relationships have three protagonists: multinational banks, their home authorities and the host supervisors. Each of these actors has legitimate claims (assets) as well as weaknesses and sins (liabilities) in the ideal balance sheet that describes its position in the triangular relationship.

The main legitimate claim of international banks<sup>5</sup> is their “one-stop preference”. They want to minimise the costs of complying with supervisory rules and requests for information by being allowed to go as near as possible to reporting to a single supervisor on all their international activities. If there are many international supervisors they should exchange information among them and then use a single front office, a single “lead supervisor”, to talk to the banks’ headquarters. Obviously the natural leading office is the home supervisor but the largest European banks would welcome any progress towards a federally (ESCB-like) organised centralised EU supervision.

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<sup>5</sup> European Financial Services Roundtable (2005).

The one-stop preference of international banks is also backed by their efforts to increasingly centralize the main management functions in their home headquarters and/or in more than one of their major subsidiaries. Centralisation involves also the most crucial and strategic risk management functions. It carries the risk that it will leave little information and a few competent personnel disseminated in the various branches and subsidiaries. This organisational attitude is aimed at increasing the efficiency of the bank by exploiting important economies of scale and scope. It can also facilitate prudential supervision in figuring out the overall picture of how sound and well managed is the international bank. But it might look as a “sin” of disregard by host supervisors that feel to be deprived of the possibility of inspecting and controlling the liquidity and the risk of a well informed, fully staffed subsidiary with a sufficient stand-alone potential. A parallel host-home problem could arise in corporate governance matters as the international bank tries to minimise the reliance on local people for the governance of its subsidiaries while host authorities would prefer to see some nationals in the board. Legislation can be on their side by requiring local board members but these can be easily chosen in such a way as to be completely dependent on the home headquarters if the bank is not convinced that having authoritative and independently minded local board members can enrich the international role of the subsidiary and enhance the success of its operations.

The worst potential “sin” of the international bank is the moral-hazard that might convince its headquarters to increase the risk exposure of certain high-expected-short-term-return subsidiaries that constitute a small part of the international group and could be abandoned to failure without major damages for the group. The bank could even artificially shift some of the risks that the group undergoes elsewhere towards certain subsidiaries, exploiting the favourable combination they offer a less severe and less expert supervision with a higher probability of a generous bail-out in case of crisis, triggered by the systemic importance of the subsidiary for the host country. To the extent that these moral-hazard attitudes and these supervisory arbitrages really happen to be present, international banking stability requires a robust solution of any problems in the relationship between the home and the host supervisors.

Contagion risks in banking are a well-known phenomenon. But with the growing domination of related subsidiaries of EU banks in most of the SEE countries, it may be worth considering in which direction the contagion risks are most likely to manifest themselves if one of those EU banks got into difficulties. For example, if Bank A in country a in the SEE region have problems, is it more likely that the contagion may spread to other EU-owned banks in Country A or spread to the subsidiaries owned by the parent of Bank A in other SEE countries. If it is thought that this second, cross-border contagion risk has some validity, the need for good information-sharing and cooperation amongst the host supervisors that have subsidiaries of the same parent bank is strengthened considerably.

Consider now the second protagonist of the triangular supervisory interaction: the home supervisor. It has the duties of a consolidating supervisor. It therefore legitimately claims all the necessary information on the foreign subsidiaries of banking groups headquartered in its country. But it often prefers to get the information, directly or indirectly (via the home headquarters), from the subsidiary itself, as it considers this channel quicker and more reliable than asking the host supervisor, also because the latter might frame the information in a different way than the one required for consolidation. As far as risk management is concerned the home supervisor strongly wants to be the Basel II final model validator and will be reluctant to allow the host supervisors to overrule its decision.

On the other hand, home supervisors do need the cooperation of the host supervisors for monitoring and inspecting the foreign branches and subsidiaries. They normally consider joint inspections to be

desirable and are available to sign MOUs to regulate home-host cooperation provided – inter alia – that sufficient secrecy is guaranteed by host supervisors on the jointly collected information.

The typical “sins” of a home supervisor in the triangular relationships are of three categories. First, it tries to minimise the information released on the parent bank to the host supervisor, for several reasons, including the lack of incentives to bear the cost of channelling the information, except when licensing is in process in favour of branches or subsidiaries of the parent bank. This behaviour can sometimes be considered “sinning” because the information on the strategy and the global organisation of the parent bank is often indispensable for the host supervisor to be able to judge the soundness of the parent’s subsidiaries. Second, the home supervisor tends to disregard the appraisal of systemic risk in host countries where the size of the subsidiary is small compared to the parent’s and to the size of its whole international group, even if the subsidiary is large compared to the host country’s total banking system. Third, EU’s home supervisors tend to resist the creation of central supranational supervisors at the Union level, thus preventing the most straightforward way to optimise host-home supervisory cooperation both within the EU and across its borders. This resistance is often triggered also by the lack of burden-sharing rules in case of crisis and bailouts: to the extent that “he who pays the piper calls the tune”<sup>6</sup> national supervisors do not release powers to foreign agents that aren’t committed to co-finance the potential settlement of the crisis of a bank for which they are currently serving as consolidate supervisors.

The third actor of the international triangle is the host supervisor. Its main legitimate claim, which is often disregarded by the actors in the other two corners of the triangle, is that the systemic risk introduced in the host country by a foreign subsidiary which sufficiently large with respect to the country’s size, should be taken into account by international supervisory cooperation even if the subsidiary is a small fraction of an international banking group. This “legitimate claim” is the other side of the above mentioned moral-hazard “sin” of the bank. For example, the New Zealand banking system is dominated by the subsidiaries of Australian-owned banks. As one part of a recent review of the banking supervision cooperation between the two countries, the supervisory authorities in Australia and New Zealand have agreed that they will both avoid taking actions that will impact negatively on the other country’s banking system.

Other legitimate claims of the host supervisors are: the transparency of information of the international banking group required to make the licensing decision of a new subsidiary; the info-transparency of long and complex multi-country ownership chains that make the host-home relationship very indirect; the local availability, inside the subsidiaries it supervises, of the crucial information on the risk strategy and management assigned to the subsidiary by the overall policy of the banking group to which it belongs; the possibility of setting certain requirements to the corporate governance of the subsidiaries, perhaps making compulsory the involvement of local independent directors; the possibility of having a role in the decision making process to validate Basle II risk models.

An additional important legitimate claim of the host supervisor is so be to be adequately informed on the risks and behaviours of other subsidiaries of the same banking group located in other host countries. When this multi-host-country aspect is very relevant the cooperation needs are no longer triangular and the classical home-host theme must also take into account an important set of *host-host issues*.

Host supervisors are naturally suspected of having certain weaknesses and tending to commit certain sins in the triangular home-host interactive game. These potential weaknesses and sins are

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<sup>6</sup> Goodhard C. and Schoenmaker D., 2006.

particularly important when the host country is a less developed or emerging economy, relatively small and still financially unsophisticated. They range from possible hostility towards foreign ownership of banks, to and insufficient independence from local political pressures, to an insufficient reliability in keeping secret on the pieces of confidential information they might receive by home supervisors, to insufficient technical competence and efficiency, to the inability to being clear and specific in asking information to parent banks and to their home supervisors, to the tendency of confusing the instruments of prudential policy with those of monetary policy in a general tendency to use non-market-friendly methods of interference with banks' management.

The set of legitimate claims and sins listed above for each of the three actors of the home-host supervisory interaction, is a "theoretical, a priori" scheme that must be tested, corrected and substantiated with direct on-ground research on specific home-host supervisory relations. Only that part of the scheme that survives the test can be relevant to figure out solutions that might improve the home-host supervisory cooperation. We conducted this testing of the "a priori" nature of the issues on the EU-SEE case, as described below.

### 3. *SEE banking*

The current situation of the banking sector in the SEE region is changing fast and, from several points of views, very promising. The banking systems in all countries of the region have been substantially *reformed* in recent years. In many of the countries bank reform has gone further and faster than reform in most other sectors of the economies. The banking systems of the SEE region are now predominantly *privately owned*.

Table One: Bank ownership: Market share of private banks at at end of 2004.

<u>Country</u>	<u>%</u>
Albania	100
Bosnia and Herzegovina	95
Bulgaria	98
Croatia	97
Macedonia	98
Romania	93
Serbia	63

It is encouraging that *confidence* of the domestic market-participants in their country's banking sectors has returned, in part because of the successful establishment of a higher degree of *macroeconomic stability* in the region and in part because of the beneficial arrival of *strong foreign-owned banks* into the domestic retail banking markets of SEE.

As a consequence of the above trends, both *loans and deposits have grown at rapid rates* in recent years in most SEE countries.

Table Two: Loan and Deposit Growth Rates from 2000 to 2004

<u>Country</u>	Average growth rate of loans (%)	Average growth rate of deposits (%)
Albania	31.5	12.5
BiH	18.2	31.4
Bulgaria	45.3	23.7
Croatia	21.3	18.2
Macedonia	15.5	18.3
Romania	42.5	38.0
Serbia	8.8	49.2
SEE average	28.9	31.8
Euro area average	4.5	6.0

Despite this, financial *intermediation is still at a relatively low level* in most of the countries so that it is likely that relatively rapid growth of loans and deposits will continue for a number of years.

Table Three: Intermediation Levels: Total Banking Sector Assets as a % of GDP.  
As at end of 2004

<u>Country</u>	<u>%</u>
Albania	53.5
BiH	72.6
Bulgaria	65.6
Croatia	108.9
Macedonia	56.7
Romania	38.3
Serbia	38.8
SEE average	58.2
Euro area average	206.3

From a macroeconomic point of view, the growth of loans is sometimes the consequence of increasing *capital inflows* that play an obviously positive and indispensable role in the catching-up process but that might turn out to be exaggerated and too short-term oriented and thus endanger aggregate stability and create problems on the *exchange-rate risk* front. These macro-policy issues create the temptation for the authorities to make use of *direct credit controls*. This is a delicate and unfortunate development that denies the benefits of competitive credit markets, slows down the speed with which the countries' monetary policies and financial markets become modern and mature, triggers a confusion between the instruments of monetary policy and those devoted to prudential policies and sometimes creates useless tensions and misunderstandings between local authorities and the management of the large international banks that are serving the countries' credit markets through their branches and subsidiaries.

As privatisation and restructuring have progressed, foreign-ownership has also increased very rapidly in most SEE countries. Cross-border banking is increasing in most countries, including the EU. But the striking feature of what has happened in the SEE countries is that their domestic retail banking markets are dominated by foreign owned banks. In many of the countries, all *systematically-important retail banks are foreign-owned*. This makes the issue of close and effective co-operation with the home country supervisors of these banks a more critical and urgent issue for the SEE countries than for almost any other region in the world.

Table Four: Market Share of Foreign-owned banks (1), as at end of 2004.(2)

<u>Country</u>	<u>%</u>
Albania	89
BiH	66
Bulgaria	79
Croatia	88
Macedonia	48
Romania	59
Serbia	37
SEE average	72

(1) The share of foreign-owned banks would have increased considerable in most

(2) In % of total assets of the countries in 2005 and 2006.

Banking markets in some of the countries are quite *highly concentrated* and current trends of *consolidation* imply this process could go further. This also raises some difficult issues for the SEE banking supervisors. For example, the recent merger of Unicredit and HVB has triggered legal concentration ratios in at least one country in the region (Croatia) and has been a cause for investigation in others. The trend towards consolidation in EU banking has not yet finished. Some may claim it has really just started. SEE banking supervisors need to think carefully about this issue and develop appropriate policy responses.

Table Five: Concentration Ratios: Market share of total assets of the five biggest banks.  
As at end of 2004.

<u>Country</u>	<u>%</u>
Albania	77
BiH	61
Bulgaria	55
Croatia	74
Macedonia	76
Romania	60
Serbia	47
SEE average	63
Euro area average	54

The banking systems are currently *adequately capitalized* and the level of non-performing loans has been reducing. But there are some concerns as to whether *provisioning policies* are always adequate.

Table Six: Non-Performing Loans as a % of Total Loans and Capital Adequacy Ratios.

<u>Country</u>	<u>Non-Performing Loans</u>		<u>Capital Adq. Ratio</u>
	<u>2000-2004 average</u>	<u>End of 2004</u>	<u>End of 2004</u>
Albania	11.0	4.2	21.6
BiH	6.7	3.3	18.2
Bulgaria	5.7	3.5	16.1
Croatia	6.5	4.5	15.3
Macedonia	22.5	13.2	23.0
Romania	5.9	8.1	18.8
Serbia	19.3	23.3	27.9

*Margins* have been declining due to increased price stability in the region and intensified *competition* that is taking place in spite of the above noted trend towards consolidation, as new entrants try to gain market share. The link between the arrival of good foreign-owned banks and the reduction of interest rates and margins and the expansion of the range of services is widely understood. There is little or no hostility to foreign-owned banks in the SEE region, in part because the quality of the local banking systems in many of the countries prior to the entry of foreign-owned banks was very poor. The arrival of foreign banks has brought the SEE countries substantial economic benefits.

Table Seven: Interest Spreads: difference between lending and deposit rates.

<u>Country</u>	<u>2000</u>	<u>2004</u>
Albania	na	na
BiH	15.8	5.9
Bulgaria	7.9	5.8
Croatia	3.3	7.3
Macedoania	na	na
Romania	20.8	14.5
Serbia	71.6	11.0

#### **4. “Convergence” and supervisory arrangements in SEE countries**

The World Bank, within its “Convergence” initiative, commenced a project on cross border supervision in the SEE region in 2005. The idea is to contribute to the joint goals of increasing the effectiveness of supervision while at the same time minimising the compliance costs faced by the banks by assisting in increasing the cooperation between the home-country supervisors of cross-border banks and the host supervisors, as well as amongst the various and different regional host supervisors. The introduction of Basel II in Europe reinforces the potential significance of this project. We were also concerned that supervisory cooperation between home and host supervisors in the SEE region and amongst the SEE supervisors with subsidiaries of the same banks on their territories hasn’t kept pace with the dramatic changes that have occurred in the SEE banking systems in the last 10 years.

The project goals have been: to gather information on home-host relationships in SEE to see if the current arrangements need to be enhanced; to gather information on bank head office – host

supervisory reporting requirements for international banks with a view to increase their mutual consistency, streamline possible overlaps and reduce unnecessary burdens; to look at the work currently underway in the EU on home-host banking supervision issues and to assess its implication for the SEE region; to develop an outline of a possible basis for enhanced regional cooperation amongst host banking supervisors.

In its information-gathering stage, the project required meetings with a number of home and host supervisors and with the management of some of the major international banks operating in the region. Meetings were supplemented by detailed questionnaires to SEE supervisors that were promptly and fully responded. The results have now been summarised and are going to be discussed in appropriate meetings where, hopefully, useful conclusions will be drawn and adequate action plans will be formulated.

A comprehensive picture of the current supervisory arrangements for banking supervision in SEE emerged from the first stage of the project. The following are among the main features of this picture.

- *Banking supervision is carried out by the Central Bank* in all countries of the region, except Bosnia and Herzegovina where a proposal is under discussion to bring it within the Central Bank. This fact helps in looking for a regional approach to supervisory issues because there is already a well established cooperation among SEE Central Banks.
- Almost all of the systematically important foreign-owned banks have *EU parent banks*, which implies that cooperation between CEBS and SEE supervisors would be sensible and mutually beneficial.
- In terms of the laws and regulations, *foreign-owned banks are licensed and supervised in the same way as locally-owned banks* in all significant respects in all SEE countries. What differences do exist are largely technical and arise from the fact that the major owner of the bank is located in a different jurisdiction.
- This also applies to *corporate governance rules and conditions*, including the approval of Board members by the host country supervisor. But there is still little contact and discussion between the home and host countries on the appointment of board members for a foreign-owned subsidiary. Given the systemic importance of many of these banks, we believe that home and host country supervisors should focus more strongly and co-operatively on these governance issues than they appear to do at present.
- Most foreign banks operating in the region have chosen to operate as subsidiaries. The major reason would seem to be that most SEE countries require a bank operating as a *branch* to be capitalised on the same basis as if it was a *subsidiary*. In this sense it is not therefore really a branch. The assumption that the local supervisors believe that the parents would stand behind the foreign owned banks in the event that they faced financial difficulties is in contrast with the requirement that even the *branches must hold capital in the host countries*. A certain degree of uncertainty seems to be present about the *degree of parent support* in all circumstances. In fact there has been at least one case in the region where the parent did not stand behind and refinance its subsidiary. This case is known by all regional supervisors and still has an impact on their thinking. The time when good understanding and cooperation amongst supervisors is most needed is when there is a banking problem or crisis. But at present there are no clear crisis management rules or policies in the SEE region, or in the EU for that matter. The worst time to establish such 'rules' is when the crisis is underway.

- The signing of a formal *Memorandum of Understanding* (MOU) is considered by SEE supervisors as a key for reaching good cooperation with home country supervisors. The current cooperation with relevant home supervisors is considered good where an MOU exists. On the contrary one has the impression that co-operation with home country supervisors is less satisfactory where a MOU does not yet exist. Unfortunately MOUs are not in place for all or most significant home-host relationships in the region. Italy, for instance, in spite of its deep involvement in cross border banking with the SEE region, has still no signed MOUs with neither Bosnia and Herzegovina nor Croatia. Austria, a very important protagonist of cross-border banking in the region, has still no signed MOUs with Bosnia and Herzegovina, Romania, Serbia. This should be a concern to both the relevant home and host supervisors. For home supervisors, in particular, the rapid expansion of their banks in Eastern Europe should be a stimulus to accelerate the cooperation in supervision. In some cases, banks are taking deposits raised in the home country and transferring them to the subsidiary for lending into SEE. We are not sure if there is a sufficient understanding of the size of these types of transactions and of the potential risks involved, especially in their rapid expansion in markets where issues relating to collateral, legal rights and other crucial aspects of sound banking are still in transition.

- There is currently little dialog or information sharing amongst the SEE supervisors relating to banks operating in their respective countries that have the same foreign parent. Of 21 possible *host-host country relationships* in the region<sup>7</sup>, MOUs exist in only seven instances. Even where a MOU exists between two SEE countries, it is not seen as a means of formalizing information-sharing and cooperation in relation to banks from third countries that operate in both countries. In fact MOUs have initially been developed as formal co-operation arrangements between a home and a host supervisor. CEBS guidelines<sup>8</sup> currently envisage that all information-sharing between host supervisors would go through the consolidating supervisor. We think the SEE supervisors should discuss whether they agree with this approach or whether they would wish to reserve the right to cooperate amongst themselves, including the sharing of relevant information, within the limits set by confidentiality requirements.

- The amount of information that host supervisors in the SEE region currently receive on a regular basis from either the parent bank or the home supervisor of foreign-owned subsidiaries operating in their countries is very low. In most cases it consists only in the bank's Annual Report and Financial Statements. Special requests are satisfied but very infrequent and, on the other hand, host supervisors very infrequently get requests for information on the subsidiaries from the home country supervisors that, moreover, never ask them to send regular reports. In other words: *information sharing* between host and home supervisors seems to be inadequate to the systemic importance of foreign-owned banks in SEE as well as to the weight of eastern European operations in the consolidated balance sheets of some EU-based banks. A close examination of this issue would seem to offer a way to improve the supervisory performance of both home and host authorities.

- *Joint home-host inspections* have the potential to be a very useful supervisory tool as well as being a way to share supervisory expertise. They are allowed in all countries of the region but have occurred very seldom in practice, sometimes as a consequence of the lack of an MOU dealing explicitly with them. We believe an increase in the incidence of the use of this tool would benefit both the home and the host country. As the greatest benefits are likely to accrue to the latter - because of the expertise the home country examiner would bring - host countries should take the

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<sup>7</sup> We have been able to check this only with 7 of the 8 SEE countries.

<sup>8</sup> CEBS (2006).

initiative, whereas one has the impression that they wait a request from home supervisors before considering joint on-site inspections.

- *Co-operation meetings* are arranged and hosted by the home supervisors of a parent bank that has subsidiaries in several countries. The host supervisors from these countries are invited to participate. The senior management of the parent bank attend for part of the meeting and present the bank's business strategies and their risk management systems. Host country supervisors would have difficulty getting this top level exposure in any other forum. We are aware that Austrian authorities have arranged some of these meetings receiving strong support from SEE supervisors, with a few exceptions. We believe these meetings are a very positive example of public-private partnership and should be adopted as a normal and regular supervisory tool by all home supervisors.

### ***5. Conclusions and suggested issues for discussion amongst SEE banking supervisors***

On the basis of the information gathered up to now and of the issues discussed with the three actors - international banks, parent company's supervisors and prudential authorities in the host countries - of the home-host supervisory interplay between EU and SEE countries, we believe that special efforts should be made to increase the host cooperation in supervision, in preparation for a stronger home-host cooperation. These efforts would benefit all the three actors and should be made by all of them. International institutions (both at the EU and at the more global level) should stimulate, advise and assist them in this process.

The developments in the banking sectors in the SEE region have run well ahead of developments in supervisory cooperation. If a crisis did develop in one of the EU banks which are systemically important in the region, we do not know how it would be handled. What worries us more from our work to date is that we do not think anyone else knows how it would be handled. The 'rules' would be made up as the crisis unfolded. If the situation was handled badly, the confidence in the regions banking systems that has grown strongly in recent years and brought large benefits could disappear – and reviving it may be very difficult and take a long time.

The themes and issues listed in the previous section, including a number of practices that have been already in use for some time as well as some useful initiatives that have already been commenced, can serve as a starting point in drawing an agenda for fostering a rapid progress in this cooperation. Further developments in the examination and solution of home-host issues within the EU, centered on the valuable and intensive work of CEBS, should continuously nourish that agenda.

A careful consideration of CEBS work suggests several themes for discussion amongst SEE banking supervision that could serve to elaborate their shared opinion while moving towards a more intense dialogue with home-EU national authorities as well as with the CEBS itself.

One of these themes is precisely the relationship between CEBS and SEE supervisors. Should the latter try to involve themselves in the CEBS process or should they agree to apply the conclusions reached in the CEBS process to the SEE region without further discussion?

Among the more specific issues, the use of national discretion in the application of Basle II deserves special attention. Discretion can create differences in national decisions that might be an obstacle to those international banks that are currently producing indispensable financial services in SEE countries. But discretion can also serve to accommodate individual countries' peculiarities. The exercise of discretion offers valuable options to host countries' authorities but is technically

rather complex and it is also risky, as you can be criticised for exercising it or not exercising it if a bank subsequently has problems. What is the attitude of SEE supervisors on this point? Which degree of international harmonisation do they favour?

Several other aspects of current CEBS guidelines on home-host supervision cooperation touch upon issues that stimulate a joint analysis and a common position of SEE supervisors. For instance: to what extent supervisory co-operation can and must go beyond the mere exchange of information? Is the distinction between “essential” and “relevant” information appropriate and workable, where the former should be communicated on the initiative of the supervisor that has the information, while the latter shall be communicated only on request?

SEE countries should make up their mind on the best way to reach an efficient multilateral approach to improving home-host supervisory cooperation. The structural evolution of cross-border banking groups is such that the bilateral approach that is being taken to date is suboptimal. A current example is the Unicredit/HVB case where an Italian bank buys a German bank whose main operations in the SEE region are conducted through an Austrian subsidiary. The control chain can become complicated (a Bosnian subsidiary of a Croatian bank owned by the Austrian subsidiary of a German-Italian group) to the point that bilateral MOUs become ineffective and the same definition of the home and host relationship becomes impossible on a bilateral basis.

The centralisation of key functions of larger banking groups, including risk management is also something regional SEE supervisors need to think about carefully. It does pose subtle and multiple problems to the home-host supervisory relationship, including corporate governance issues. A useful example to be studied, from this point of view, is the relationship between Australia and New Zealand, that we have summarised in Appendix 2.

The sooner SEE authorities will elaborate their ideas on such types of issues, the better will be the potential result of any enhancement of their dialogue and co-operation with the supervisors of the parents of the subsidiaries that operate in the region.

## *Appendix 1*

### **THE TRANSFORMATION OF THE BANKING SYSTEM OF BOSNIA AND HERZEGOVINA: WHAT WERE THE KEY ELEMENTS?**

#### *THE STARTING POINT*

In 1997, when the Central Bank of Bosnia and Herzegovina (CBBH) was first established, there were 76 registered banks in Bosnia and Herzegovina (BiH). Most of them were very small, many of them were state-owned and none of them operated over the whole country. The citizens didn't really trust or use the banks so the level of bank deposits was very low. The citizens primary means of savings was holding DEM banknotes under the mattress. Bank lending to the private sector was negligible: at the end of 1997 it totalled only KM (DEM) 134 million<sup>9</sup>The non-cash payments system was a monopoly of the state-owned payments bureaus, as it was in all of former Yugoslavia. But this institution had split into three parts during the war and in 1997 was still operating on this basis. The CBBH started its operations on 11 August, 1997. It started with foreign reserves of KM 130 million, which represented one week's import coverage. In short, the banking system in BiH in 1997 was very small, very fragmented and played no significant economic role.

#### *THE SITUATION TODAY*

The number of registered banks has fallen from 76 to 32. But consolidation has gone even further than that. The largest four banks, all of which are foreign-owned, have 67% of the system's deposits and the largest ten banks have 85.5% of the system's deposits. Bank deposits have grown from less than KM 1 billion in 1997 to over KM 10 billion today. Bank deposits are continuing to grow at an annual rate of around 25%, even on this much higher base. Bank lending has grown similarly dramatically. Total loans at the end of March, 2006 were KM 7.8 billion. Of this amount, around 95%, was extended to the private sector. The banking sector is now playing a very significant economic role, so much so that the CBBH has in the last two years increased the reserve requirements it places on banks' deposits on three occasions in order to try and moderate the rate of growth of bank lending, primarily because of concern about BiH's continuing large current account deficit.

The payments bureaus were abolished and the non-cash payments system has since 2001 been operated by the banks and cleared through clearing houses owned and run by the CBBH. BiH now has a very modern payments system and it has operated without problems since it started. The CBBH's foreign reserves are now around KM 4.4 billion, which is about five months of import coverage, a rather more comfortable level than the one week's in 1997.

In short, the banking sector in BiH is now relatively normal. The term 'normal' is used here in the sense that it looks very similar to and plays a similar economic role to the banking system's in a EU country. Reform in the banking sector has gone further and faster than reform in any other sector of the BiH economy. However, the BiH banking system has still not completed its transition to becoming a modern, European-type banking system. The levels of financial intermediation in BiH, despite the rapid growth rates over the last few years, are still low compared to those in developed financial markets. So strong growth in deposits and lending should continue to occur for some years yet. For example, there is an estimate that 45% of the citizens of BiH still do not have a bank

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<sup>9</sup> 1KM = 1 DEM = 0.51129 Euros

account. Also, a large proportion of bank deposits are still relatively short-term and this constrains the ability of the banks to offer medium and long term funding.

The rest of the transition in the BiH banking system should occur quite quickly and much of it will be carried out by the banks themselves. But there are still some areas where policy action is necessary. For example, there are still problems in the legal and regulatory frameworks in BiH that make it difficult for banks to take and use collateral for lending. Specialist commercial courts have been recently established and a pledge registry has been created. It is to be hoped that these will lead to further improvement in this key area.

A second area where reforms still need to be completed is in banking supervision. While BiH now has a single banking system that operates over the whole country, bank registration and supervision is still carried out primarily by two entity banking agencies. This does create inefficiencies and complicates the important relationships BiH needs to have with the home country supervisors of the foreign banks that now dominate the BiH banking system. It is expected that in the near future, banking supervision will shift to the state level under the responsibility of the CBBH.

### *THE ACTIONS AND POLICIES*

What were the main actions and policies that have allowed BiH to develop a sound and expanding banking sector in less than a decade?

First, a situation of macroeconomic and financial stability was established. The CBBH operates as a very strict currency board. A country's central bank is the base of its banking system and a sound central bank is therefore one of the key building blocks for a sound banking system. This currency board type of monetary policy has been very successful in BiH (and in other countries in Eastern Europe). The country has had a stable exchange rate against the anchor currency, first the Dem and now the Euro, since it was introduced in 1997. Inflation was quickly reduced and has remained very stable at around 1-2% over the last three years. The fiscal position is also stable as the government overall runs a small surplus, in part because of the terms of successive stand-by arrangements the country has had with the IMF.

Second, the behaviour of the citizens has been a very important part of the currency and bank reform projects in BiH. It is an element that often gets overlooked or under-estimated. The citizens have learnt their financial behaviour the hard way – by frequent losses of wealth. They were not using the state-owned banks that existed in BiH in 1997. As good private banks came into the market, they began to use them.

Third, a number of policies were successfully implemented that played important roles in the reform process. The key ones were:

Payments system reform: in the non-cash payments area, the old state-owned centralised system that had a monopoly was closed in early 2001. It was replaced with a modern European-type system with two clearing houses, an RTGS one and a Giro one, owned and operated by the CBBH. Payments are conducted by the commercial banks. The new system has worked smoothly and efficiently since its introduction;

Minimum capital requirements: these requirements have been substantially increased through a series of steps from an initial KM 2.5 million to KM 15 million. The initial low level of minimum capital is the main explanation why so many small banks were established in BiH in the mid-1990s. The subsequent increases in minimum capital have forced banks to merge or find strategic partners.

This, plus increased competition, has led to a sharp reduction in the number of banks in BiH and has strengthened the banks that remain.

Inter-entity banking: prior to 2001, a bank registered in one of the two entities that make up the state of BiH could not open a branch in the other entity. If it wanted to operate in the other entity it had to register, and capitalise, a separate bank. The laws were changed in 2001 to make it possible for a bank registered in one entity to operate branches in the other entity. Fourteen banks, including most of the larger ones, are now operating in both entities as a single bank. In the banking sector, BiH now has a single economic space. This may not sound like a significant statement. But in BiH, it makes the banking sector relatively unusual.

Deposit insurance: a deposit insurance scheme was started in 2001. It initially covered deposits in approved banks up to KM 5,000. This limit was raised in 2005 to KM 7,500. The deposit insurance scheme has also helped citizens' confidence return to the banks that qualified.

Privatisation of government owned banks: progress in bank privatisation was initially very slow but accelerated markedly in 2002. The process of privatisation is now complete in the Republika Srpska but continues to be very slow in the other entity, the Federation. There are still six state-owned banks in the Federation. But between them they have only 1.8% of the banking system's deposits so they are insignificant at the systemic level. The BiH banking sector is essentially now completely privately owned.

The fourth major influence on the bank reform process has been the behaviour of the banks themselves. The dominant influence has been the arrival of a number of foreign-owned banks into the BiH banking system, especially in the last five years. The four largest banks are all foreign-owned as are a number of the other banks. At present the share of foreign capital in the system's capital is just over 70%. This is likely to increase further in the next few months as other purchases are under discussion. Most of the foreign banks have entered the BiH market by purchasing existing BiH banks. In many cases, they have retained BiH managers but brought in technical assistance, improved governance and new products. The parents of some of the banks also play an important maturity transformation role.

Increased foreign competition has been very good for the BiH economy. It has given depositors more choice and it has forced the local banks to improve the range and quality of the services they provide in order to survive. It has given the citizens and companies of BiH some safe savings options and the citizens are responding by increasing their bank savings substantially.

The combination of macroeconomic stability and increased competition in the banking sector has brought down interest rates in BiH substantially. There was not good interest rate data back in 1997 but most bank interest rates were over 20% at that time. In March, 2006, the average lending rate on short-term loans to the business sector was 10.2% and on long-term loans was 7.6%. While that is still relatively high, it is a marked improvement over the situation the business sector faced eight years ago.

## *CONCLUSION*

The transformation of the BiH banking system has been very rapid and very profound. It has been driven by a combination of strong and sensible policies, including banking supervision policies, cautious but sensible financial behaviour on the part of citizens and the arrival of good private-owned banks, including some major foreign-owned banks.

The transformation is not complete and there is still a need for some further policy measures. But most of the remaining transformation will be completed by the banks themselves. The outcome of the reform process has been very beneficial for the BiH citizens and economy.

## *Appendix 2*

### **USING BANKING SUPERVISION POLICIES TO IMPROVE BANK GOVERNANCE: A CASE STUDY OF NEW ZEALAND.**

#### *BACKGROUND*

New Zealand (NZ) went through a rapid period of reform and deregulation in the 1980s and 1990s. During this process the NZ banking sector went from being one of the most regulated in the OECD countries to one of the least regulated. Some of the key elements of the reforms NZ went through were a reduction in government intervention in the economy to allow markets to function more efficiently, making markets contestable wherever possible, improving governance, especially in the public sector, and re-examining the roles and structures of most government agencies.

In the financial sector most of the regulations that segmented financial markets and constrained the price and asset allocation choices of financial institutions were removed, the government progressively sold most of the financial institutions it owned, and the 'commercial bank' sector was opened up to new entrants, both domestic and foreign, in 1987. The number of banks rose from 4 to peak at 22 in 1991. It is currently 16.

So the review of banking supervision that occurred in NZ in the early 1990s did not happen in isolation. Its aim was to try and apply the same principles that had already been applied to many other areas of public policy to banking supervision.

#### *MOTIVATIONS*

The initial question that was asked was 'is there a public sector justification for banking supervision at all?' Or to put that question another way, 'why isn't the core legal code that applies to other corporations adequate to supervise banks?' This question has probably not been examined in any other country for a long time – but the power of the first principles review of the appropriate role of the public sector in NZ meant this is where the discussion started. Policy interventions, and banking supervision is a policy intervention, can only be justified if they are likely to improve the soundness and efficiency of a system compared with a situation where there was no policy intervention.

In many other industries that were opened up to competition, entry was made entirely open. But it was decided that an explicit authorisation process for banks was justified and would be retained. Banks were regarded as different from other enterprises for the following main reasons:

- the centrality of the role the banks played in a developed economy like NZ.  
More than 90% of NZ's narrow money supply was in bank deposits and bank credit was the major source of household and business finance;
- the need for the public to have confidence in the payments system in which the banks played the major part;

- banks operate with much lower equity/debt ratios than any other companies.

It was therefore decided that there was a public policy justification for banking supervision and an authorization policy for banks was retained. This is an important part of the overall banking supervision regime in New Zealand. The process for becoming a bank in NZ is quite demanding. There have never been any quantitative criteria on how many banks would be allowed to operate in the market. The criteria are entirely qualitative. Dealing with problem banks is always difficult. Preventing the entry of potentially weak banks in the first place is seen as the best approach in NZ.

The other key motivation for the banking supervision reforms in NZ was a desire to reduce moral hazard and the potential fiscal costs that go with it. This desire to limit moral hazard led to the government selling virtually all the financial institutions it owned. It also led to detailed consideration being given to how you could design a system of banking supervision that reduced or eliminated the implicit moral hazard and fiscal risk in licensing and supervising banks.

### *THE NEW POLICIES*

NZ was one of the first countries to use market discipline, strong corporate governance and pre-determined responses to some breaches as major parts of their system of banking supervision. The RBNZ describes itself as having a three pillar approach to banking supervision: self discipline, market discipline, and regulatory discipline. In a speech in 2005, the Governor of the RBNZ, Allan Bollard, said ' this approach places risk management largely in the hands of those closest to it, and lays responsibility for outcomes with boards of directors, management and creditors – that is, those who have the most to lose from a mismanaged bank.'

#### Pillar One: Self discipline:

This pillar covers the policies and structures that promote effective governance by banks' boards of directors, including effective oversight by local boards of the local banks' managements. The NZ authorities expect high standards of corporate governance from the boards of New Zealand banks, and this expectation is reinforced by some quite severe penalties that could apply should a bank's directors fail to properly discharge their responsibilities appropriately.

Bank directors must sign the disclosure statements of their bank as being true and fair. The consequences of producing a statement that is false or misleading include fines and imprisonment. Moreover, if creditors lose money as a result of reliance on a false statement, directors face potential unlimited personal liability.

However, the requirements on directors go further than this. They must also make certain attestations, the main one being that they are satisfied that their bank's risk management systems are adequate and are being properly applied. Both elements are important. We have all seen banks get into difficulties that have fine risk management systems on paper – but they weren't being monitored and parts of them were being ignored. So directors are required to do more than just read the description of the bank's risk management policies. They have to satisfy themselves they are being applied in practice and attest to that.

The RBNZ did not expect bank directors to be personally expert in every area of the bank's operations, including its risk management. The obligation placed on them was to 'satisfy themselves' that the systems were appropriate and were being used. They could do this by getting independent experts to assess the systems and the way they were being used. This is what most, if

not all, bank boards of directors did in NZ. They brought in experts to assess and test systems and controls and, where these expert reports identified weaknesses, got the bank to deal with them.

In most of the incredible stories of management excesses or malfeasance seen in recent years, there was usually a Board that was either asleep or part of the problem. If a bank director did either of those things in NZ – and depositors or other creditors lost money as a consequence – they could be sued personally. The importance of good self-regulation and governance has gained a lot more recognition around the world in recent years. This can be seen in the Sarbanes Oxley Act in the US. Also, in its Basel II recommendations, the Basel committee has put more weight on the importance of good self-regulation and governance for ensuring bank stability than it did previously. The RBNZ policy on self discipline introduced in the 1990s no longer looks that unusual today.

#### Pillar Two: Market Discipline through a Disclosure policy:

Since 1996, banks in NZ have been required to make comprehensive financial and prudential disclosures to the market-place. These disclosures, combined with a policy of not bailing out failed institutions, help to strengthen market scrutiny of banks and the market disciplines that go with that.

Disclosure statements must be published quarterly and they contain a wide range of financial and other information on a bank. By law, a bank's disclosure statement must not be false or misleading. Directors face criminal and civil penalties if information contained in the disclosure statement is found to be false or misleading. This requirement links the two pillars of self-discipline and market discipline.

Few, if any, people would argue today that disclosure is not a useful supervisory tool. It does assist the financial markets to exert appropriate market discipline on banks. NZ believes that it also reduces the complexity and scope of the traditional supervision tools. Many other supervisors would not go that far. They would agree that disclosure is a useful addition to the set of tools available to a supervisor but that it doesn't reduce the importance and value of any of the other tools.

One of the frequent criticisms made when NZ was shifting to mandatory disclosure was that the average depositor wouldn't understand what the disclosure document was telling him. Too often the commercial 'common sense' of the 'common person' is underestimated. But more importantly, the criticism misses the main point. It is not the ordinary depositor that the RBNZ expected to analyse the disclosure statements. In NZ there were enough knowledgeable journalists and financial analysts to do this work and disseminate the results to the ordinary depositor. If this industry of financial journalists and analysts doesn't exist in a country, disclosure will not play a significant role in influencing depositors' savings behaviour when it is first introduced. But such countries should still adopt a disclosure regime as part of their supervision frameworks – financial analysts and journalists will only develop their skills if they have something to analyse.

The other group that looks at banks' disclosure statements are the competitor banks and the large corporate treasuries. They do have people who understand the disclosure statements and would act, by shifting their deposits, if they had concerns.

The other purpose of the disclosure policy that does not always receive as much attention is its role in encouraging good risk management and governance in banks. This impact comes from the act of regular disclosure of information, both good and bad. When the policy was being developed, some banks said to the RBNZ that if they have to publish

negative information this could lead to a run on the bank and they should be given time to deal with the problem before having to disclose it. The RBNZ agreed that this was a potential problem for a bank but the solution for the bank was to deal with the problem at an earlier stage so that the negative situation didn't arise.

A lot is written about the need to avoid 'regulatory forbearance'. But Board and management forbearance, ie the desire to wait and hope improved market conditions will solve a problem, can be a reality also. Having mandatory disclosure within 90 days, as in New Zealand, hugely changes the incentives to avoid having bad information to disclosure and thus reinforces the need for early action by banks' Boards and managers.

The situation the RBNZ was determined to avoid was one where the only people who were aware a problem existed was the bank's management and the banking supervisor. Access to such 'confidential' information on the part of the supervisor can be a major source of moral hazard risk.

### *Appendix 3*

#### **THE IMPACT OF FOREIGN OWNERSHIP AND CONCENTRATION ON THE APPROACH TO SUPERVISION IN NEW ZEALAND**

NZ did not set out on its process of bank reform in the 1980s with the aim of shifting to a banking system that was predominantly foreign-owned. But the fact that this has been one of the outcomes of the reform process has not been a cause of concern either. A phrase I used on one occasion when I was Deputy Governor of the RBNZ and another NZ -owned bank was being sold to a foreign buyer was that the RBNZ was primarily concerned about the quality of a bank's owner, not their nationality.

The RBNZ has always paid close attention to the structure and make-up of a bank's Board, including the Board's of foreign-owned banks. For example, they require that at least two members of the NZ Board be 'independent'. For this purpose, the RBNZ defines 'independence' to mean that these directors are not employees of the registered bank or directors or employees of any holding company or of any other entity capable of controlling or significantly influencing the bank in NZ. I also believe that one of these 'independent' directors has to be the Chairman of the NZ Board.

They had also always received the names and cvs of the proposed members of the Board and senior executives. In amendments to the RBNZ Act in 2003, this element of the policy has been further strengthened. A 'suitability requirement for bank directors and senior management' has been introduced. It explicitly requires the RBNZ to take into account when deciding whether or not to register a bank, the suitability of the proposed directors and senior managers for their jobs. They also have the option of considering this on an on-going basis through a bank's conditions of registration.

More recently, the RBNZ has been reconsidering the impact of the high degree of foreign ownership and a high degree of concentration on its supervision policies recently, particularly their ability to handle a banking crisis. The RBNZ has published a number of papers on these issues over the last two years. There has been no single set of 'conclusions' but a series of developments and decisions.

The RBNZ wants to ensure that the major banks in NZ, the 'systemically important ones', all of which are currently Australian-owned, have the capacity to operate in NZ on a stand-alone basis should a banking problem arise in Australia.

The new policy has two main planks at present. All major banks are required to incorporate in NZ. Second, a policy on outsourcing of key operations was introduced last year. Using parent-bank systems, tools and techniques is permitted, but only with the full understanding and ownership of the local bank and board. The local bank board is responsible and accountable for all aspects of bank operations.

So this new policy too is consistent with pillar one of the RBNZ's approach to banking supervision, self-discipline and directors' responsibility. The NZ bank board can outsource functions if they so choose but they are required in all areas, including this one, to act in the best interests of the NZ bank. The one thing they can't outsource is responsibility. They therefore have to very conscious of the risks involved in outsourcing before proceeding.

The banking systems in many eastern european countries have similar characteristics to the NZ banking sector: a high degree of foreign-owned banks and a growing degree of concentration that can be affected by mergers between foreign-owned banks (eg Unicredit and HVB). The recent adjustments to the supervisory framework in NZ therefore should receive close attention in the eastern europe region.

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# **HOST SUPERVISION COOPERATION IN SOUTH EAST EUROPE**

**HARMONIZING REPORTING REQUIREMENTS:  
THE ROMANIA CASE STUDY**

Regional Technical Seminar  
Vienna Airport, September 13, 2006

# THE MOST RELEVANT REPORTING ISSUE:

## Monitoring Safety

### Best scenario

The best scenario is the one in which home supervision, host supervision, and home bank fully cooperate to ensure that the host bank is conducted in a safe and sound manner

### Cross-Country Problems

- Different supervisory capital requirements (solvency ratios)
- Different limits on lending (single client, insider)
- Different liquidity requirements
- Different limits on foreign exchange exposure
- Different minimum registered capital
- Different auditing requirements

### Source of problems

- Different regulatory frameworks
- Different banking laws

### Solutions

- Adoption of international supervision standards
- Bilateral agreements (MoU)
- On-site inspections by the home supervisors
- Harmonize host country laws

# ANOTHER RELEVANT REPORTING ISSUE: Costs of Compliance/Efficiency

### Best scenario

The best scenario in terms of efficiency is the one in which home supervision, host supervision, and parent bank require the same set of reports (prudential, financial and statistical) from the local bank

### Cross-Country Problems

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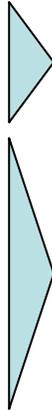
- Different definitions of relevant entities (profits, assets,...)
- Different file contents / formats
- Different deadlines



### Source of problems

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- Different accounting standards
- Different reporting formats
- Different reporting frequencies



### Solutions

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- Adoption of international accounting standards
- Adoption of international reporting templates (CEBS)
- Bilateral agreements (MoU)

# MONITORING SAFETY – Romania Example

Indicator	Romania	Austria	Greece	France	EU
• Solvency ratio*	• 12%		• 8%		
• Limits on lending**					
– Concentration per client	• 25%		• 25%		
– Insider lending	• 25%		• 20%		
• Liquidity requirements	• Actual ≥ Required		• None		
• Limits on foreign exchange exposure**					
– Overall	• 20%		• If greater than 2%, provisions must 8 times the excess amount		
– Each currency	• 10%				
• Minimum registered capital	• 8.85 mill. Euros		• 5 mill. Euros		
• Auditing requirements	• Audited annual reports		• Comprehensive auditing		
• MoU with Romania	• NA	• No	• Yes	• Yes	• NA
• Home on-site inspections	• NA	• Yes (rare)	• No	• No	• NA

• Romanian banking regulation is stricter than European one, as expected for a former transition economy

• Auditing requirements seem less comprehensive

\* Risk weighted \*\* As % of own funds

# REPORTING EFFICIENCY – Romania Example



**Indicator**      **Romania**      **Austria\***      **Greece\***      **France\***      **EU\***

<ul style="list-style-type: none"> <li>Accounting standards</li> </ul>	<ul style="list-style-type: none"> <li>IFRS (from 2007)</li> </ul>	<ul style="list-style-type: none"> <li>IFRS</li> </ul>			
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<ul style="list-style-type: none"> <li>Reporting documents:</li> </ul>	<ul style="list-style-type: none"> <li>About 40 reports</li> </ul>	<ul style="list-style-type: none"> <li>Solvency report (quarterly)</li> <li>Other non-supervisory reports</li> </ul>	<ul style="list-style-type: none"> <li>Solvency report (quarterly)</li> <li>Currency position report (quarterly)</li> <li>Large exposure report (quarterly)</li> </ul>	<ul style="list-style-type: none"> <li>Solvency report (quarterly)</li> <li>Liquidity report (quarterly)</li> <li>Interest rate sensitivity report (quarterly)</li> <li>Financial report (monthly)</li> </ul>	<ul style="list-style-type: none"> <li>No unique standard at the moment, even if CEBS is working on this issue</li> </ul>
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• MoU with Romania      • --      • Yes      • Yes      • Yes      • --

• Reporting requirements for host supervision by National Bank of Romania (NBR) are more extensive than those for home supervision.  
 • Until today this situation was compounded by the need to comply with different accounting standards.

\* As home supervisors

# FOCUS: NBR REPORTING

Type of reporting	Content of reporting	Main documents	Frequency			
			D	M	Q	Y
Supervisory	Balance Sheet	<ul style="list-style-type: none"> <li>Net assets' statement</li> <li>Mod 4081 (Derivatives' P&amp;L), Mod 4000 (Net Capital), Mod 4014 (Operations with Clients), Mod 4026 (Country Risk, Overdue &amp; Doubtful Debts), Mod 4027 (Provisions), Mod 4080 (Income statement / PL Account)</li> <li>All the above plus Mod 4020 (Security portfolio), Mod 4021 (Capital, reserves and provisions), Mod 4023 (Off balance sheets - derivative instruments), Mod 4025 (Term currency operations), Mod 4028 (Off balance sheet placements and debts), Mod 4090 (Indicators for the operational activity)</li> </ul>		√ √		√
	Own Funds	<ul style="list-style-type: none"> <li>Own funds' report</li> </ul>		√		
	Deposits	<ul style="list-style-type: none"> <li>Mandatory Minimum Reserve (MMR) statement</li> </ul>		√		
	Liquidity	<ul style="list-style-type: none"> <li>Liquidity report (including the calculation of the liquidity ratio)</li> </ul>		√		
	Currency	<ul style="list-style-type: none"> <li>Currency position report</li> </ul>	√			
Financial	Credit	<ul style="list-style-type: none"> <li>Solvency report (own funds/total weighted assets)</li> <li>Report of currency loans' exposure (foreign currency risk)</li> <li>Large exposure report</li> <li>Report of loans and provisions</li> <li>Report of retail loans (consumption/mortgage)</li> <li>Report of consumption loans (insured/non-insured)</li> </ul>			√	
				√	√	
				√	√	
				√	√	
				√	√	
	Financial info	<ul style="list-style-type: none"> <li>Report of deposits for Romanian Guaranty Fund</li> <li>Monetary balance sheet</li> <li>Report of Ron claims of non-resident clients</li> <li>Report of average interest rate for customers' assets and liabilities</li> <li>Loan classification report</li> <li>Report of non RON assets &amp; liabilities</li> <li>Report of non RON resources &amp; placements</li> </ul>			√	
				√		
				√		
				√		
						√
Statistic	Statistic info	<ul style="list-style-type: none"> <li>Report of financial behavior of customers</li> <li>Report of currency operations (cash exchange, foreign currency payments)</li> <li>Statement of balance of foreign payments</li> <li>Report of consumers without RDPE number</li> </ul>		√ √		
				√	√	

# FOCUS: HOME SUPERVISOR REPORTING

Type of reporting	Content of reporting	Main documents	Frequency			
			D	M	Q	Y
<div style="border: 1px solid black; padding: 10px; width: fit-content; margin: auto;">Supervisory</div>	<ul style="list-style-type: none"> <li>Balance sheet</li> <li>Liquidity</li> <li>Currency</li> <li>Credit</li> </ul>	<ul style="list-style-type: none"> <li>Financial report</li> <li>Liquidity report</li> <li>Currency position report</li> <li>Solvency report (own funds/total weighted assets)</li> <li>Interest rate sensitivity</li> <li>Large exposure report</li> </ul>		<b>F</b>	<b>F</b> <b>G</b> <b>A F G</b> <b>F</b> <b>G</b>	
<div style="border: 1px solid black; padding: 10px; width: fit-content; margin: auto;">Financial</div>	<ul style="list-style-type: none"> <li>Financial info</li> </ul>	<ul style="list-style-type: none"> <li>CAD interface file (trading positions)</li> <li>Financial report</li> <li>Risk monitoring report</li> <li>Banking group report</li> </ul>		<b>A</b> <b>A F</b>	<b>A</b> <b>A</b>	<b>A</b> <b>A</b>

<b>A</b> Austria	<b>G</b> Greece	<b>F</b> France
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# FOCUS: REGIONAL BENCHMARK

## Reporting to National Bank of Croatia

Type of reporting	Content of reporting	Main documents	Frequency			
			D	M	Q	Y
Supervisory / Financial	Balance Sheet	<ul style="list-style-type: none"> <li>Supervisory reports</li> <li>Report of interest rates on loans and deposits</li> </ul>			√	
	Deposits	<ul style="list-style-type: none"> <li>Report of total amount of retail deposits</li> <li>Reserve requirements report</li> </ul>		√ √		
	Liquidity	<ul style="list-style-type: none"> <li>Money market report</li> <li>Money market trading report</li> <li>Intraday liquidity report</li> </ul>	√ √		√	
	Currency	<ul style="list-style-type: none"> <li>Report of foreign investments (debt securities, equity)</li> <li>Report of buying and selling foreign currency (from/to local banks, foreign banks, corporate clients, and retail clients)</li> <li>Report on the condition of accounts in foreign countries</li> <li>Report of liabilities in foreign currency</li> <li>Report of limitation of banks' exposure to foreign exchange risk</li> </ul>	√	√	√	
	Credit	<ul style="list-style-type: none"> <li>Report of financial loans</li> <li>Report of individual debtor's borrowing (if exceeding HRK 5 million)</li> <li>Report of claims secured by unconditional guarantees of the Republic of Croatia</li> <li>Credit cards payments report (including credit cards' classification)</li> </ul>		Once a week	√ √ √	
	Payments	<ul style="list-style-type: none"> <li>Report of non-cash payments</li> <li>Report of cash payments</li> <li>Report of transaction accounts' payments</li> <li>Report of international payments</li> </ul>		√ √ √ √		
Statistic	Statistic info	<ul style="list-style-type: none"> <li>Statistical report</li> <li>Consolidated statistical report</li> <li>Audited consolidated statistical report</li> <li>Exchange office places report</li> </ul>			√	√ √ √

# FOCUS: REGIONAL BENCHMARK

## Reporting to National Bank of Serbia

Type of reporting	Content of reporting	Main documents	Frequency						
			D	W	M	Q	Y		
Supervisory / Financial / Statistic	Balance Sheet	<ul style="list-style-type: none"> <li>Report of capital and reserves</li> <li>Report of assets and liabilities (classification per branch and per term structure)</li> <li>Report of business indicators</li> <li>Report of net investments to public sector</li> <li>Market risk report</li> <li>Deposit/credit activities of bank toward non banking sector</li> </ul>				√	√		
	Deposits	<ul style="list-style-type: none"> <li>Report on Dinar deposits and interest rates</li> <li>Calculation of mandatory Dinar reserve</li> <li>Report on the number of savings accounts</li> <li>List of major Bank's depositors</li> </ul>		√		√			
	Own Funds	<ul style="list-style-type: none"> <li>Own funds' report</li> </ul>				√			
	Liquidity	<ul style="list-style-type: none"> <li>Liquidity report (including calculation of liquidity index)</li> <li>Cash flow report</li> <li>Report on monetary aggregates</li> </ul>	√		√	√			
	Currency	<ul style="list-style-type: none"> <li>Report on foreign currency position</li> <li>Report on turnover with Kosovo and Montenegro</li> <li>Report on collection from abroad</li> <li>Report on foreign currency trading (with clients and other banks)</li> <li>Report on foreign currency reserves (including calculation of mandatory foreign currency reserves)</li> <li>Report on exchange risk</li> </ul>	√		√	√			
	Credit	<ul style="list-style-type: none"> <li>Report to Central Loan Register</li> <li>Report on granted Dinar loans, interest rates and fees</li> <li>Report on total loans and placements to individual</li> <li>List of major loans</li> <li>List of loans to co-borrowers</li> </ul>	√		√				
	Payments	<ul style="list-style-type: none"> <li>Report on cash and checks</li> <li>PPI -70/73/74/77 (Report on foreign payment orders)</li> <li>PPI – 06/07 (Classification of transactions)</li> <li>Report on large/suspicious transactions</li> <li>KNJBIFO (Report on transactions per account)</li> <li>NT Report on aggregate transactions</li> </ul>	√	√					
						√			
							√		
								√	
									√

# CONCLUSIONS

- Large differences in reporting requirements
  - Due to historical reasons
  - Particularly costly for international banks
  - Makes data comparison more difficult
  - Obstacle to host supervision coordination
- Is progressive harmonization desirable?
  - Starting with core reporting data
    - Capital
    - Large exposures
    - Liquidity
    - FX Positions

**“Convergence”<sup>1</sup>** is a World Bank-sponsored financial sector development program for South-East Europe focused on:

- Undertaking analytical tasks of micro-institutional issues calling for solutions tailored to country circumstances
- Taking EU integration as a strategic perspective
- Building awareness of market participants and involving them in the search of market-building solutions
- Fostering dialogue between authorities and market participants to identify workable solutions in local context
- Using the experience of regional former policy makers and experts whenever possible



## **HOST SUPERVISOR COOPERATION.**

A discussion paper for a meeting of SEE banking supervisors

Vienna, 13 September, 2006.

**PETER NICHOLL**

**CONVERGENCE**

**SARAJEVO, BIH.**

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### **INTRODUCTION:**

This morning we discussed the results of the questionnaire on banking supervision practices in the SEE region that we sent to regional supervisors late last year. One conclusion from that survey was that at present there is little dialogue, information-sharing or other forms of cooperation amongst the banking supervisors in the SEE region.

Given that all the countries in the region have been going through, and are still going through, a period of intense banking system reform, you must all be facing very similar policy issues. You should therefore be able to learn from and assist each other. You can a lot from each other's successes but you can also learn a lot from each other's problems and failures if you are willing to share them.

Secondly, the major retail banks in many of the countries in the region are the subsidiaries of the same foreign parent bank. Information-sharing and cooperation in respect to these banks is reasonably well-advanced in the region between the home country supervisor of the parent bank and the various host countries of that bank's subsidiaries, especially where the two countries have signed an MOU. But there appears to be little information-sharing and cooperation at present amongst the regional host supervisors.

There are a number of reasons why increased cooperation amongst the SEE banking supervisors could be useful and valuable for each supervisor and for the future development and stability of the regional banking sector as a whole. This discussion note sets out some of those reasons and poses a number of questions related to each reason that participants could discuss at the Vienna seminar.

#### **1. CONCENTRATION:**

Retail banking markets in some of the countries in the region are already highly concentrated. (See Table 5 Bruni/Nicholl paper) The decisions that have an impact on concentration in the SEE banking markets are generally not taken in the SEE region. For example, the recent merger of Unicredit and HVB has triggered statutory concentration ratios in at least one country in the region and has been a cause for investigation in some others.



**The trend towards consolidation in EU retail banking has not yet finished. Indeed, it could be claimed that it is just starting.**

**Questions:**

- i) How do you assess what level of competition is ‘adequate’ in a retail banking market? (This is a more difficult question to answer the smaller the country as competition and efficiency can potentially conflict in a small country)**
- ii) Who makes this assessment in your country, the Banking Supervisor or is there a separate ‘Competition’ body? If there is such a body, what role does/should the Banking Supervisor play in assessing cases affecting competition in the banking sector?**
- iii) Can a formula-based approach be used in this area or does it need to rely primarily on judgment?**
- iv) Should you look only at actual competition or would a policy of open-entry that facilitates entry of new banks (ie potential competition) also be a factor in assessing competition?**
- v) What is the appropriate response if the merger of two banks outside your country leads to a very high degree of concentration in your country’s retail banking market? (As a hypothetical example, if Unicredit (HVB) and Raiffeissen banks merged, the combined bank would have around 46% of the bank deposits in BiH. Should this be a concern to the BiH authorities?)**
- vi) Would it be useful to have a regional approach to this issue, at least at the analytical level?**

**2. CREDIT GROWTH:**

**Both bank deposits and bank credit have been growing very strongly in most SEE countries in recent years. The monetary authorities (and the IMF) in many of the countries have become concerned that the growth may be too strong and have taken policy measures to contain or slow the credit growth.**

**There are two main concerns:**

- the strong credit growth could exacerbate economic imbalances, especially the current account deficit;**
- the high rate of credit growth could lead to a deterioration in the quality of banks’ loan portfolios.**

**The first concern is not the direct responsibility of banking supervisors. But bank supervisors need to have good contacts with the monetary authorities and be aware of these economic risks. If inflation and/or exchange rate volatility does return to these countries, the soundness of the banking systems will be affected and it will become a problem the banking supervisors will have to deal with.**

**The second concern is a direct responsibility of the banking supervisors. In most countries in the region, the quality of bank loan portfolios pre-reform was very poor. So the bank reform process to date has led to an improvement in loan**



quality. The current concern is that as the foreign-owned banks compete to increase their market shares in SEE countries and local banks try to survive in the much more competitive environment, loan quality may be given a lower weight by banks' managements compared to growth. The issue is an empirical one and supervisors need to regularly analyse trends in loan quality.

**Questions:**

- i) Are the SEE banking supervisors confident they have good systems in place to analyse the quality of banks' loan portfolios? Is there scope in this area to learn from each other and/or to move to a standardized approach across the region?
- ii) What would their policy reaction be if they saw this loan quality was beginning to deteriorate? How would this reaction differ if the problem is only in one or two banks as compared to a situation where it seems to be affecting the whole banking system?
- iii) Would sharing more information with other host countries who have related subsidiaries be useful? (eg, it could indicate if the problem relates to a bank's overall policy or is mainly related to an aggressive local manager)

**3. USING PRUDENTIAL TOOLS FOR MONETARY POLICY PURPOSES:**

There is another inter-relationship between monetary policy and prudential policy in many SEE countries that was described to Prof. Bruni and myself by some of the banks with whom we had discussions. Because the money and capital markets in some SEE countries are still relatively undeveloped, central banks cannot use market operations to any significant degree to implement a policy of restraining credit growth. They therefore tend to use direct instrument such as reserve requirements, liquidity requirements etc. Some banks complained that some of the tools that were being used for monetary policy purposes were really prudential instruments, or at least had prudential impacts on banks. Using them as monetary policy tools caused the following types of problems for banks:

- they interfered in many areas of business management;
- they were generally introduced at short notice, making it difficult and costly for banks to comply. They could also be removed quickly if the economic problem eased, thus making the compliance costs a sunk cost for the banks;
- they were seldom introduced in exactly the same way in two countries in the region so banks had to develop and use different accounting and IT systems in different countries for what was essentially the same banking operation.

**Questions:**

- i) Do the SEE supervisors think this complaint from banks is valid? If so, how should the authorities respond?
- ii) When such a tool is being imposed for monetary policy purposes, are the supervisors consulted and do they try to harmonise them with existing prudential requirements?



- iii) **How quickly do you think your country will be able to shift to relying predominantly on market operations for monetary policy, thus leading to a better separation between monetary policy and prudential supervision?**

#### **4. INTEREST MARGINS IN TRANSITION COUNTRIES.**

**Interest margins in the banking system's in the region have been declining in recent years (see Table 7, Bruni/Nicholl paper) due to increased price stability in the region, intensified competition and a gradual lowering of perceptions of country risk. But these margins are still relatively high. To date, most foreign banks have made very good profits from their SEE subsidiaries. But as competition intensifies and country risk continues to fall, bank margins and profits should move towards international norms.**

##### **Questions:**

- i) **How do SEE bank supervisors think the foreign banks will handle this particular 'transition'? (eg, if the parent banks continue to seek or demand recent levels of profit and return on capital from their SEE subsidiaries into the medium and long term, the only way they will be able to do this is by getting into riskier areas of business)**
- ii) **Is this an area of analysis the SEE supervisors should be thinking about now or is it an issue that can be left to the medium term?**

#### **5. INFORMATION-SHARING AMONG HOST SUPERVISORS.**

**There is considerable work under way in Europe looking at the sharing of information between a home country supervisor and the host countries where the parent bank has subsidiaries. Increasingly, this exchange is being formalized through mechanisms such as MOUs, co-operation meetings, joint inspections etc. But the questionnaire we conducted showed that there was still relatively little exchange of information amongst the host supervisors of related subsidiaries.**

##### **Questions:**

- i) **Should there be greater information-sharing amongst these host supervisors?**
- ii) **If so, what mechanism(s) should be encouraged? (eg, should there be formal MOUs amongst host supervisors in the region?)**
- iii) **What do you think the attitude of the 'home' country supervisors would be to increased information-sharing amongst host supervisors that did not go through the channel of the home supervisor?**

#### **6. TECHNICAL CAPACITIES OF SUBSIDIARIES.**

**In many SEE countries, all the systematically-important retail banks are foreign-owned. Some of these banks have much larger market shares in some of the host countries than the parent bank does in its home country.**



These two characteristics do not occur in many (or any) of the EU countries. In the EU countries, the retail banking sector is still dominated by 'local' banks. This situation is gradually changing in the EU as cross-border mergers of large retail banks are now beginning to occur. But it is a much more relevant and significant issue in the SEE region right now.

The New Zealand banking system has the same two characteristics as most SEE systems. Appendix Two of the Bruni/Nicholl paper briefly describes some recent responses of the NZ supervisory authorities to concerns that the NZ subsidiaries were increasingly 'out-sourcing' many key managerial and technical issues to the parent bank in Australia. This made the NZ authorities worried about the ability of their systematically-important banks to be able to continue to operate smoothly in NZ if the parent bank got into major difficulties.

#### Questions:

- i) Do the SEE supervisors see this 'outsourcing' of key functions to the parent bank as a problem they need to analyse now or do they think the risk is currently insignificant?
- ii) If it is the latter, is this because they think the largest subsidiaries of the foreign-owned banks operating in their country will be able to continue to operate all functions satisfactorily even if the parent bank's financial and technical support ceased or is it because they think the probability of one of these parent banks getting into major difficulties is close to zero?
- iii) Will the introduction of Basle II accelerate the trend of the centralization of risk management and other key functions to a bank's Head Office?
- iv) Would the SEE supervisors be interested in learning more about the recently-introduced NZ policies in this area?

#### 7. COMPLIANCE COSTS FOR BANKS

Another concern mentioned to Prof Bruni and myself when we met with bankers was that differing approaches adopted in the prudential regulations of countries in the region raised the compliance costs for a bank that was operating in several countries. The advantages of minimising compliance costs for banks by having similar or even identical reporting requirements and regulations in all countries in the region include:

- it will clearly lower overall bank costs and also probably improve the efficiency of bank management;
- by lowering bank costs it should (hopefully) lead to a lowering of interest rates;
- it makes the sharing and aggregation of data more useful for both the banks and the supervisors;
- it would make intra-country comparisons more meaningful (peer review can be an important supervisory tool, (eg DFC in NZ)



**Questions:**

- i) should minimizing compliance costs for banks be a factor in designing prudential regimes?
- ii) Should the cost effects of having different requirements in different countries in the SEE region be taken into account by host country supervisors? If so, how? (eg, you could adopt the policies of the home country, you could meet together and agree on a common SEE approach etc)

**8. CONTAGION**

Contagion risks in banking are a well-known phenomenon. But with the growing domination of subsidiaries of EU banks in the retail banking markets of most SEE countries, it may be worth considering in which direction the contagion risks are most likely to manifest themselves in future if one of those subsidiaries of an EU bank got into difficulties. For example, if Bank A in Country X in the SEE region had problems, is it more likely that the contagion would spread to other EU bank-owned subsidiaries in Country X or spread to the subsidiaries of the same parent of Bank A in other SEE countries? If it is thought that this second cross-border contagion risk is at least a possibility, the need for information-sharing and cooperation amongst the host supervisors that have subsidiaries of the same parent bank is strengthened considerably.

**Questions:**

- i) is cross-border contagion a risk regional supervisors need to think about?
- ii) if so, what do you think is the best mechanism for doing this?

**9. GOVERNANCE:**

Another finding of our survey was that there currently seemed to be little contact between home and host country supervisors on the appointment of Board members for a foreign-owned subsidiary in many SEE countries. We concluded in our summary of the questionnaire findings that ‘the governance area deserves further study amongst SEE supervisors with a view to developing a more harmonized regional approach to bank governance issues for foreign-owned banks, especially as these banks now dominate the banking systems of most of the SEE countries’.

This is only one reason why we think there is a need for SEE supervisors to pay much more attention to bank governance, especially the structure and role of bank boards. We have attached as an appendix to the Bruni/Nicholl paper a brief description of the strong focus that the banking supervision authorities in New Zealand apply to this issue. We have used the NZ case study because the NZ banking system shares the same fundamental characteristic of most of the systems in the SEE region: all the systemically-important banks are foreign-owned.



**Questions:**

- i) **How much attention do/should SEE supervisors pay to the governance structures of the banks operating in their markets, including the subsidiaries of foreign-owned banks?**
- ii) **Do the SEE supervisors ever meet with the Chairman and other Board members of the major banks in their countries?**
- iii) **What should be the responsibilities of a bank's Board? Are these responsibilities spelt out in by-laws or regulations in SEE countries? Do these responsibilities differ depending on whether the bank is locally or foreign-owned?**
- iv) **What should the structure of the local Board of a foreign-owned subsidiary be?**
  - **the proportion of 'local' members;**
  - **the proportion of 'independent' directors;**
  - **qualifications of directors;**
  - **who should be the Chairperson, an executive from the bank or an independent director.**

**10. REGIONAL GROUPING OF SUPERVISORS:**

All of the replies to our questionnaire late last year gave a favourable response to the idea of forming a regional forum for SEE banking supervisors.

**Questions:**

- i) **Do the SEE supervisors still feel that there is a sufficient number of important issues that are relevant to all of them as 'host' country supervisors to warrant forming a cooperation group of SEE banking supervisors?**
- ii) **What are the key issues that such a group should focus on first?**
- iii) **If the SEE supervisors do think such a group would be useful, 'Convergence' would be prepared to help initiate and develop the Group. How do the supervisors think 'Convergence' could help them most effectively in such a project?**

**7 September, 2006**



**“REGIONAL HOST SUPERVISION ISSUES”**  
**2<sup>nd</sup> TECHNICAL WORKSHOP**

November 29 2006  
**NH Vienna Airport Hotel**  
Budapest Room  
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- 10.00 Welcome and coffee
- 10:30 Governance Convergence Program (Peter Nicholl)
- 11.15 Consumer Information National Bank of Serbia (Dejan Simic)
- 11:45 Bank Ombudsman Convergence Program (Shkelqim Cani)
- 12:30 Lunch  
With Messrs. Roland Berger and Peter Hofbauer, BA-CA  
Andreas Klingen and Franz Reif, Erste Bank  
Heinz Hoedl, Raiffeisen International
- Issues submitted for lunch discussion:*
- *SEE Plans for IFRS adoption*
  - *Harmonization of home-host reporting formats*
  - *Home supervisor agreement to use host supervisor data*
  - *Status of Basel II implementation into SEE national laws*
- 14:30 After Lunch Discussion
- 15:00 Information Sharing Data National Bank of Romania (Elena Georgescu)  
National Bank of Serbia (Dejan Simic)
- Qualitative Assessments National Bank of Macedonia (Igor Davkov)
- 16:00 Planning and Conclusions
- 16:30 End of Meeting



# **Second Regional Host Supervisory Cooperation Technical Workshop**

Vienna, 29 November 2006

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**Paper Prepared by:**

**Peter Nicholl, Convergence Program**  
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## **Review of Corporate Governance of the Banking Sector: a pilot project of the World Bank.**

### **1. Methodology and Scope of the Review**

In both emerging and developed markets, banks have a public obligation to adhere to high standards of corporate governance. As financial institutions that accept deposits from the public, banks have strong fiduciary obligations--and onerous responsibility--to many stakeholders. The stakeholders include not only bank shareholders but also creditors, depositors, bank supervisors, and even other banks (since the failure of one bank may affect the stability of the banking sector, both at home and abroad). Strong corporate governance arrangements reinforce sound and safe banking practices and are needed to ensure bank management takes full account of the interests of all stakeholders. Following the banking crises of East Asia in 1997, Russia in 1998, and Turkey and Argentina in 2000-2001, and the failure of a reputable UK bank, sound corporate governance of the banking sector has become recognized—even more than before--as an important component for ensuring the stability of a country's financial system.

In recent years, the World Bank has reviewed issues related to corporate governance of banks and other financial institutions as part of the Financial Sector Assessment Program (FSAP). Looking to take a highly structured approach on bank governance reviews, the World Bank developed a questionnaire and a set of 27 draft principles (or “criteria”) reflecting strong corporate governance practices in banks. Three assessments have been done in Eastern Europe so far and a fourth is currently underway.

The bank governance reviews have three main objectives:

- (i) to develop a set of corporate governance criteria for analysing banking sector corporate governance;
- (ii) identify possible governance weaknesses,
- (iii) make recommendations on provisions that would help to strengthen the governance structure of banks in the country being reviewed, thereby ensuring the interests of depositors and other stakeholders are protected.



As a starting point, the methodology for the review was based on identifying a set of important and prudent criteria for assessment. The selection of criteria was based on the experience of the World Bank, the International Monetary Fund and national supervisory agencies in preparing FSAPs in over 100 countries among developed and emerging markets. However, a wide range of materials was also used in preparing (and revising) the criteria. The materials include the 1999 guidelines of the Basel Committee on Banking Supervision as well as the 2005 updated guidelines, the 2004 OECD Corporate Governance Principles, as well as various national codes on corporate governance. Additional input came from the European Union's Financial Services Action Plan and the Action Plan for Company Law and Corporate Governance as well as the July 2004 of the European Commission regarding the role of non-executive or supervisory directors.<sup>1</sup>

The criteria are considered to be “work-in-progress” and are revised by the Bank Teams during the various assessments. It is hoped that the detailed criteria will provide an effective methodology for systematically reviewing the corporate governance of the banking sectors throughout emerging markets. In this sense, the criteria could be considered as part of an implementation methodology for the corporate governance practices identified in the Basel Committee's Consultative Document.

## **2. International Guidance on Corporate Governance of Banks**

The Basel Committee on Banking Supervision has played a leading role in setting standards for banking regulation and supervision. Several of the Basel Core Principles for Effective Bank Supervision, issued in September 1997, refer to the importance of a strong bank governance framework. The emphasis on bank governance is also reinforced by the revisions that are currently underway.

The Basel II Accord on Capital Measurement and Standards, issued in June 2004 goes a step further in granting an important role to oversight mechanisms for review of banks' systems and processes of risk management. Basel II identifies three key pillars, referring to minimum capital requirements, self-assessment and the supervisory review process, and disclosure and market discipline. The Basel II framework requires that banks maintain a capital base sufficient to foster financial stability in times of adversity and uncertainty. The framework also obliges banks to establish risk measurement and management processes, which should be based on both historical data and formal quantitative techniques.<sup>2</sup>

In July 2005, the Basel Committee issued its Consultative Document, *Enhancing corporate governance for banking organisations* which updated and expanded an earlier report from October 1999.<sup>3</sup> The Consultative Document notes that,

*“The [supervising] board of directors and senior management at each institution have an obligation to understand the risk profile of that institution and ensure that capital levels*

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<sup>1</sup> The Committee of European Banking Supervisors (CEBS) is also planning to release a set of more detailed guidelines in the coming months.

<sup>2</sup> Within the European Union, Basel II has been reinforced by the September 2005 approval of the European Parliament of the proposed Capital Markets Directive for credit institutions and investment firms.

<sup>3</sup> The full text of the Basel Committee's Consultative Document can be downloaded at <http://www.bis.org/publ/bcbs117.pdf>



*adequately reflect such risk...Pillar 2 requires bank management to ensure that adequate capital is maintained to support risks beyond the minimum requirements, that a sound system of oversight and control is in place and that risk management procedures are appropriate in relation to the institution's risk profile. The board of directors also needs to ensure adequate disclosure of key information under Pillar 3 so that market discipline becomes an integral part of the control framework for senior management."*

In addition private sector institutions--and in particular the debt rating agencies--have expressed a strong interest in having banks maintain good corporate governance practices. Both Moody's Investors Service and FitchRatings have prepared useful analyses of the key issues and have used these extensively in evaluating the credit-worthiness of banks.

Moody's Investors Service has developed "risk management assessments" that emphasize the importance of strong governance and oversight structures of banks. Using the three pillar strategy of Basel II, the risk management assessment framework for Moody's focuses on: (1) self-discipline within banks (robust corporate governance and risk management), (2) regulatory discipline (regulations and supervision applied to banks), and (3) market discipline (pressures exerted by the market on banks to maintain sound banking practices).<sup>4</sup>

FitchRatings provides still more detailed analysis. In its April 2005 special report, *The Framework for Corporate Governance in Major European Banking Systems: Still Evolving but Good Progress Made*, FitchRatings identifies five key issues related to corporate governance of banks. The issues are:

- 1) Independence and quality of the bank's supervising board of directors,
- 2) Quality of process for overseeing related-party transactions,
- 3) Integrity of the audit process,
- 4) Acceptability of levels of executive and director remuneration, and
- 5) Ownership structures (particularly for banks that are owned by the state or families or are controlled by a core group of shareholders, or are part of complex holding structures).

While there are many ways to review corporate governance of banks, all three approaches—those of the Basel Committee's Consultative Document and the two rating agencies--reflect a common approach to the key issues that must be addressed if a banking sector is to enjoy sound corporate governance.<sup>5</sup>

### **3. Importance of Corporate Governance in Banks**

The banking crises of the 1990s highlighted the importance of effective government regulation and supervision of the banking sector. Banks need to meet the minimum corporate governance

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<sup>4</sup> The Moody's report adds a fourth pillar--maintenance of sound and sustainable macroeconomic policies for managing the economy--but macroeconomic issues lie beyond the scope of this review.

<sup>5</sup> In the US, the Sarbanes-Oxley Act of 2002 (H.R. 3763) highlighted the corporate governance roles of supervising boards of directors. The Act increased the obligations of (supervising) boards to oversee management and auditors and required the direct involvement of board audit committees to oversee internal control and auditing matters. While Sarbanes-Oxley is directly applicable only the companies that are publicly listed on US stock exchanges, US-based private corporations and financial institutions are also under pressure to comply with the same requirements.



standards for all corporations, including protection of shareholder rights. However banks are different from other types of corporations and need to go beyond the minimum standards applicable for other types of companies. Five key issues are important.

- 1) In all economies, banks provide a critical source of funding for both the private and public sectors. Where banks experience problems and lending is restricted, economic development and growth are similarly constrained.
- 2) Banks accept deposits from the public whose funds the government has an implicit (and often an explicit) obligation to protect.
- 3) Banks survive or fail based on their ability to monitor and manage complex and changing financial risks. Yet these risks cannot easily be evaluated by outside analysts.
- 4) Banks typically have high ratios of debt to equity as well as a substantial maturity mismatch between assets and liabilities. As a result, banks are vulnerable to a sudden withdrawal of funds (or “run on deposits”) if public confidence in the banking system declines.
- 5) The failure of a major bank can have serious consequences for the financial sector and can have an adverse impact on the national economy. World Bank research indicates that, after a major crisis, the cost of recapitalizing a banking sector reaches on average 15 percent of GDP. The collapse of the banking system of a major country may also create “contagions” for the banks in the same geographic region.

Strong corporate governance of banks contains many benefits. It strengthens the supervisory system, including reducing the costs of banking supervisions. Transparent and accountable relationships within banks establish a first level of defence against fraud, misrepresentation (or in the case of bankruptcy and default, defalcation.) A strong corporate governance framework for banks directly assists banking supervisors in four ways:

- 1) It provides banking supervisors with comfort that the banking sector is managed prudentially and with transparency and accountability;
- 2) It assures supervisors that the banks are being well-managed on their own, in a form of “auto-pilot”, allowing them to focus on strategic issues and the design and effectiveness of internal systems and controls;
- 3) It allows supervisors to focus their resources on the troubled banks where supervision is most needed; and
- 4) It increases public confidence in the banking sector and the safety of depositors’ funds.

## **Annex I**

### **Review of the Corporate Governance Framework for the Slovenian Banking System: A Comparison against Assessment Criteria**

The review divides governance structures into two forms—internal governance systems and external forms of governance discipline. Both forms must be effective to promote a sound corporate governance culture and establish a strong foundation for prudent management of banks.



The *internal systems* start with getting appropriate owners of banks and then focus on the roles of two key governing organs: (i) the supervising board which supervises the management board and should be responsible for reviewing the bank's strategic plans and goals and approving the systems of internal controls and risk management inherent in sound governance arrangements and (ii) the bank's management board consisting of the executive officers responsible for the day-to-day management of the bank.

In addition, to the two governing organs, proper risk management process and strong internal controls plays an important role in safeguarding the assets of the bank. It ensures that members of the supervisory and management boards have proper and timely information to make sound and prudent decisions.

*The external systems* of corporate governance are those factors that exist outside the bank but exert strong influence on governance culture within the bank. These include the role of the banking supervisor, the role of the external auditor, the role of disclosure, the role of the market in exerting discipline on banks, and the role of industry and professional associations. This report uses both the internal and external factors for the review of bank corporate governance in Slovenia.

In addition, Annex I identifies two other specific sets of criteria. One set is related to banks that are wholly or majority owned or controlled subsidiaries of foreign banks or financial groups and the second is related to banks that are wholly-owned or controlled by the Government of the country being reviewed.



<b>INTERNAL FACTORS</b>	
<b>SECTION A</b>	<b>OWNERSHIP</b>
<b>Criterion A.1</b>	<p>The owners of a bank should meet ‘fit and proper’ criteria and be free of any material conflicts of interest. The supervisor should have the authority to refuse to license a bank where one of the owners fails to meet these criteria or to freeze the shareholders voting rights if the breach arises after the bank is licensed.</p> <p>The ownership of a bank should be transparent. The supervisory authority should not authorize or continue to authorize banks where their ultimate ownership or control structure cannot be easily understood and supervised.</p>
<b>Description:</b>	<p>The first point at which the governance of the banking sector in a country can be influenced in the appropriate direction is by the authorities ensuring that the owners of the banks operating in their country are sound and suitable. The first test is that the owners should not have been guilty of criminal behaviour, especially in the financial area, in any jurisdiction. A second test is that the owners should be free of material conflicts of interest that could arise from their ownership of competing financial institutions or institutions that are related parties to the bank. A third test is that they have a strategic view of their ownership of the bank as without guidance in this respect from the owners, the board and management will have problems in setting a clear strategic direction for the bank.</p> <p>-----</p>
<b>Criterion A.2</b>	<p>Preferably, the banking legislation should prohibit non-financial corporate control of banks. Where such control is permitted, or where a bank is part of a non-financial conglomerate, the supervisor should require stringent controls over related-party transactions and require that the supervising board consist of a majority of independent directors.</p>
<b>SECTION B</b>	<b>SUPERVISORY BOARD</b>
<b>Criterion B.1</b>	<p>The supervising board should have clear, well defined and understood roles and responsibilities, including responsibility to approve the bank’s strategic direction, appoint and oversee senior management, and take ultimate responsibility for the prudent management of the bank.</p> <p>Members of the supervising board should legally be required to perform their duties with due care and diligence and for the purpose of maintaining the long-term safety and soundness of the bank and members of the supervising board should have joint and personal liability for actions taken, or not taken, that could harm the bank.</p>



	<p>Members of the supervising board should avoid conflicts of interest that could unduly influence their judgment. Where such conflicts cannot be avoided, they should be disclosed to the other members of the supervisory board and the regulatory agency.</p>
<p><b>Criterion B.2</b></p>	<p><b>The supervising board should have a sufficient number of members to achieve broad based understanding of the bank’s business activities and effectively discharge its responsibilities. The process for appointing SB members should be transparent and should ensure a reasonable degree of continuity at the Board level.</b></p> <p><b>Members should have the requisite skills, experience and knowledge and should be required to meet ‘fit and proper’ criteria. All members of the supervising board should receive sufficient training to assist them in the performance of their roles.</b></p> <p><b>Supervisory board members should be able to devote sufficient time to their duties in order to make a sound contribution to the supervising board’s functions.</b></p> <p><b>Members of the supervising board should be adequately remunerated, commensurate with their obligations and the risks inherent in the role.</b></p>
<p><b>Criterion B.3</b></p>	<p><b>The supervising board should be chaired by a non-executive director and include a minimum number of independent directors as needed to monitor related-party transactions, particularly those with the parent bank or other affiliated companies.</b></p>
<p><b>Criterion B.4</b></p>	<p><b>The supervising board should establish and maintain committees to assist it in the performance of its duties. Such committees should include at least: (1) an audit committee responsible for oversight of internal audits, external audits, approval of published financial accounts, internal controls, and compliance and (2) a business conduct review committee responsible for non-financial issues including risk management, remuneration and nomination and review and approval of related-party transactions.</b></p> <p><b>Each committee should include at least one independent member of the supervising board. In the case of the Audit Committee, it should be chaired by an independent director.</b></p>



<b>SECTION C</b>	<b>MANAGEMENT</b>
<b>Criterion C.1</b>	<p>The management team should have clearly defined role and responsibilities specified by the Supervisory Board with necessary authority and resources to manage the bank.</p> <p>All members of the management team should be required to perform their duties with due care and diligence, and for the purpose of maintaining the bank's long-term safety and soundness.</p> <p>Members of the management team should be free of conflicts of interest and the bank should prepare and publish a code of ethics prohibiting such conflicts of interest.</p> <p>Members of the management team should be fully accountable to the supervising board under the bank's statutes.</p>
<b>SECTION D</b>	<b>SYSTEMS OF RISK MANAGEMENT &amp; INTERNAL CONTROLS</b>
<b>Criterion D.1</b>	<p>Banks should have reliable risk management systems to identify, measure, monitor and manage all business risks of the bank. Key risk exposures relate to compliance, operations, reputation, credit, interest rates, exchange rates, basis differentials, concentration by sector, geography or industry, and loans to related parties, activities associated with criminal activity and money laundering.</p> <p>The bank's risk management systems should be subject to regular review by internal auditors and, from time to time, by independent experts to ensure that the systems are appropriate for the nature of the bank's business activities and risks.</p>
<b>Criterion D.2</b>	<p>The bank should maintain systems of effective internal controls. The systems of internal controls should meet international standards such as those of COSO.</p> <p>All banks should have effective internal audit arrangements. Internal audit offices should have adequate resources, independence, access to all bank data and direct access to the Supervisory Board Audit Committee.</p>
<b>Criterion D.3</b>	<p>The bank should maintain reliable systems and controls for identifying, measuring, monitoring, and managing transactions with related parties, including upstream and downstream entities and controlling or significant shareholders.</p> <p>All business dealings with related parties should be at fair market value and</p>



	<p>on arm's length basis and be in the interests of all stakeholders, including shareholders, creditors and depositors, etc.</p> <p>Banks should not be permitted to control or participate in non-financial activities either directly or indirectly.</p>
<b>EXTERNAL FACTORS</b>	
<b>SECTION E</b>	<b>BANKING SUPERVISION</b>
<b>Criterion E.1</b>	<p>The banking supervisor should have the legal authority to impose corporate governance requirements on banks where necessary.</p> <p>The supervisor should also issue corporate governance guidelines to banks on desirable corporate governance policies, practices and structures and should have an established process to evaluate banks' corporate governance.</p>
<b>Criterion E.2</b>	<p>The supervisor should apply a "fit and proper" test to members of a bank's supervising board, senior managers and controlling and other significant shareholders, and should have the authority to remove directors or freeze shareholders voting rights where the tests are not met.</p>
<b>Criterion E.3</b>	<p>The supervisor should approve a list of accepted auditors for banks using transparent criteria.</p> <p>The supervisor should meet with each bank's external auditors on a regular basis, including periodically without the bank being present.</p> <p>The supervisor should also evaluate each bank's internal controls and risk management systems.</p>
<b>Criterion E.4</b>	<p>The law should precisely define related-party transactions and the supervisor should issue regulations to establish limits and methods of monitoring related-party transactions.</p>
<b>Criterion E.5</b>	<p>The supervisory authority should maintain regular contact (at least annually) with each banks Supervisory Board. They should meet the Board without management being present.</p>



<b>SECTION F</b>	<b>EXTERNAL AUDITORS</b>
<b>Criterion F.1</b>	<p>Bank financial statements should be audited by an independent external auditor at least annually.</p> <p>Audits should be performed using International Standards of Auditing (ISA).</p> <p>All approved banking auditors should be certified by the professional audit body.</p>
<b>Criterion F.2</b>	<p>The audit firm should be sufficiently independent of the bank to ensure a fair and objective audit. Banks should be required to rotate their external audit firm on a periodic basis. A five year rotation maximum is recommended.</p> <p>Audit and non-audit services should be separated so that the non-audit services do not compromise the independence of the audit.</p>
<b>Criterion F.3</b>	<p>Auditors should have the legal obligation to report immediately to the supervising board of the bank and the supervisor any concerns they may have relating to breaches of laws or regulations by the bank, non-compliance with the bank's risk management policies or internal controls or issues that could impact negatively on the bank's solvency or liquidity.</p>
<b>Criterion F.4</b>	<p>The engagement letter for the external audit should be approved by the audit committee of the supervising board. At the end of the external audit process, the auditor should prepare a management letter, to which the bank's management should prepare a formal response. The management letter and management's responses should be reviewed by the Board audit committee and should be presented to the supervisor after review by the Board Audit Committee along with the Audit Committee's formal conclusion.</p>
<b>SECTION G</b>	<b>PUBLIC DISCLOSURE &amp; MARKET DISCIPLINE</b>
<b>Criterion G.1</b>	<p>Banks should be required to prepare financial statements in accordance with international accounting standards such as the International Financial Reporting Standards (IFRS). Where disclosed data is not in accordance with these accounting standards, the supervisory agency should have the authority to set additional requirements.</p>
<b>Criterion G.2</b>	<p>Banks should be required to prepare and publish annual reports covering:</p>





Criterion I.2	The host supervisor of a foreign banking branch should issue guidelines regarding its expectations concerning the corporate governance of local branches of foreign banks.

**Section J: SPECIAL ISSUES RELATING TO GOVERNMENT-OWNED OR CONTROLLED BANKS.**

**Criterion J.1** The Government should set out clearly the purpose for its ownership of the bank so that the Board and Management can develop an appropriate medium-term strategy for the bank.

**Criterion J.2** All Supervisory Board members and senior managers of a government owned or controlled bank should meet the same criteria of being ‘fit and proper’ persons for their positions as Board members and managers of privately-owned banks.

**Criterion J.3** The responsibilities of Supervisory Board members and senior management in these banks should be identical to the responsibilities in a privately-owned bank. Their main responsibility is to act in the interests of the bank. Where this may diverge from some of the interests of the government, the Board should inform the shareholder but must continue to act in the interests of the bank.



## **Annex II**

### **Corporate Governance Practices Highlighted in the Basel Committee's Consultative Document**

The Consultative Document of the Basel Committee identifies eight key corporate governance practices for banks. They are:

- 1) Establishing strategic objectives and a set of corporate values that are communicated throughout the banking organization;
- 2) Setting and enforcing clear lines of responsibility and accountability throughout the organisation;
- 3) Ensuring that (supervising) board members are qualified for their positions, have a clear understanding of their role in corporate governance and are able to exercise sound independent judgment about the affairs of the bank;
- 4) Ensuring that there is appropriate oversight by senior management;
- 5) Effectively utilising the work conducted by internal and external auditors, as well as other control functions, in recognition of their critical contribution to sound corporate governance;
- 6) Ensuring that compensation policies and practices are consistent with the bank's ethical values, objectives, strategy and control environment;
- 7) Conducting corporate governance in a transparent manner; and
- 8) Maintaining an understanding of the bank's operational structure, including operating in jurisdictions, or thorough structures, that impede transparency (i.e. "know-your-structure").



National Bank of Serbia

# CONSUMER INFORMATION AND EDUCATION

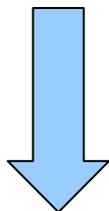
**DEJAN SIMIĆ**  
**ADVISOR TO GOVERNOR**

**Second Technical Meeting on Regional Host Supervisory Cooperation**  
**Vienna, 29 November 2006**



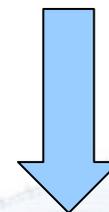
# ROLE OF THE NBS IN CONSUMER INFORMATION AND EDUCATION

## VISION



Build a modern, efficient and safe financial system to ensure high-quality financial services provided by banks, as well as by insurance companies, leasing companies and voluntary pension funds

## STRATEGIC GOALS



Ensure a safe and sound financial system to protect the interests of users of financial services, to strengthen the public confidence in the financial sector, and to ensure efficient servicing of needs of citizens and the economy alike



# WHAT HAS THE NBS OBSERVED?

- **lack of transparency**
- **insufficiently educated customers**
- **ill-informed customers**
- **inadequate information on loan conditions provided by banks to their clients**
- **active marketing activities of banks in selling loans**





# ACTIONS TAKEN BY THE NBS

- Introduction of rules on calculating and disclosing the effective interest rate on loans and deposits (real costs of loans) – applied as of 15 March 2005
- First stage of inspection – compliance with the rule on disclosing the effective interest rate in a clear and conspicuous manner in advertisements
- Second stage of inspection – on-site examinations
- Sanctions - public statements issued by the NBS naming the banks which failed to comply with the rules (no legal possibility for other sanctions at that time)



# REACTION OF BANKS

- Banks claimed:
  - clients are well-informed
  - clients are educated in financial products
  - NBS is interfering with the business policy of banks
  - consumer education and protection is not the role of the NBS





# WHAT ELSE HAS THE NBS OBSERVED?

“Creativity” of banks in by-passing the NBS rules:

- effective interest rates disclosed in a non-conspicuous manner
- bank advertisements without naming the currency to which a loan or deposit is indexed
- retail price index used for revaluation of loans without additional explanation to clients
- unilateral changes of loan conditions by banks
- increase of interest rates on all loans using as excuse the increase of mandatory reserve requirement on short-term foreign borrowings of banks
- exchange rate on FX-indexed loans applied only in one direction - at the expense of borrowers (appreciation of dinar)
- maximum exchange rate margins for disbursement and repayment of loans – at the expense of borrowers

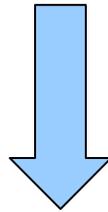


## FURTHER ACTIONS OF NBS

- Amendments to the Decision on Effective Interest Rate – clearly specifying what is expected of banks in terms of information provided to clients (indexation, revaluation method, clear and noticeable display of all elements,...)
- Statements issued by the NBS to inform the public about (non)transparent behaviour of banks
- New Law on Banks introduced fines for non-compliance with the effective interest rate rules – as of 1 October 2006
- Meetings with banks and the Association of Serbian Banks
- Codex of Professional Behaviour of Banks towards Clients – role of the Association of Serbian Banks



*NBS received numerous complaints from users of financial services against banks, insurance companies and leasing companies*



*Activities on further education, information and “integrated protection of clients” of all financial institutions supervised by the NBS (Centre for Protection of Clients of Financial Institutions)*

# ACTIVITIES OF THE NBS

- **CALL CENTRE** – started operation on 31 October 2005
  - **ACTING ON COMPLAINTS** – practice + draft regulation
  - **MEDIATION** – started in December 2005 for insurance companies; draft regulation for banks
  - **CODEX** - professional behaviour of banks
  - **OMBUDSMAN** – should be introduced
- 



# NBS CALL CENTRE

## 0800-111-100 (toll-free)

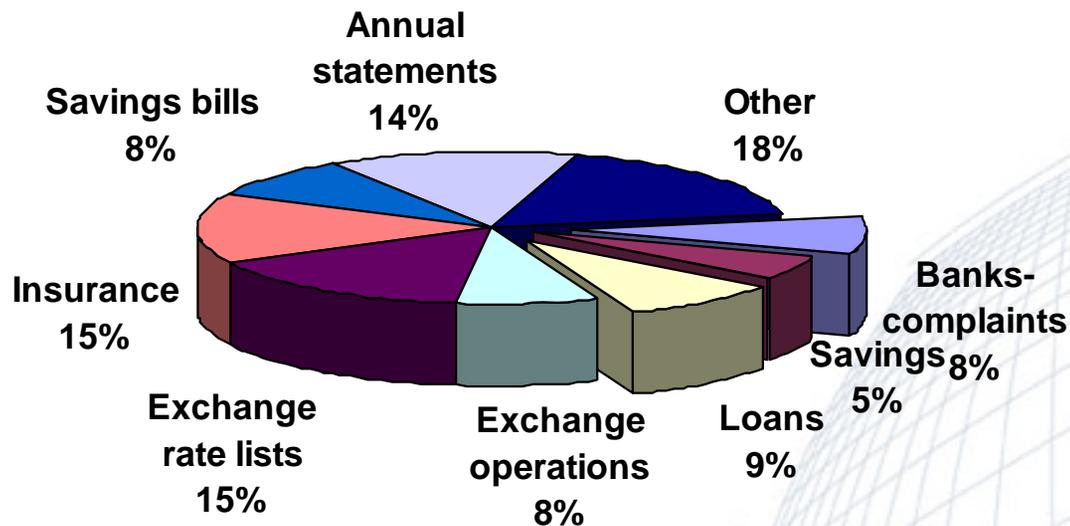
*NBS Call Centre provides information on:*

- different banking services (loans, deposits, etc.)
- NBS savings bills
- exchange transactions
- possibilities of downloading financial statements and financial data
- certification procedure for insurance agents and brokers
- rights of damaged parties
- filing complaints with the NBS
- exchange rate lists
- and other

*NBS Call Centre replies within 48 hours*



# CALL CENTRE JANUARY-OCTOBER 2006



<b>Banks-complaints</b>	1129
<b>Savings</b>	704
<b>Loans</b>	1245
<b>Exchange operations</b>	1070
<b>Exchange rate lists</b>	2144
<b>Insurance</b>	2128
<b>Savings bills</b>	1161
<b>Annual statements</b>	1958
<b>Other</b>	2440
<b>Total</b>	<b>13979</b>



# PROCEDURE FOR ACTING ON COMPLAINTS

- 1) CLIENT – first lodges a complaint with the financial institution (prerequisite for addressing the NBS)
- 2) CLIENT - if the response of the financial institution is unsatisfactory or not received by client, complaint may be lodged with the NBS
- 3) NBS - sends a letter to the financial institution (request for explanation) and notifies the client
- 4) FINANCIAL INSTITUTION – replies to the NBS
- 5) NBS – informs the client of the reply

The procedure is finished within 30 days from the date of receipt of the client's complaint (possibly with a proposal for mediation)



# MEDIATION BY THE NBS

- Initiation of the mediation procedure:
  - by the client – unsatisfied with the financial institution's reply,
  - by the NBS – if it finds that the disputed issue may be solved through mediation
- Requirements - mutual consent of the parties
- Mediation is managed by a professional mediator
- If the parties agree – a written agreement is concluded
- Mediation organized by the NBS – free of charge



# CODEX

- Codex of professional behaviour of banks towards their clients
- Draft prepared by the Association of Banks
- NBS made many comments





# OMBUDSMAN

- Should it take over the function of the NBS in consumer protection?
- Necessary legal regulations should be put in place
- Assistance by the Convergence Programme!





# Establishing a “Banking Ombudsman” in Romania

## Summary of Preliminary Findings

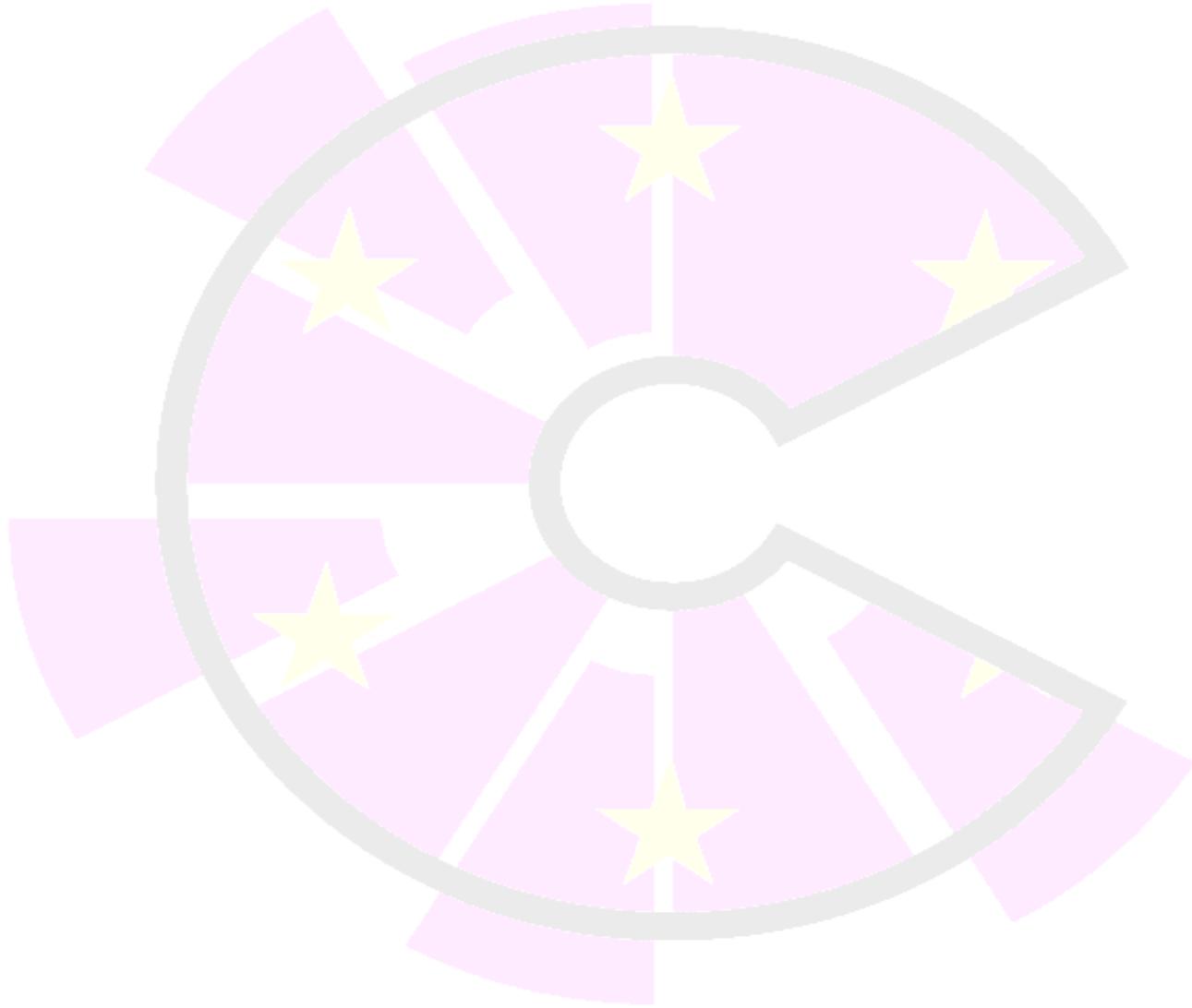
2<sup>nd</sup> Technical Host Supervisor Meeting  
Vienna, November 29, 2006

# The Assignment

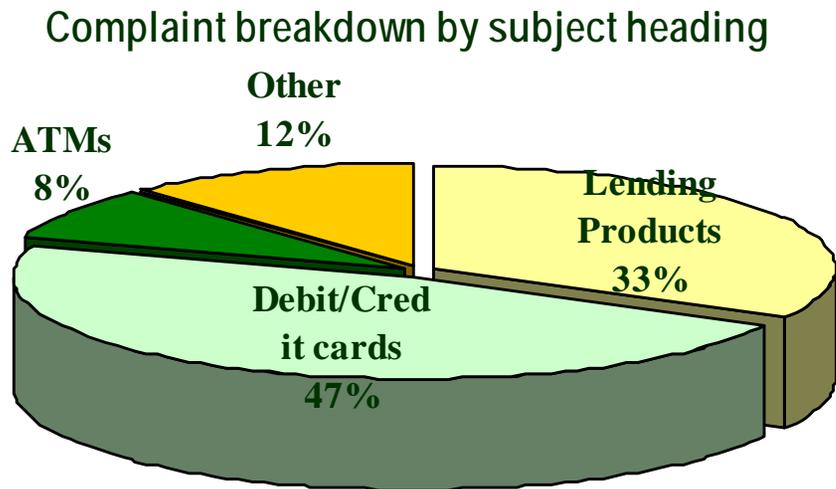
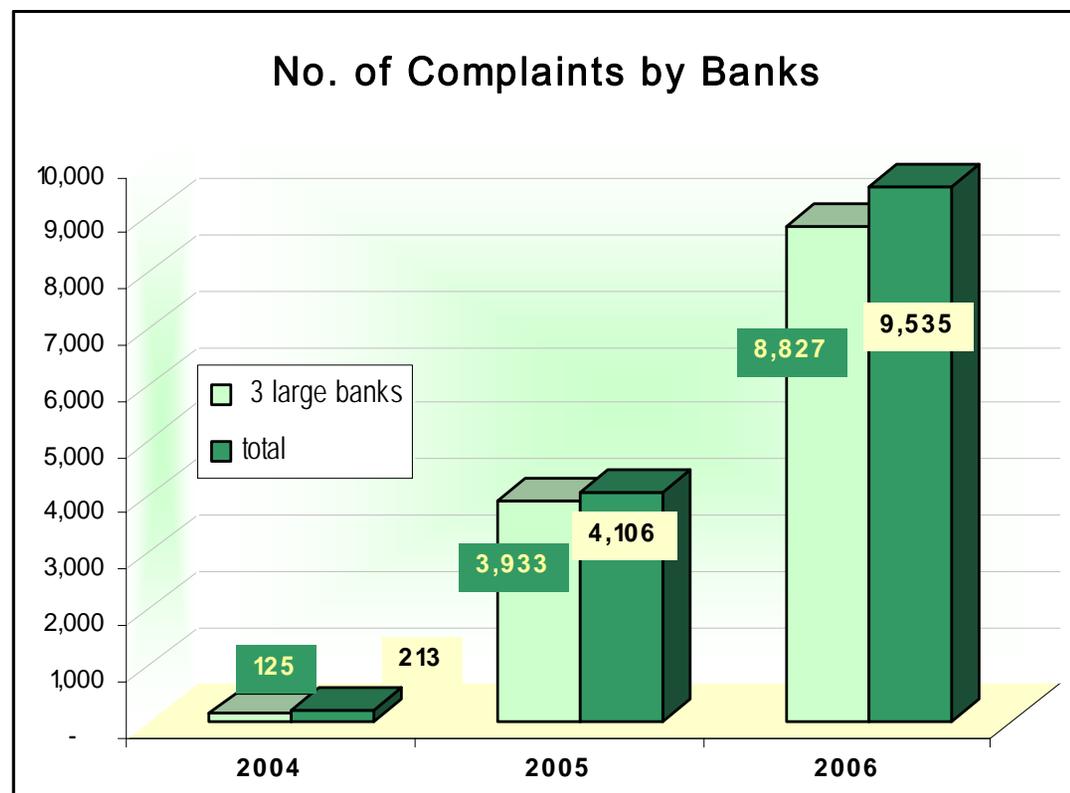
**SPI Committee has asked the Convergence Program to prepare a background study on how to set up a Banking Ombudsman (BO) in Romania:**

- to address adequately the complaints from individuals/businesses against banks,
- to improve the public image of banks,
- to protect banking customers,
- to ensure an informal out-of-court alternative

# Main Complaint Examples



# Analysis of Survey Findings



Insufficient docs by clients  
 >55%: customers' lack of banking knowledge/ info.  
 Conclusion: "consumers' education and protection is urgently required"

# Analysis of Consumer Protection

Present channels to address complaints:

- service providers
- consumer protection bodies/regulators
- courts

**Survey** conducted from consumer and banks perspective

- observation: flaws and deficiencies in complaint tracking systems
  - unable to respond, poor complaint collection, controversial data
- banks have in-house systems, but only 42% of customers are aware of this!
- banks report “effective” systems, but consumers have a “weak” perception!

# Bank Ombudsman

## Governing Principles

- ✓ **Objectivity & independence**
- ✓ **Accessibility**
- ✓ **Consistency**
- ✓ **Timeliness**
- ✓ **Courtesy**
- ✓ **Reasonableness, clarity & accuracy**
- ✓ **Confidentiality**
- ✓ **Quickness**
- ✓ **Informality**

### **Eligible complainants**

A consumer usually =:

- *an individual,*
- *a self-employed (professional),*
- *a small business.*

# Scheme Mandate & Organization

- **Public & statutory schemes**: owned and run by CB/regulators/boards (UK); funding from CB + budget/industry
- **Private, voluntary** set up by BAs, designed in industry's interest & funded by BAs budget
- Germany and Italy: BOs not registered as legal entities, admin. functions run by BA.
- **hybrid schemes\***, with separate legal entities, funded by ind. (cost-sharing method)
- **By-laws & ToR** set out governance structure

# Governance Structure

## **By-laws define:**

- Board meeting rules, voting rights, election, power & responsibilities of officers.

## **TOR define:**

- scope of BO, principal powers and duties of BO,
- members' rights & obligations, BO complaint rules.

## ***Fundamental functions of Board***

- A. create public confidence in the process;
  - B. ensure appropriate management & funding;
  - C. approve ToR, budget, calculate member fees
  - D. appoint Ombudsman;
- Ombudsman accountable only to Board. Board plays no role on specific complaints.

# Bank Ombudsman's Powers and Duties

- ✓ consider disputes within ToR,
- ✓ advise public on complaint procedures,
- ✓ issue bulletins on banking practice,
- ✓ ask parties to provide necessary info.,
- ✓ implement procedures, issue decisions,
- ✓ decline a dispute if outside ToR, etc.,
- ✓ dismiss a complaint,
- ✓ prepare/publish dispute resolution proced.,
- ✓ publish Annual Report.

# Bank Ombudsman Jurisdiction

## Disputes within ToR

- Complaints after passing bank's internal resolution
- Complaints incl. offering, providing of a bank product/service to consumers or breach of privacy
- any complaint up to a limit amount (most EU - €50K).

## Disputes outside ToR

- about banks not affiliated to BO's schemes
- not first considered by the bank
- outside various time limits
- about systemic issues
- considered previously by BO
- more appropriately dealt with another forum
- where the claim exceeds limit amount

# Rights & Obligations of Members

## ***Member banks shall:***

- act within ToR, BO Rules, law & ind. codes
- provide to BO any information required;
- promote to clients BO membership;
- display Banking Code, etc.;
- pay membership fee or/and service fees;
- comply/enforce BOs decision to take action.

## ***Member banks shall not:***

- resort to litigation while being in a BO procedure;
- prevent a customer from using BO services;
- provide BO with misleading info.

# Bank Ombudsman's Summary Profile

## *What BO can do?*

- provide an independent and fair alternative to the court, free to customers
- help parties see options for agreement/solution
- keep service confidential
- quality and consistency of complaint process
- make decisions binding to bank up to limit amount
- decide on individual cases,
- encourage best practices

## *What BO Cannot Do*

- be a regulator /"watchdog"
- play the advocate for parties
- accept complaints before lodged first with banks
- deal with systemic issues
- make management decisions
- provide assistance on issues in litigation, arbitration, etc.
- force customers to accept its decision\*
- provide general information on banks/banking services

# Recommendations

RBA consult with members & NBR to establish Bank Ombudsman

## ***A) To determine the scheme status:***

Voluntary/compulsory, private/government-run.

## ***B) How To Safeguard Ombudsman's independence***

- i. Creation of independent governing body
- ii. Conclusion of a binding ToR
- iii. Assurance of Ombudsman qualifications, O appointment
- iv. To upgrade & promote banks' in-house complaint-settlement schemes,
- v. To design a strategy to increase consumer awareness
- vi. To design and adopt the Banking Code

# BO Benefits- consumers' perspective

- Benefits are double: in-house complaint offices and an independent third party redress body,
- BOs impartiality, objectivity, etc. encourages consumers to bring more business to banks,
- Benefit from application of common standards,
- Free service & binding BO rulings on banks,
- Difficulties in court discourage consumers,
- Discourage use of legal rep., reducing costs,
- A less bureaucratic and jargon-free,
- No risks for consumers- still free to go to a court<sub>14</sub>

# BO Benefits- bank's perspective

- “Conciliation is better than litigation” due to high costs/reputation problems
- Costs banks pay per case to BO are lower than costs in court.
- Better customer retention rates (bank has options to rectify errors/improve relations).
- BO publishes case studies, as educational materials for consumers/banks

# This Is A “Convergence” Review

**“Convergence”**<sup>1</sup> is a World Bank-sponsored financial sector development program for South-East Europe focused on:

- Undertaking analytical tasks of micro-institutional issues calling for solutions tailored to country circumstances
  - Taking EU integration as a strategic perspective
  - Building awareness of market participants and involving them in the search of market-building solutions
  - Fostering dialogue between authorities and market participants to identify workable solutions in local context
  - Using the experience of regional former policy makers and experts whenever possible
- 1/ “Convergence” is supported by a grant from Italy’s Ministry of Economy and Finance



## Second Regional Host Supervisory Cooperation Technical Workshop

Vienna, 29 November 2006

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**Paper Prepared by:**

**Elena Georgescu, Head of Division, Supervision Department,  
National Bank of Romania**

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### Proposed list ratios

#### Number of Financial Institutions (at year-ends)

Type of Financial Institutions	2003	2004	2005
Commercial Banks			
Branches of Foreign Banks			
Credit cooperatives			
<b>Total Banking System</b>			

#### Ownership Structure of Financial Institutions on the Basis of the Registered Capital (%) (at year-end)

Item	2003	2004	2005
State Ownership			
Other Domestic Ownership			
Domestic Ownership, Total			
Foreign Ownership			
<b>Total Banking System*</b>	<b>100</b>	<b>100</b>	<b>100</b>

\*) excluding Credit cooperatives

#### Ownership Structure of Financial Institutions on the Basis of assets total

Item	2003	2004	2005
Public sector Ownership			
Other Domestic Ownership			
Domestic Ownership, Total			





(at year-ends)

<b>Assets</b>	<b>2003</b>	<b>2004*</b>	<b>2005*</b>
Cash and Claims on Banks			
Net Loans			
Securities			
Fixed Assets and Other Assets			
<b>Total Assets</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Liabilities</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Due to Other Banks and Financial Institutions			
Due to Clients			
Other Liabilities			
Own Capital			
<b>Total Liabilities and Capital</b>	<b>100</b>	<b>100</b>	<b>100</b>

\*) including Credit cooperatives

#### Development of Off-balance Sheet Activities (%) (off-balance sheet items\*/balance sheet total)

<b>Type of Financial Institutions</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Commercial Banks			
Branches of Foreign Banks			
Credit cooperatives			
<b>Total Banking System</b>			

\* commitments in favor of banking and non-banking customers

#### Solvency Ratio of Financial Institutions

<b>Type of Financial Institutions</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Commercial Banks			
Branches of Foreign Banks			
Credit cooperatives			
<b>Total Banking System</b>			

#### Asset Portfolio Quality of the Banking System

Mill EUR

<b>Asset Classification</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Standard			
Watch			
Substandard			
Doubtful			
Loss			
Classified Total			
Specific Reserves			

According to the classification statement of Commercial Banks



**The Structure of Deposits and Loans in 2005 (%)**  
(at year-end)

	<b>Deposits</b>	<b>Loans</b>
Households		
Government Sector		
Corporate		
Foreign		
Other		
<b>Total</b>	<b>100</b>	<b>100</b>

**The Structure of Deposits and Loans and commitments in 2005 (%)**  
(at year-end)

<b>Maturity of Deposits</b>	<b>Loans and commitments</b>	
At sight	Short-term	
Within one year	Medium-term	
Over one year	Long-term	
<b>Total</b>	<b>100</b>	<b>Total 100</b>

**Proportion of Foreign Exchange Assets and Liabilities**  
(at year-ends)

<b>Type of Financial Institutions</b>	<b>FOREX Assets/Total Assets</b>			<b>FOREX Liabilities/Total Liabilities</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Commercial Banks						
Branches of Foreign Banks						
Credit cooperatives						
<b>Total Banking System</b>						

\*The figures about off-balance Foreign Exchange sheet items are not available

**Structure of Revenues and Expenditures of Financial Institutions**  
(at year-end)

<b>Revenues</b>	<b>2003</b>	<b>2004*</b>	<b>2005*</b>
Interest Income			
Income from Securities Transactions			
Recoveries from Provisions			
Income Not Derived from Interest			
Extraordinary Income			
<b>Expenditures</b>	<b>2003</b>	<b>2004*</b>	<b>2005*</b>
Interest Expenses			



Expenses for Securities Transactions  
Provisions Expenses  
Expenses, Other Than Interest  
Extraordinary Expenses  
Profit Tax

\*) including Credit cooperatives

### Structure of Registered Capital and Own Funds of Financial Institutions in 2005

Type of Financial Institution	Registered Capital Mil. EUR	/Total Assets %	Own Funds Mil. EUR	/Total Liabilities %
Commercial Banks				
Branches of Foreign Banks				
Credit cooperatives				
<b>Total Banking System</b>				

\* own capital



## **Second Regional Host Supervisory Cooperation Technical Workshop**

Vienna, 29 November 2006

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**Paper Prepared by:**

**Igor Davkov, Director, Supervision Department,  
National Bank of the Republic of Macedonia**  
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### **Information sharing (Host Supervisor Cooperation)**

#### **Qualitative Assessment**

The issues related to foreign bank subsidiaries Qualitative Assessment can be divided in two major groups:

1. Banks' Corporate Governance; and
2. Banks' Risk Management Policies and Practices;

#### **1. Banks' Corporate Governance**

From a financial industry perspective, corporate governance involves the manner in which the business and affairs of banking groups are governed by their Boards and senior managements, affecting how banks within the group:

- Set corporate objectives;
- Manage the day-to-day operations of the business;
- Consider the interests of recognized stakeholders;
- Align corporate activities and behaviors with the expectation that the banks and banking groups will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and
- Protect the interests of depositors.

With respect to banks' corporate governance, bank supervisors must understand how the Board and Management conduct the banks' affairs and daily activities. Issues to be taken into consideration by the supervisors when discussing about banks corporate governance on a banking group and stand alone basis could be the following:

- How the strategic goals of the banks are defined, and are these goals in line with the parent bank's and the banking group's strategic goals;



- In line with the established strategic goals what are the primary targeted market segments, type of clients and financial services offered;
- Issues related to the responsibilities and authorities in decision making process from the aspect of the defined corporate governance structure by the parent bank;
- How the daily activities of the banks are managed and what is the level of parent bank involvement;
- How the relations among the Management, the Board and the Auditors of the bank are defined;
- Has the banking group succeeded in developing code of ethics and other standards of “good behavior” for all employees and how these standards have been implemented in practice by the subsidiaries;
- Issues related to banks' adherence to established market standards and compliance with prudential norms and other laws and regulations; and
- Issues related to established information systems for public disclosure.

## 2. Banks' Risk Management Policies and Practices

The parent bank should ensure that the subsidiaries have established policies, procedures and controls to manage the various risks these banks face with. As banking becomes more complex, it is all the more important that banks have in place a comprehensive risk management process to identify, measure, monitor and control the various types of risk with which they are faced and, where appropriate, to hold capital against them.

It is the responsibility of the Board to approve and periodically review the risk management strategies and policies of the bank to ensure that they remain adequate and consistent with the bank's operating environment. This should not be done merely for formal purposes i.e. simply to satisfy the requirements of the regulator, but rather, such policies should dictate how the day-to-day operations of the bank are actually managed in practice.

We can recognize that the Board of a bank which is a subsidiary of another banking institution may operate in an environment which is different from that of an independent bank. Key functions and policies are usually determined and centralized at the parent bank level. As the subsidiary is a separate legal entity, however, its directors are not absolved from the responsibility for policies and actions that are applied by the parent bank to the bank. As we know the Board of the subsidiary is ultimately responsible for the approval and monitoring of the implementation and effectiveness of all bank group policies applied to the bank. The Board should therefore review such policies as if they were its own. If the Board is not satisfied that the policies are appropriate to its circumstances, it should notify the parent bank and discuss appropriate modifications.



With respect to bank's risk management, it requires the supervisors to understand whether the Board and Management have established adequate risk management process i.e. whether they have developed proper tools to identify, measure, monitor and control the risks to which they are exposed. Issues to be taken into consideration by the supervisors when discussing about banks' risk management on a banking group and stand alone basis could be the following:

- Issues related to defined risk mission and risk objectives of the parent bank and the subsidiaries;
- Issues related to how banks identify, measure and control risks inherent in their activities or embedded in their portfolios and disseminate the risk philosophy and policies
- Issues related to how banks assist risk-taking business units in understanding and measuring risk/return profiles and develop risk and control infrastructure;
- Issues related to organization of risk management process on a bank group basis and individual stand alone basis i.e. on bank subsidiary basis;
- The role of the specialized board committees, such as the Audit Committee, Risk Management Committee and other committees in the risk management process and risk management policies and systems and the extent to which these are operating effectively;
- Issues related to possible bank functional areas for which supervisors have identified that risk management policies lack;
- Issues related to risk management policies and their implementation related to:
  - composition of assets and liabilities, including those off-balance sheet;
  - maintaining an appropriate minimum capital adequacy ratio;
  - maintaining adequate liquidity to meet expected and unexpected cash needs;
  - limiting exposure to maturity mismatch, and to interest rate, foreign exchange rate and other market risks; and
  - limiting concentrations of exposures, both to individual borrowers, and to economic sectors; and
- Issues related to risk reporting and disclosure.



**Bank of Albania**  
**Regional Financial Market and**  
**Financial Stability Conference**  
**Tirana 30-31 October 2006**

# Regional Host Supervisor Cooperation

Why Is It Desirable and How To Make It Happen?

**Franco Bruni, Peter Nicholl & Luigi Passamonti**  
**“Convergence” Program**

# International coordination in European banking supervision

- Second Banking Directive (1988): *host-home/branch-subsidiary, with exceptions and the general good clause*
- *further steps* with the Banking Consolidation Directive (1992) and with
- CAD: 1993, 1998, 2005: *consolidated supervisor*
- Recently: *strengthening the consolidating supervisor approach* (see over)

# Strengthening the consolidating supervisor approach

- Lead supervisor model
- Lead supervisor with an EU mandate
- Single European super-national supervisor
- Harmonisation (from Lamfalussy to CEBS, in particular with CAD)
- European Company Statute

# The limits of a within-EU approach

- Trying to tackle supervisory coordination issues in a purely within-EU manner...
- ... contrasts with the wide ***extra-EU activity of several EU banks*** and underestimates the ***interests of extra-EU countries*** and of the valuable contribution that can be offered by ***their authorities*** in improving the stability, the efficiency and the correctness of international banking
- A unified EU internal supervisory structure is needed...
- ... but success depends also on integration with, say, US, China and ... SEE (all the “still” non-EU Europe)!
- EU coordination to be conceived in an ***“open fashion”***

# Special issues

*(here, there and everywhere!)*

- The role of central banks
- Anti-trust
- Stability vs transparency and correctness
- Burden-sharing and fiscal authorities in bailouts (with and without explicit deposit insurance)

# Three actors in home-host relationships

- *Multinational banks, home authorities and host supervisors*
- A triangular relationship
- But ***host-host*** relations should also be considered, and will end up to be a crucial step in the solution of triangular problems!
- Each actor has ***legitimate claims*** (assets) and ***possible sins*** (liabilities) in the ideal balance-sheet of the triangular relationship
- The following is an ***“a-priory” list of claims*** and sins, a check list of issues to be researched in a ***case-by-case*** fashion (as the “Convergence” project has started to do) and ***proposed for consideration to an indispensable host-host cooperation programme***

# Multinational Banks

## *Legitimate claims*

- “one-stop preference”
- centralisation of strategic risk management and economies of scale and scope in their international organisation

## *“Possible Sins”*

- potential disregard towards the information needs of host authorities
- potential disregard of the quality (and nationality) of the subsidiary’s corporate governance
- moral-hazard, risk shifting and regulatory arbitrage (host-host contagion risks to be evaluated and monitored)

# Home Supervisor

## **Legitimate claims**

- all the information required to the *consolidating supervisor* ...
- ... preferably via the subsidiaries via the home headquarters
- cooperation of host supervisors with sufficient *confidentiality* and secrecy on the jointly collected information
- Final say in Basel II model validation

## **“Possible Sins”**

- tries to minimise the information released on the parent bank to the host supervisor
- potential disregard of the systemic risk in the host country when the subsidiary is small in the group, even if large in the host country
- resist the creation of central supra-national supervisors that could facilitate the solution of home-host issues (often the cause is the burden sharing problem in case of crisis: “he who pays the piper calls the tune”)

# Host Supervisor

## Legitimate claims

- *systemic risk in the host financial system* taken into account internationally even when of limited international relevance
- transparency of information for *licensing*
- transparency of multi-country *ownership chains*
- Information on *other subsidiaries* hosted elsewhere
- local availability of information on the banking group *overall risk strategy*
- *corporate governance* requirements
- a role in *Basel II validation* process

## “Possible Sins”

- suspected *hostility towards foreign ownership* of banks
- suspected insufficient *independence from local political pressures* in favour of special interests
- suspected unreliability in keeping pieces of *confidential information* released by home authorities
- suspected insufficient *technical competence* and efficiency
- inability to be clear and precise in *asking information* to the parent bank and to the home authorities
- tendency to confuse the instruments of prudential policy with those of monetary policy in a general tendency of using *non-market-friendly* methods of interference with bank management
- suspected resistance and inability in setting up the ***host-host cooperation*** needed to effectively present their legitimate claims to the international authorities and multinational banks

# Key Host Supervisor Issues

- How can it enforce its “legitimate claims” vis-à-vis home supervisors and multinational banks?
  - Very asymmetric relationships
- How can it be forgiven of its “possible sins”?
  - To build up reputational capital

➤ A collaborative host approach could help

# Regional Host Supervisor Cooperation

Vienna September 13 Technical Seminar

## Participants

- Bosnia and Herzegovina
- Macedonia
- Montenegro
- Romania
- Serbia

## Secretariat

- Convergence Program  
(Franco Bruni, Peter Nicholl & Luigi Passamonti)

## Apologies

- Albania
- Bulgaria
- Croatia

## Agenda

- Review of “Convergence” survey of regional supervisory practices and concerns
- Harmonizing Host-Home-Head Office reporting requirements – Romania’s example
- Discussion of headline policy issues
  - Market concentration
  - Profitability trends
  - Group risk management

# An Overarching Conclusion

- Host supervisors believe that a common understanding of regional activities of international banks could be beneficial
  - To reduce informational asymmetries with international banks and home supervisors
    - Legal entity activities framed in group context
  - To calibrate prudential actions given regional context developments
  - To exercise proportionate supervisory activities over local subsidiaries

# How To Frame Host Cooperation

Two possible sets of criteria

- What could the focus of host cooperation be?
  - Non-traditional policy goals
  - Choice of instruments
  - Implementation challenges
- How could host cooperation be organized?
  - “Quick wins”
    - Building longer-term momentum
    - External support and recognition
  - Through a co-operative structure
    - Regular working meetings

# Priority Policy Issues of Regional Interest

Vienna September 13 Technical Seminar

- Governance and management arrangements
  - ***Board composition***
  - ***HQ outsourcing***
- Competition and concentration issues
  - ***Assessment and possible remedial measures***
- Risk profiles and contagion scenarios
  - ***Household lending and interest spread compression***
- Consumer protection
  - ***Bank Ombudsman***
- Prudential information sharing
  - ***Qualitative and quantitative comparable data***

# Instrument Choice

Vienna September 13 Technical Seminar

## Cooperation could help with instrument choice

- Peer review of nature and implications of issue to address
- Benchmarking with international and regional experiences
- Use of international norms and practices
- Analysis of suitable legal and regulatory approaches

# Implementation Options

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## Cooperation could help with implementation challenges

- Sharing of experiences on:
  - Enforcement challenges
  - Coordination with other domestic institutions
  - Role of self-regulation
  - Influence over bank HQs
  - Support from home supervisors

# Longer-Term Momentum

- Progress on “quick wins” could trigger larger-scale technical work to develop a comparable approach to prudential and market-building regulatory approaches
- Working groups may evolve into a regional discussion and coordination forum

Next Regional Technical Seminar: November 29, 2006

# Regional Host Supervisor Cooperation

## Broader Public Benefits

- Regional financial stability
- More meaningful home supervisor dialogue
- More standardized bank products and services for clients
- Better operating conditions for financial institutions
- Early phased integration with EU procedures
  - CEBS

# External Support Needed

- Home supervisors
  - could encourage better host preparedness to form a common supervisory approach
- International organizations and fora
  - Sharing of collaboration templates
- International banks
  - More understanding for host supervisor needs may result into lower compliance costs

# Convergence Program Support

- Acts as catalyst for regional cooperation
- Provides technical support on new market-building prudential challenges
- Makes an analytical person available to support a regional co-ordination leader
- Helps shape a common interface with home supervisors

# “Convergence”

**“Convergence”**<sup>1/</sup> is a financial sector development program for South-East Europe focused on:

- Undertaking, as an “honest broker”, analytical tasks of micro-institutional issues as a basis for identifying solutions tailored to country circumstances
- Taking EU integration as a strategic perspective
- Building awareness of market participants, involving them in the search of market-building solutions, and fostering their dialogue with authorities
- Using the experience of regional former policy makers and local experts whenever possible
- Working in partnership with other institutions

# PROGRAM

6th International Conference of the Bank of Albania



## Regional Financial Market and Financial Stability

A concept between national sovereignty and globalization

Hotel "Sheraton" Tirana, Albania, October 30 – 31, 2006

### Monday, October 30, 2006 – Morning Session:

**08.30 - 09.00** Registration

**09.00 - 09.30** Opening Addresses

**Ardian Fullani** – GOVERNOR OF THE BANK OF ALBANIA - WELCOME SPEECH  
**Sali Berisha** – PRIME MINISTER OF THE REPUBLIC OF ALBANIA - GREETING SPEECH  
**Lorenzo Bini Smaghi** – MEMBER OF THE EXECUTIVE BOARD, EUROPEAN CENTRAL BANK – SPEECH (RECORDED)

**09.30 - 10.45** First panel: "Is there a regional financial market developing?"

CHAired BY **MR. ARDIAN FULLANI** – GOVERNOR OF THE BANK OF ALBANIA  
**Antonio de Lecea** – European Commission "Prospective EU membership - catalyst for financial integration in the South-East European region"  
**Andrew Spindler** – Financial Services Volunteer Corps - "The development of financial markets in the Balkans: An assessment of regional progress"  
**Evan Kraft** – Croatian National Bank and **Marko Škreb**, Former Governor of the Croatian National Bank - "How financially integrated are the Western Balkans? Preliminary analysis and policy issues".

Floor Discussions

**10.45 - 11.00** Coffee Break

**11.00 - 12.30** Second panel: "The role of commercial banks in financial stability; national and supranational levels"

CHAired BY **MR. SEYHAN PENCAPLIGIL** – CHAIRMAN OF THE ALBANIAN ASSOCIATION OF BANKS  
**Giuseppe Cuccurese** – San Paolo IMI – "Financial stability in transforming economies: the role of foreign banks"  
**Agis Leopoulos** – National Bank of Greece – "Commercial banks: Major contributors to financial stability".  
**Steven Grunerud** – Raiffeisen Bank Albania  
 Floor Discussions

**12.30 - 14.30** Lunch

### Monday, October 30, 2006 – Afternoon Session:

**14.30 – 16.00** Third panel: "Financial Stability and Surveillance"

CHAired BY **MR. RIDVAN BODE** – MINISTER OF FINANCE  
**Sean Craig** – International Monetary Fund – "The expansion of foreign-owned banks in emerging Europe: implications for surveillance"

**Boštjan Jazbec** – Bank of Slovenia – "Who supervises whom? The role of national financial regulators"

**Valentin Lazea** – National Bank of Romania – "Enhancing financial stability through banking supervision: the case of Romania"

**Klodian Shehu** – Bank of Albania – "Recent developments in the Albanian banking sector and challenges for the future"

Floor Discussions

**16.00 - 16.30** Coffee Break

**16.30 - 18.00** Fourth panel: "Monetary policy and stability"

CHAired BY **MR. MUGUR ISARESCU** – GOVERNOR, NATIONAL BANK OF ROMANIA  
**Mehmet Yörükoğlu** – Central Bank of the Republic of Turkey – "The role of financial stability for the conduct of monetary policy"  
**George Demopoulos** – Bank of Greece – "Monetary Policy and Financial Stability"  
**Vit Barta** – Czech National Bank – "The interactions between the monetary policy and financial stability: Czech experience and lessons"  
**Istvan Szekely** – International Monetary Fund - "Macroeconomic policies and financial stability in SEE: Is Albania different?"  
 Floor Discussions

### Tuesday, October 31, 2006 – Morning Session:

**9.00 - 10.30** Fifth panel: "Issues in Financial Supervision"

CHAired BY **MR. MARKO ŠKREB** – FORMER GOVERNOR OF THE CROATIAN NATIONAL BANK  
**Luigi Passamonti** – World Bank, **Franco Bruni** – Bocconi University, Italy and WB-Convergence Program and **Peter Nicholl**, Member of the Governing Board, Central Bank of Bosnia and Herzegovina – "Host Supervision Issues in South Eastern European Countries: Why is Host-Host Cooperation Desirable and How To Make It Happen?"  
**Allen Frankel** – Bank for International Settlements - "Nontraditional Mortgage Loans"  
**Michael Würz** – National Bank of Austria – "Austria's perspective as a home and host country"  
 Floor Discussions

**10.30 - 11.00** Coffee Break

**11.00 - 12.30** Sixth panel: "Governor's round table: How to work together even better in the future?"

CHAired BY **MR. ARDIAN FULLANI** – GOVERNOR OF BANK OF ALBANIA  
**Mugur Isărescu** – National Bank of Romania  
**Radovan Jelasić** - National Bank of Serbia  
**Kemal Kozarić** – Central Bank of Bosnia and Herzegovina  
**Ljubiša Krgović** – Central Bank of Montenegro  
**Michel Svetchine** – Central Banking Authority of Kosovo  
**Petar Goshev** – National Bank of the Republic of Macedonia  
 Closing of the Conference

**12.30 - 14.30** Lunch