

1992

## Introductory Observations

Joseph J. Norton  
*Southern Methodist University, Dedman School of Law*

---

### Recommended Citation

Joseph J. Norton, *Introductory Observations*, 26 INT'L L. 943 (1992)  
<https://scholar.smu.edu/til/vol26/iss4/5>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in *International Lawyer* by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

**SYMPOSIUM**  
**International Bank Supervision**  
**Post BCCI**

JOSEPH J. NORTON\*

## **Introductory Observations**

As the domestic dust of Parliamentary and independent (Bingham) enquiries and Bank of England bashing subsides in the Bank of Credit and Commerce International (BCCI) debacle, we will undoubtedly see new United Kingdom (U.K.) banking legislation and enhanced U.K. supervisory practices (à la the secondary banking crises and Johnson Matthey affair), as we just have witnessed substantial revisions of the United States (U.S.) banking law and practices under the 1991 Foreign Bank Supervision Enhancement Act (FBSEA). Enhanced supervisory activity and pronouncements will also be apparent within the Basle Committee on Bank Supervision, the European Community, and within the national banking systems of many other jurisdictions.

The pervasive and gnawing dilemma left by BCCI is not primarily a domestic question of bank fraud, money laundering, and bank regulation and supervision. Rather, it is a question of the necessity, nature, and viability of the incipient network of international bank supervision emanating from the Basle Committee of Bank Supervisors and the coordination of this evolving international supervisory framework with the revamped U.S. system of foreign bank supervision, the newly unfolding EC framework, and the yet-to-be enhanced U.K. and other national frameworks.

---

\*Editor-in-Chief, *THE INTERNATIONAL LAWYER*; Cameron Markby Hewitt Professorial Fellow in Banking Law at the Centre for Commercial Law Studies, University of London; Professor of Law, Southern Methodist University; Of Counsel, *Jenkins & Gilchrist*, Dallas. These observations are derived, in part, from Professor Norton's concluding remarks to his presentation on international bank supervision at a recent Euromoney Conference on the "BCCI Aftermath."

Beyond this complex, multidimensional matrix of international bank supervision post BCCI, one can discern certain preliminary lessons:

### **International Banking Supervision**

Though BCCI involved the failure of a \$20 billion financial institution (with third-party exposure in the United States having been limited to \$25 million), it does not appear that such failure, even if left unattended by the international regulators, would have created any serious systemic problems for the international banking community. Nevertheless, it is clear that for London, New York, and other world financial markets to continue to prosper there must be a level playing field to instill integrity and confidence on a global basis.

This decade will further demonstrate that we are in a global financial market transcending national and regional boundaries. Increasingly, supervisors will be required to act jointly if they are to create and to preserve integrity in what has become a worldwide banking system.

### **Consolidated Supervision**

For several decades the international bank supervisors of the Organization for Economic Cooperation and Development (OECD) jurisdictions have been aware of significant gaps in international supervision and have developed principles of consolidated supervision under the original and 1983 Revised Basle Concordats, as further revised.

The BCCI utilization of affiliated bank holding company structures in jurisdictions self-admittedly incapable of any effective consolidated supervision (Luxembourg and the Cayman Islands) and the operation of a hidden "bank within a bank" revealed glaring supervisory gaps. The new EC Consolidated Supervision Directive and recent pronouncement by the Basle Committee should go a long way in closing these remaining loopholes (though, most likely, all gaps cannot be sealed).

But the realities of consolidated supervision operate on national levels and require effective coordination and convergence of regulatory and supervisory standards and flows of quality information between home and host country regulators. The recent U.S. statute and regulations on foreign bank supervision incorporate the principles of "effective" consolidated supervision into the application, termination, and examination processes for foreign banks.

### **Home Country Regulation**

The principle of home country regulation as espoused by the Basle Committee and the EC Second Directives should not be abandoned. Nevertheless, what BCCI makes clear is that home country supervision only makes sense where that jurisdiction has (i) comparable supervisory standards, (ii) a capacity to imple-

ment and enforce such standards, and (iii) a deposit insurance or lender-of-last resort dimension, or both.

As 1993 comes upon us, the EC authorities will undoubtedly rethink and refine the "mutual recognition" vehicle for convergence of national supervisory standards. The U.S. authorities have already given their Federal Reserve the powers to step into the breach where home country supervision is unfeasible or inadequate, and the issue of "reopening" (that is, requiring foreign banks to establish subsidiaries and not branches) still is open.

### **The International Institutional Structure**

The recent Key and Scott Report of the Group of Thirty has pondered possible international supervisory structures, and some commentators even suggest a multilateral treaty approach. What appears realistic and feasible is a continuing maturation and enhancement of the currently informal Basle Committee structure so that this vehicle can assume a broader role in the overall convergence process of supervisory standards; in the assembly, coordination, analysis, and dissemination of relevant supervisory information; in the uniform interpretation of the standards and practices; and in the ultimate surveillance of national jurisdiction compliance and effective implementation.

The Basle Committee also most probably will accelerate its attempts to influence and to assist the practices of non-OECD bank supervisors and its dialogue with international securities supervisors. On an EC level, it is probable that when European monetary union approaches there will also be proposals for an umbrella EC bank supervisory authority appended to the new EC Central Bank. On a national level, effective linkages will need to be created between national authorities, regional authorities, and the Basle Committee.

### **Transparency and Disclosure**

Secrecy and confidentiality traditionally are ingrained in the temperament of bankers and central bankers. However, this can lead to an opaque system as witnessed by the BCCI affair. A radical review of the possibility that greater transparency (not only on a supervisory level, but on public and marketplace levels) is what is needed in a somewhat similar way as it was needed with securities firms and markets. Clearly, there needs to be a better informed and more transparent international banking system respecting both quantitative and qualitative data and respecting an appropriate international vehicle for digesting, evaluating, and disseminating such information.

### **Role of Auditors**

Related to the issue of transparency is the proper role of auditors in the supervisory processes. In BCCI we found different auditors auditing different

affiliated entities under differing national auditing standards. For a consolidated and transparent supervisory network, this situation cannot be permitted.

But though it may be possible to require one reputable independent auditor for an affiliated group, or at least a coordination of audits, it will be a long-term project to try to harmonize or converge the disparate accounting and auditing principles and standards existing worldwide (though the Basle Committee and the IACPA have begun this dialogue). Also, the relationship of the auditors to the bank regulators and the depositors will need to be thought through carefully and comprehensively.

### **Legalism**

Because of the complexities of the issues, the multiplicity of the parties involved, the needs for transparency and fairness of application, and the inherent "culture" of various jurisdictions (for example, the United States and certain continental countries), greater legalism will creep into international and EC bank regulation. Such legalism has been anathema to the Bank of England, which prefers the more informal method of "moral suasion" and participative discussions with relevant parties. However, it was in part this inability to come to terms with the legalism of the U.K. 1987 Banking Act and an apprehension of judicial review that stymied the Bank from acting sooner and more decisively.

Certainly, the density of regulation as in the United States is not a desired international norm. Nevertheless, some reasonable level of legalism in bank regulation and supervision is needed to ensure transparency, uniformity of application, and fairness within the international banking system.

### **Insolvency Laws**

Multilateral work will need to be encouraged respecting acceptable international solutions to transnational insolvencies such as BCCI. Such attempts have proven to be protracted and most difficult, as can be seen in the efforts to harmonize EC bankruptcy laws. These attempts become further aggravated when dealing with financial institutions. But for an international supervisory network to work at an optimum level, such problems will need to be addressed on a regional and broader multilateral basis.

### **Enforcement**

An international supervision network cannot ensure effective national supervision on a ground level or prompt an effective national enforcement action. These aspects will remain in the hands of national authorities. As such, the final chain of international supervision will always be subject to the problem of weak or uncoordinated national links in the chain. However, more and better cooperation between the Basle Committee, the EC authorities, and the dominant na-

tional authorities (for example, the United States, the United Kingdom, Germany, and Japan) can promote better national enforcement and examination practices.

Perhaps the efforts of the Bank of England and the ad hoc "college" of international supervisors in BCCI were too little, too late. But the broader observation is that the only feasible approach was through a working international network of cooperating supervisors. Over this coming decade, something better than this ad hoc crisis-oriented approach will emerge, with the EC and the U.S. efforts in the area serving as centrifugal forces for international reform.

### **This Symposium**

With this backdrop, *The International Lawyer* presents this Symposium section on "International Bank Supervision Post BCCI." Professor Dale, one of the leading commentators on international bank supervision over the past decades, presents a perspective on the BCCI affair and its broader implication from the vantage point of what turned out to be the "practical seat" of this supervisory nightmare. Then Messrs. Corrigan et al. of the Federal Reserve System carefully elaborate (based on congressional testimony) upon BCCI and the U.S. FBSEA. FBSEA not only raises the delicate balance between international collaborative supervisory principles and efforts and the possibilities of unilateral, national protective standards and actions, but also presents significant challenges and adjustments to the traditional "dual banking" system of foreign bank regulation in the United States. The conclusions and recommendations of Mr. Heimann's report to the New York State banking commissioner are germane on this latter point of consequences.

Next, Messrs. Gail et al. summarize the primary thrust and main provisions of FBSEA, and Mr. Whitener analyzes the April 1992 interim regulations of the Federal Reserve Board implementing FBSEA.

Notwithstanding the exaggerated image BCCI forged for all foreign banks, what needs to be remembered is that most foreign bank operations in the United States have been conducted responsibly and have provided significant economic benefits for the U.S. economy over the past decade. Mr. Hand speculates on the additional burdens the new U.S. statute and regulation place on foreign banks doing business in the United States.

Future issues of *TIL* will publish "recent development" articles respecting further developments in the area of international bank supervision.

