

# EXCHANGES OF INFORMATION BETWEEN BANKING AND SECURITIES SUPERVISORS (April 1990)

## I. Introduction

At two meetings in Basle in 1988 and 1989, banking and securities supervisors from G-10 countries discussed the constraints on the freedom of financial market regulators to pass prudential information<sup>1</sup> to their supervisory colleagues in their own and other countries. It was noted that in a number of countries legislation (or administrative practices) contains provisions which impede the passage of prudential information to other supervisors, thus jeopardising the effective supervision of financial groups and institutions undertaking both banking and securities activities. As would be expected, there is a wide variety of circumstances in different countries but, partly as a consequence of the work of the Basle Committee over the years, rather fewer constraints remain in the case of cross-border flows from one banking supervisor to another. Clearly the constraints do not apply to the same degree in respect of those national systems where universal banking is practised and where the same supervisor monitors all aspects of a banking group's business.

Participants at the Basle meetings feel that today's financial conditions make it necessary for supervisors not only to be free to exchange financial information needed for the prudential supervision of financial institutions, but also to be permitted in certain circumstances, to:

- consult their colleagues abroad if they have a concern about a financial conglomerate or institution operating internationally or believe that information will be useful to their fellow supervisors;
- be able to rely on the ability of their foreign supervisory colleagues to notify them of relevant prudential information of which they may be unaware.

---

<sup>1</sup> Prudential information in the sense in which it is used in this document would normally be restricted to statistical material concerning the financial soundness of institutions, such as their capital, liquidity and exposure to different kinds of risks. However, it would also encompass non-statistical material, e.g. impressions of management reputation and competence or reports on the efficiency of internal reporting and control procedures. There may well be good reasons why other types of information relating for

The objective of this paper is to examine, in the light of the experience of the G-10 supervisory institutions, possible ways of facilitating flows of prudential information between banking and securities supervisors. While the paper is confined, in view of its authorship, to these particular flows, the issues it considers are also relevant to exchanges with the regulators of other disciplines (particularly insurance regulators). In this context, it may be noted that the EC's Second Banking Co-ordination Directive extends the provision for information exchanges between banking supervisors contained in the First Directive to information exchanges between all bona-fide financial supervisors. It should also be noted that progress continues to be made under the aegis of the International Organisation of Securities Commissions (IOSCO), and bilaterally between its members, to develop information exchanges between securities supervisors.

## **II. General criteria for the exchange of cross-border information between banking and securities regulators**

### **(a) Prudential use of information received**

Since the purpose of the information exchanges envisaged in this paper is to enhance the effectiveness of prudential supervision, it is understood that information received under these arrangements would be used for purposes related to the prudential supervision of financial institutions only. There should, in particular, be no possibility of government departments or public sector officials not responsible for, or involved in, prudential supervision having access to the information. If necessary, this may mean some form of internal barrier between different departments or divisions of institutions in which one part of the recipient institution carries out a supervisory function and another part some different responsibility.

In the same spirit it is understood that information supplied through these arrangements would have a solely prudential character, being restricted to matters concerning the financial health of institutions as defined in the footnote on the previous page. Under present regulations affecting some supervisors, generalised or consolidated information may

---

example to the financial activities of customers should be passed to other regulatory authorities, but that is

be supplied but not specific statistical information relating to the solvency or liquidity of individual entities. The transmission of unpublished information of a specific character by these supervisors needs to be conducted carefully unless its confidentiality can be guaranteed by the recipient. They can supply specific information only when there is a material concern or if the consent of the institutions to which the information relates has been obtained. Alternatively, if the supervisor who is unable to supply specific information were able to provide reassurance that the operation is sound, or to verify that there is no cause for concern, a degree of comfort would be possible. However, this may be regarded as a less than satisfactory solution.

Both for practical and for legal reasons the supervisor supplying information should seek to ensure that what is being passed is needed by the recipient. Some supervisors are required to make a judgement on a case-by-case basis as to whether it is necessary and desirable to pass unpublished information. Recipients can assist their fellow supervisors by indicating what types of information they wish to receive and why they wish to receive it. On occasions, a supervisor may be asked to supply information which is not available to him in the normal course of business. In such cases, it may be prudent for the two supervisors to discuss the matter to see whether some pragmatic solution may be found. In the end, however, the ability to supply information must remain discretionary. A supervisor may have good grounds for refusing to supply information, e.g. if to do so would contravene the public interest or interfere with an investigation in progress.

**(b) Confidentiality of information received**

A precondition for exchanging prudential information which is common to all jurisdictions is that its confidentiality should be assured by the recipient to the greatest extent possible. In some cases, a certain level of confidentiality is specified, e.g. no less strict than that applicable to the institution providing the information. It is highly desirable that the recipient should be free from any statutory obligation to divulge information received from other supervisory authorities in the course of its prudential supervision. For example, the law should not oblige such information to be disclosed in court unless the foreign supervisory authority which supplied it has given its consent. There will in most countries be some

---

not the focus of this paper.

exceptions to this principle but ideally these should be narrowly confined, e.g. to the prosecution of criminal charges. In those countries where a Freedom of Information Act is in force, the recipient supervisor should see that the person supplying the information is aware of the implications of the legislation so that he can take any precautions he deems appropriate in advance.

For a number of supervisory authorities, the passing of prudential information to self-regulatory organisations (SROs) poses difficulties. This may be partly because of the legal status of the recipient. However, a more important obstacle appears to be uncertainty that the information might not remain confidential, with the possibility of conflicts of interest arising if a member of an SRO who is a market practitioner receives unpublished information about one of his competitors. In practice, however, the enforcement staff of SROs are permanent officials who must be subject to procedures which ensure that such information remains confidential if it is to be passed to them. The concern about confidentiality is one which SROs share.

**(c) Reciprocity**

A condition laid down by statute or administrative practice in a number of countries is that information exchanges can only take place on a reciprocal basis. So long as the concept of "information" remains rather broadly defined, there may not be many instances in practice where a supervisor is prevented from passing prudential information because the intended recipient is unable to pass any information in return. If, however, the information is to be of a similar type or quality, it is easy to imagine uncertainty arising. For example, a bank supervisor may be able to pass information about *institutions* but not about their *customers*, whereas a securities regulator may be able to pass both. Strict reciprocity on each party would prevent any information being exchanged.

If information is to flow reasonably freely, the interpretation of reciprocity needs to be fairly liberal. It is recommended that the possibility of a two-way flow of information should be acceptable, without demanding strict reciprocity in respect of the type of information capable of being exchanged. Moreover, the absence of reciprocal arrangements should not by definition preclude a supervisor from supplying information where, for example, it comes to his notice that an institution that operates from another jurisdiction is engaging in undesirable activities.

**(d) Acting on information received**

Some supervisors tend to feel uneasy about revealing information which might lead to precipitate action on the part of the recipient. Such action might take the form of calling for special guarantees or extra capital from the parent institution, demanding changes of management, requiring a branch to incorporate as a subsidiary or, in an extreme case, the closure of the entity. Since exchanges of information must be based on trust, it is essential that the recipient does not take decisive action without consulting the authority supplying the information (unless the latter has signified that consultation is unnecessary). This would have the advantage of ensuring that any action might be coordinated with that being planned by the other supervisor.

**III. Flows of prudential information from a bank supervisor to a foreign securities regulator**

The principal circumstance in which an information flow of this type is desirable arises when a bank is undertaking securities activities in a foreign country, with or without a physical presence, in which case the host securities regulator will wish to be assured of the continued overall health of the bank. However, there is also a need for information to pass when a securities house is operating a banking business in a foreign country and the securities regulator will wish to monitor the global activities of the group.

While bank supervisors in many cases have no constraints on passing information to foreign bank supervisors, there are frequently impediments to the transfer of information to foreign securities regulators, particularly where they are SROs. This situation can hinder effective supervision. As a temporary expedient, it may be possible to use a fellow supervisor as a conduit, so long as the latter can obtain assurances that the information will remain confidential and be used for supervisory purposes only. This could include circumstances in which the bank supervisor notifies his fellow supervisor if there is a fundamental change in the position of the parent bank, leaving the latter to judge whether it is desirable to warn the securities supervisor concerned.

An alternative is to obtain the bank's consent to the supply of prudential information to a foreign securities regulator. Except when forbidden by law, banks do not usually object to such a proposal, since it often means the avoidance of double reporting. In any event, it would seem desirable that all means possible should be explored to ensure the passage of necessary information. It is recognised that statutory constraints on confidentiality

may prevent the use of a fellow supervisor as a conduit. Statute may also make special arrangements necessary in the case of SROs but, even here, pragmatic means of passing information may be available, at least when material concerns arise.

#### **IV. Flows of prudential information from a securities regulator to a foreign bank supervisor**

There are a number of circumstances in which there is a need for a flow of this type, notably when a bank supervisor wishes to oversee the consolidated activities of a banking group operating a securities activity abroad (with or without a physical presence) or when a securities house is operating a foreign establishment with a banking authorisation and the bank supervisor wishes to verify the health of the parent institution.

The constraints on securities regulators to pass information appear to be at least as onerous as those on banking supervisors. Some countries have provided for bilateral

exchanges of information between their securities regulators and foreign supervisors by drawing up intergovernmental memoranda of understanding. Such arrangements can play a useful role for the parties involved, but developing them on a multilateral basis could be somewhat cumbersome. As in III above, it may be possible as a temporary solution to use a fellow supervisor as a conduit on the conditions cited or, alternatively, to obtain the consent of the institution concerned to the transfer of information concerning its activities.

#### **V. Conclusion**

This paper has reviewed a number of constraints on supervisors' ability to exchange prudential information with fellow supervisors. Practical ways have been suggested whereby some of the impediments can be overcome, but nonetheless in some countries serious constraints remain.

The opinion was widely expressed at the meetings in Basle in 1988 and 1989 that what is needed at this juncture is a basic framework for multilateral supervisory collaboration which enables supervisors to discuss between themselves the particular circumstances of individual institutions and to arrange for the exchange of unpublished prudential information. This could involve, where applicable, changes to national rules and practices in order to

enable supervisors, subject to the conditions set out in Section II of this paper, to transfer information relevant to the prudential supervision of financial institutions to fellow regulators.