CONSOLIDATED SUPERVISION OF BANKS' INTERNATIONAL ACTIVITIES (March 1979)[1]

In the light of the rapid increase over the past twenty years in the internationalisation of many banks' operations, it should be a basic principle of banking supervision that the authorities responsible for carrying it out cannot be fully satisfied about the soundness of individual banks unless they are in a position to examine the totality of each bank's business worldwide. At the same time the Basle Committee recognises that supervisors will also need to continue to look at banks' accounts on a non-consolidated basis.

So far as the foreign *branches* of banks are concerned, consolidation should follow naturally from the fact that branches are legally not independent of their head offices. Few problems should arise for parent supervisory authorities with regard to consolidating that category of their banks' foreign establishments, and all member countries whose banks currently operate branches abroad observe the principle that the risk assets of all branches should be aggregated for supervisory purposes with those of the parent bank.

The problems associated with the consolidation of banking figures for supervisory purposes thus principally concern banks *foreign subsidiaries, participations* and *joint ventures*. For these establishments the position is different for at least two reasons: first, such banks are legally independent from their parent institutions; secondly, they come under the jurisdiction of the country in which they are incorporated, which may have different features from those applying to the parent institution.

The establishment of foreign subsidiaries, participations and joint ventures can substantially gear up a parent bank's overall lending capacity if the capital adequacy of such foreign establishments is judged separately from that of the parent institution and if solvency requirements in the host country are significantly lower than at home. The Committee is agreed therefore that it is essential for supervisors, in looking at a bank's solvency, to be in a position to do so on the basis that the risk-bearing assets of all foreign establishments in which a bank has a controlling interest should be consolidated with those of the parent institution. This means that consolidation should be applied by one means or another not only to the figures of banks' foreign branches but also to those of their wholly-owned and majority-owned foreign subsidiaries.

For minority participations and joint ventures, no single parent institution may have the predominate responsibility since none has a controlling interest. In such cases it is

[1] A more comprehensive definition of what is understood by consolidated supervision is contained in the October 1996 report on the *Supervision of Cross-border Banking* contained in Volume 3 of the Compendium.

desirable that the parent supervisory authorities satisfy themselves that the capital of the parent bank is adequate to sustain its commitment to these minority interests. Most members of the Committee are agreed that this assessment is best undertaken on a case-by-case basis, taking into account in particular the degree of effective control exercised by the parent bank and the extent of its involvement in the management, although some countries choose to consolidate such holdings on a pro rata basis. It appears that the scale of international banking operations undertaken by member countries' banks through minority interests located outside the countries represented on the Committee is small in relation to the total of international bank lending.

Continued progress has been made by a number of member countries to develop and improve their own supervisory procedures with a view to extending the effective implementation of the basic principles of consolidation set out above. While recognising that certain problems may arise, particularly of a statistical nature, the Committee believe that all member countries should continue their efforts to improve consolidation techniques. These are directed particularly to ensuring the adequacy of banks' solvency in their international operations, but it is recognised that they can also be important for the analysis of banks' country risk exposure and of their exposure on large individual loans (although their application in the last-named area may give rise to banking secrecy problems).

The Committee recognises that the practices of member countries with respect to consolidation vary considerably at present and that, for a variety of reasons, it is not to be expected that they can readily be made uniform. The Committee recommends, however, that all parent supervisory authorities should, within the context of their own systems and present circumstances, be required to give effect to the agreed principle that the capital adequacy and the risk exposure of all their banks be examined and assessed on the basis of the totality of their international activities. Furthermore, host supervisory authorities should cooperate in all ways they can to facilitate the achievements of this objective.