

AUTHORISATION PROCEDURES FOR BANKS' FOREIGN ESTABLISHMENTS¹

(March 1983)

In seeking to promote high banking standards, not only within its member countries but on as wide a basis as possible, the Committee is agreed that a basic aim of international supervisory cooperation should be to try to ensure that no foreign banking establishment escapes supervision.

Procedures relating to the authorisation of new foreign banking ventures are important for both host and parent authorities in seeking to fulfil this aim. At present there is no uniformity between member countries' authorisation procedures, either for the entry of foreign banks to their markets or for the setting-up of foreign establishments by their own banks. So far as inward authorisation is concerned, one member country does not permit foreign banks to set up establishments of any kind, except for representative offices, in its territory. All the other member countries have authorisation procedures, but the conditions on which authorisation is granted vary considerably. Some member countries, for instance, require certain commitments with respect to parental supervision. So far as outward authorisation is concerned, in some member countries no formal authorisation procedures exist. Among those member countries which have authorisation procedures, one country does not permit its banks to establish any foreign branches, while some others make authorisation for the setting-up of foreign establishments dependent upon commitments from the parent banks with respect to the provision of information about the operations and financial soundness of such establishments. In some countries represented on the Committee the responsibility for inward or outward authorisation procedures lies with regulatory bodies other than the banking supervisory authorities

While fully recognising these differences in national laws and practices and the difficulties involved in legislation, the Committee believes that some common understandings about desirable general principles with regard to the granting of inward and outward authorisations would be beneficial. It continues to be a major objective of the Committee to ensure that supervisory gaps should not appear in the international banking system. Members are agreed that, notwithstanding difficulties which may arise from particular countries' regulatory

¹ The principles set out in this paper were subsequently incorporated in the Supplement to the Concordat (see *Information Flows Between Banking Supervisory Authorities*, April 1990).

framework in realising this objective, every effort should be made to ensure that foreign banking establishments do not operate in practice in a way which gives rise to significant supervisory loopholes. Particular situations relating to the setting-up of such establishments are set out in the remaining sections of this paper, but it does not attempt to cover every possible situation. The Committee believes that consultations and cooperation between the relevant supervisory authorities are required in all cases where there is uncertainty about precise supervisory responsibility.

1. Inward authorisation procedures

When a foreign institution applies for permission to set up a banking operation, the host authority will wish to satisfy itself about the status of the new venture and the standing of its parent institution. It will also wish to take account of the general economic background in the parent institution's territory and the purposes for which the new banking operation is being established. The Committee believes that as part of this process the host authority should always make contact with the supervisory authority of the country in which the parent institution is incorporated.

These contacts between host and parent authorities will establish a basis for future cooperation in the supervision of these new ventures. Such cooperation is well-developed between Committee members and it is the hope of the Committee that the increasing involvement of other supervisors in its work has laid the foundations for closer cooperation in this area between supervisors worldwide. Contact with the parent authority concerned will enable the host authority to obtain confirmation that the parent authority has given formal authorisation for the establishment of the new venture (or, in those countries where this is not required, that they have no objection), as well as to establish the extent to which the parent authority supervises the parent institution and how far parental supervision will extend to the new venture. In making their decisions, host authorities should seek the confirmation of parent authorities either that the accounts of such new establishments will be consolidated for supervisory purposes with those of the parent institution or, at least, that all relevant information about the activities of such foreign establishments will be made available to the parent institution and, as necessary, to the parent supervisory authority. The Committee recognises that some applications for the establishment of new foreign banking establishments can raise special problems for host supervisory authorities. While these problems are best dealt with on a case-by-case basis, involving cooperation between the relevant supervisory authorities, the Committee nevertheless feels that there are a number of

general considerations which experience suggests host authorities should bear in mind, within the framework of their own legal systems, when faced with the particular circumstances set out below:

- (a) where the parent institution is a bank established in a country where supervisory arrangements are non-existent or inadequate, or where it has been granted a specific exemption from supervision by its parent authority**

Where parental supervision is non-existent, or a specific exemption has been given from such supervision, the Committee is of the opinion that member countries should discourage and, if legally possible, prevent the entry of such banks. Where parental supervision is regarded as inadequate, a number of options may be available to the host authority. One would be to refuse any form of banking licence. Another option could be for the host authority to apply appropriate conditions governing the conduct of the business of the foreign establishment, including stipulations concerning its independence from the parent bank, for example by ensuring full autonomy for its management, or by requiring the maintenance of specific levels of capital or the observation of other prudential requirements.

- (b) where the parent institution is not authorised as a bank in its own country and is therefore not subject to supervision by a parent banking supervisory authority**

Problem situations of this kind can arise for host authorities in a number of ways: through the parent institution being an industrial or commercial company; or a holding company; or in the ownership of one or more private persons; or through institutions which would be regarded as banks in the host country not being so classified in the parent country.

In all cases where the parent institution is not supervised as a bank by the parent supervisory authority, unless the host authority can persuade that authority to supervise the parent institution, the host authority has two possible courses of action: simply to refuse the application; or to insist upon certain conditions being fulfilled. Such conditions might well include a requirement that the applicant and its shareholders be of impeccable reputation and first-class financial standing; also that the host country's permission should be obtained for the acquisition of a dominant or substantial participation by a non-bank; or that the new venture take the form of a legally independent subsidiary, subject to operating conditions similar to those suggested in a) above.

(c) where there is doubt about which authority has the principal parental supervisory responsibility

Such doubts can arise in cases where a bank is incorporated in one country but undertakes the whole, or the bulk, of its operations outside that country. Where the parent authority of the country of incorporation supervises its banks on a consolidated basis worldwide, or even where it is regularly and adequately informed about the activities of those of its banks whose operations are carried on wholly or mainly in other countries, this type of situation may not pose any major problem for host authorities. Where parental responsibility is not present in a form satisfactory to the host authority, then the application may need to be dealt with in the same way as in a) above.

(d) where the application is to form a consortium or joint venture bank

Where applications to set up consortium banks are received, the authorities in the country in which the new venture is to be incorporated need to consider the standing of all the shareholder banks or other shareholders concerned, in particular their capital resources and the quality of their management. In doing so they will need to contact the different supervisory authorities of the shareholder banks. In the event that one of the shareholder banks holds a dominant position in the joint venture, the authority in the country of incorporation may feel able to deal principally with that bank as the parent bank and with its supervisory authority as the parent authority. Some countries consider that the provision of comfort letters by shareholder banks is a useful additional safeguard

(e) where the applicant institution is not the ultimate parent but an intermediate institution

The problem that arises for host authorities in such cases is whether, in assessing such applications, to deal simply with the intermediate institution and its supervisory authority, or whether to deal also with the ultimate parent institution and its supervisory authority. The Committee believes that, in general, it will be preferable for host authorities to deal with both the applicant institution and its parent, as well as with their respective banking supervisory authorities. Where either the parent or the intermediate institution is not a banking company (for example a non-bank holding company) the considerations in section b) apply.

(f) where there are changes in the effective ownership of a bank

There are two ways in which changes in the effective ownership of a bank can give rise to problems for host authorities in authorising the operations of foreign banking establishments in their territories: where such changes involve changes in the nationality or country of residence of the effective owners, converting what had been a domestic bank into a foreign bank; and where there is a change in the effective ownership of a bank which is already a foreign bank. In either case the Committee believes that the host authority should, to the extent appropriate in the light of the knowledge it already has of the establishment concerned, follow its usual procedures for assessing the quality of applicants. These should include making contact with the parent authority concerned. A possible course of action which could be considered is for the authorities to require their permission to be obtained before a dominant or substantial participation in a bank is acquired.

2. Outward authorisation procedures

Outward authorisation procedures exist in about half the countries represented on the Committee. The Committee believes that an important part of such procedures should normally consist, as is already the case in some of those countries where they are in force, of the parent authority satisfying itself both that it will receive regular information on the operations and situation of such establishments and that such establishments will be adequately supervised by a host authority. In order to satisfy itself on these points, the parent authority would need to establish both that adequate supervisory arrangements exist in the host country and that local regulations would not inhibit adequate flows of information to it about such establishments.

Supervision on the basis of consolidated accounts, to the extent that it takes place, helps the parent authority to satisfy itself about the soundness of the operations of its banks' foreign establishments. However, progress towards full consolidation is not yet complete in a number of member countries. Nor can consolidated supervision by the parent authority be a substitute for adequate supervision of those aspects of the operation of banks' foreign establishments which are regarded as the responsibility of the host authority. The Committee therefore believes that outward authorisation procedures can be a useful additional safeguard to avoid the risk that foreign establishments of banks may be unsupervised.

In those member countries which do not at present have full outward authorisation procedures and where there are obstacles to introducing them, the Committee believes that it would be desirable if banks were required to notify their parent authority whenever they intend to

establish a presence in a foreign country. Although the parent authority may in practice learn of such applications from the applicant bank or from the host authority concerned (which has a responsibility to contact the parent authority), a formal notification procedure would eliminate any risk that neither of these things will happen. Moreover, once notified of an intention by one of its banks to establish a new venture abroad, the parent authority concerned may be expected to satisfy itself that the conditions exist both for adequate supervision of the new establishment and for assuring the necessary information flows.