International Conference of Banking Supervisors

The Bank of England sponsored an international conference of banking supervisory authorities in London on 5th and 6th July 1979. The conference was arranged by the Bank in association with the Standing Committee of Banking Supervisory Authorities of the Group of Ten Countries and Switzerland, which was set up by the Central Bank Governors' meeting at the Bank for International Settlements in Basle in 1974.

Representatives of central banks and other supervisory authorities from over eighty countries attended, together with observers from the EEC Commission, the World Bank and the International Monetary Fund. The meeting was the first occasion on which banking supervisory authorities had been brought together from such a wide range of countries around the world.

The conference was arranged with the object of allowing supervisors concerned with international banking to meet each other, and to establish or renew useful working relationships. It also enabled a much wider range of countries than those meeting regularly in Basle to discuss matters which have been considered in that forum.

The conference programme covered a number of matters of interest to supervisors of international banking activity, with speakers from most leading financial centres. The Governor of the Bank of England opened the conference, and the text of his address on International Co-operation in Banking Supervision is reproduced below. The meeting was chaired by Mr W. P. Cooke of the Bank of England, and among the principal contributors were: Mr John Heimann, the US Comptroller of the Currency; Mr Pierre Jaans, Head of the Luxembourg Banking Commission; Mr Michael Wong, Managing Director of the Singapore Monetary Authority; Mr Herman Baeyens, a Director of the Belgian Banking Commission; M. Gerard Aubanel, a Director of the Bank of France; Mr Alan Moore, Adviser of the Bahrain Monetary Agency; and Mr Huib Muller, an Executive Director of the Nederlandsche Bank. Subjects covered included the principles agreed in Basle governing parental responsibility for banks' branches and subsidiary companies; capital and liquidity adequacy for international banking; the consolidated appraisal of banks' international business; the significance of off-shore banking activities; and the regulation of foreign exchange operations.

The Governor's address to the conference, given on 5 July 1979.

I will, if I may, begin by adding to the Chairman's words my own very warm welcome to you all. I know some of you already as frequent visitors to the Bank; others have less occasion to come here in the ordinary course of events and are especially welcome. I believe that this conference—the first to bring together those directly responsible for banking supervision over the greater part of the world—is an important event not only in itself but also in the prospect of future co-operation which it opens up. The programme before you addresses important and complex issues. But I hope that, beyond these immediate questions, the personal contacts established between you will foster the process of understanding and co-operation between the national authorities. This, I believe, is of paramount importance in a world increasingly marked by the internationalisation of commercial banking.

The Bank of England has arranged this conference in association with the Standing Committee of Banking Supervisors from the Group of Ten countries and Switzerland; and, while I think it is appropriate for London to be the scene for the conference, it would be right to regard this meeting as an extension of the Basle Committee's work. I should like to take this opportunity of thanking those who regularly participate in the Committee for devoting a great deal of time and effort to the programme for this conference. During the last five years, the Committee, meeting regularly in Basle, has played a most important rôle in preparing the ground for greater consultation and understanding between supervisory authorities in many countries. It is my hope and expectation that this conference, with its much broader membership, will extend this process on a wider scale than before, and I am glad to see that the speakers are drawn also from a number of important financial centres outside the Group of Ten and Switzerland. I very much appreciate their participation in the discussions.

International banking saw much of its early flowering in London in the second half of the last century, when British banks built up a major rôle as the principal intermediaries in the finance of trade within the then British Empire and between it and other economic powers. British overseas banks established an extensive network of branches and subsidiaries in many countries round the world, and London became the world's major international financial centre. In the more recent past London has, of course, come to terms with the changed rôle of this country among the economies of the world. While it still maintains its position as one of the world's most important financial market places, that market has now become truly international, operating through various centres spread around the world, and in which the major banks of an increasing number of countries participate fully through the international currency and bond markets.

The currency and banking crisis of the late 1920s and 1930s in Europe and the United States, together with the long delays in restoring currency convertibility after the Second World War, effectively stalled the internationalisation of money and capital markets—though international lending from domestic markets has of course a much longer history. The restoration of convertibility in the late 1950s to a wide range of leading currencies and the consequent development of largely unimpeded foreign exchange markets provided the conditions necessary for the gradual emergence of the euro-bond and international syndicated loan markets that we know so well today, and which are adding so markedly to the more traditional forms of international lending. During the 1960s, these international markets grew steadily alongside traditional foreign lending in domestic currencies, stimulated by the buoyancy of the world economy and international trade.

For some years this new and vigorous growth in the international banking system proceeded without causing concern to the main national supervisory authorities. But these new developments inevitably increased banks' exposure to certain types of risks. In particular, movement towards freer exchange rates in the early 1970s increased the potential exposure of banks to foreign exchange risks. These risks became much larger after the four-fold increase in oil prices in 1973. This came at a time when there were signs that economic activity in the main industrialised countries would begin to turn down after a period of rapid and unusually coincident expansion. The oil price increases and the world recession which started in 1974 greatly increased payments imbalances, and led to unprecedented needs for international capital flows. As we all know, the banks succeeded in recycling a substantial part of the newly-acquired wealth of the oil producers to the deficit countries. But in 1974, the system was faced with a severe test; a few bank failures, and one or two other cases of highly publicised, large losses, and a more general unease about the ability of the banks to recycle such large sums, led to greater consciousness of the risks involved. There was, in fact, a temporary weakening in confidence in international financial markets.

This period of uncertainty was, however, successfully weathered; and international bank lending, both in traditional and euro-currency forms, resumed the rapid increase which has continued to this day. The system now is larger, much more experienced, but still requires constant vigilance.

It is against this background that I, and my colleagues in other central banks, have worked to promote closer co-operation between the supervisory authorities in the major nations. It is entirely fitting that the Bank for International Settlements (BIS) should have been the focus of these efforts. Set up in 1930 through the co-operative effort of its founding central banks, it played an important rôle in helping to alleviate the problems of that era. Its value as a forum for the exchange of ideas and the development of ways of dealing with international monetary problems has been sustained and developed with the passage of time.

No wonder, then, that in 1974 my fellow Governors at the BIS and I should have discussed the troublesome developments in the international banking scene. These discussions led to the establishment of the Standing Committee of Bank Supervisors in Basle. This group necessarily involved others apart from central bankers, and brought in representatives of those supervisory authorities of Group of Ten countries, Luxembourg and Switzerland which are separate agencies.

The meetings of this Committee have helped to develop both a common language and an understanding of the way in which other authorities go about their day-to-day activities. We all now have a closer familiarity with the supervisory practices in each of the countries where leading banks are based, and with the ways in which their international operations are regulated.

This group was set up to undertake a joint responsibility. It was seen to be important that there should be not only shared general goals but also a clear and shared understanding of where responsibility lay. At that time, the first priorities were to determine how far existing supervision provided adequate coverage of banks' international operations and to reach an international understanding on national responsibilities that would ensure that no area of banks' activities escaped proper surveillance, whilst avoiding needless overlapping of supervisory activity. Previously, foreign branches and subsidiaries of banks in one country operating in the markets of another country had sometimes fallen outside the perceived responsibilities of the supervisory authorities in either country. Defining responsibilities for monitoring the activities of such foreign establishments was thus one of the first tasks to which the Committee in Basle set its hand.

It may be helpful if at this point I summarise the broad lines of agreement which the Governors endorsed. We agreed that a bank or banking group has responsibility for its activities throughout the world—whether through branches, subsidiary companies or joint ventures—where the parent bank's name is involved. This is to take a view wider than that of the law. It was recognised that when a bank is the controlling shareholder in a company incorporated with limited liability, its own good banking name is involved in the affairs of that subsidiary company. To seek to avoid or deny that involvement could be very damaging. Its own credit could be damaged if that company failed. So its liability in practice goes beyond that deriving from the legal status of the subsidiary company. We agreed that the supervisory authority in the country where a banking group's head office is located should assume the primary responsibility for monitoring the solvency of the whole of that group's activities.

Given the immediate needs at the time, it was reasonable that the dialogue should be between the authorities of the Basle Group. But the principles there developed extend, of course, much further. My own responsibilities for the banking community in London have made me increasingly aware of the need for discussions on a much wider geographical scale than can be accomplished within a group drawn exclusively from the major industrialised countries. While it is true, and much to be welcomed, that discussions already take place in some regional groupings, for example recently among the Caribbean countries and within the European Economic Community, I am strongly of the opinion that the broadest possible exchange of views is needed.

There is another reason why a conference of this sort is timely. As I see it, the outlook for the world economy is distinctly uncertain. Only a year ago, it was possible to hope that the tide had turned in the long and often painful struggle in which we had all been involved since the early 1970s against low growth, high inflation, and large payments imbalances. But, even then, I feared that those hopes had a fragile base, chiefly because I regard inflation and the attitudes and responses it engenders as the cancer of the 1970s; and in many countries inflation had not fallen below a malignant level. Experience over recent months has, I am afraid, confirmed that the hopes were indeed misplaced.

Inflation has clearly been on the increase again. It was, indeed, clearly on the increase before the recent successive rises in oil prices. There are many cost increases still working their way through the world economic system—in oil and in other commodity prices. These are—unfortunately—liable in turn to produce pressure for increases in wages and other costs. The shorter-term outlook therefore is, I fear, for continued high rates of world inflation. Equally important, it is likely that the very considerable disparities in inflation rates between countries will persist, with all that this can imply for strains on exchange rates.

There had been signs that the payments imbalances between OECD countries, which had become a greater source of disturbance to the world economy than the dwindling OPEC surplus, would narrow significantly this year. Indeed there may still be some improvement within the OECD. But now we must anticipate a resurgence of the OPEC surplus.

Much will, of course, depend on how governments and monetary authorities react to this more difficult outlook. I will venture two observations. The first is that all the experience of the past decade must point towards a cautious, perhaps to a degree restrictive, response. The prospects for the growth of output are therefore not at all good; and the longer slow growth persists, the more difficult it will be to recover the rates of growth that were thought of as normal less than a decade ago. The second observation is that we shall once again see, as we did after 1973, that some economies will show themselves more successful than others in adapting to a harder environment, and that there may, as a consequence, be a re-emergence of wider disparities in performance, and a need to re-assess country risks.

It is tempting to draw parallels between the situation now and that of 1973–74. There are some disturbing similarities: an incipient weakening in the US economy, and large oil price rises superimposed on an already rising trend of inflation. Some of the dissimilarities also are not encouraging: the level of unemployment is higher, inflation is accelerating from a higher base, and the level of external indebtedness is much higher. But we can draw some comfort from at least two facts. One is that the scale of disturbance from oil price increases is so far much smaller. The other, and in my view more important, is that we have experience to draw upon; we have a better understanding of what we are up against, and should not make the same mistakes.

I have sketched in for you a less than sunny picture. We may all hope that things will turn out better; but it would, I feel, be prudent for those who work in the supervisory area to be alert to the possibility that the resilience of the international banking system may be tested again in the next few years.

This brings me to some of the other issues which, from my vantage point as Governor of a central bank, seem particularly relevant to the work of participants at this conference. An important question is the ability of national banking authorities to monitor developments affecting their own banks effectively, at reasonably small cost to themselves and to the banks. The Governors at the BIS have firmly backed the Committee of Bank Supervisors' conclusions as to the proper assumption of responsibility for foreign establishments of banks; and the consolidation of banks' accounts with those of their subsidiaries has been accepted as the best method of monitoring banks' international activities. The larger the number of supervisory authorities which endorse these conclusions, the more effective will be surveillance of banks' international operations. The implications of setting up a mechanism for consolidated reporting also need to be examined. It will, for example, in some aspects require the passing of confidential information from one country to another; and that may call for a change in national bank secrecy laws or regulations. Consolidated reporting may also mean that banks will be required to submit similar information to two or more national authorities. The demands on the banks for more harmonised statistics may prove irksome, but it is obviously in everyone's interest that reports on the same business to different authorities should be compatible. In both these aspects, the adoption of consolidated reports will present a major challenge to the willingness of authorities to co-operate.

Among more specific issues which are of current concern, I would perhaps mention two. The first is the exposure of the banking community to country risk. This has received much attention in the last two years, during which the BIS has devoted considerable resources to improving the flow of information—the essential pre-requisite for proper risk assessment. The Governors have been conscious that this is an area where the interests of general economic policy-makers and supervisory authorities may approach closely, and where co-operation between the two may be very fruitful. We are not, however, disposed to accept the view that direct regulation by the authorities of banks' exposure to individual countries is an appropriate response. The second specific issue of current concern is the deterioration which we have seen in the capital ratios of banks in many countries—largely because of the impact of high rates of inflation.

The last issue I would mention here is the need to ensure that we understand the changing ways in which banks operate in the markets. In the last two decades, there has been something of a revolution in banking practice, with banking skills broadening from the traditional emphasis on achieving the best disposition of assets to include the active management of liabilities. This has enabled banks to economise on their holdings of traditional liquid assets, as they have come to place increased reliance on their ability to borrow from other banks or to hold claims on other banks. I do not believe that the effects of this development have yet been fully explored; that all the risks have been adequately weighed up; or that acceptable techniques of assessment have been developed either by the supervisory authorities or by the banks themselves.

Before I finish I will say a few words about the development of banking supervision in the United Kingdom. I do so not in order to 'sell' the British system to others—for circumstances differ widely between countries. Our system has benefited from the tradition, which perhaps exists to a unique degree in this country, of intimate contact and co-operation between the Bank of England and the banking community in a non-statutory environment. To some commentators, the strength and persistence of this participative tradition is something of a mystery. But its advantages, both to the Bank of England in its supervisory capacity, and to the banks in London—not least to those from abroad—are, I believe, evident and important. I am glad to be able to assure you that the spirit of this traditionally flexible approach has been maintained in the legislation which has recently been enacted.

Let me amplify a little that reference to the foreign banking community in London. Our advocacy of co-operation between bank supervisors stems in part from our responsibilities towards this community. These responsibilities have led us to our long-held conviction that the operations of branches, wherever situated, are indivisible from those of the parent bank itself, and we welcome the general acceptance of that principle, and the increased co-operation between supervisory authorities which results. We welcome visits of inspection by foreign supervisory authorities to London. Moreover, the new statutory system of authorisation of deposit-taking businesses in the United Kingdom enables the Bank to look to the opinion of the supervisory authorities of foreign parent banks as to whether some of the statutory criteria for authorisation in the United Kingdom are satisfied. On the other hand, in conformity with the conclusions of the Basle Committee of Bank Supervisors, we assume responsibility for supervision of subsidiaries of foreign banks incorporated in the United Kingdom. In pursuit of this, we have clarified the position of foreign shareholders by obtaining written confirmation from them that they recognise their parental responsibilities.

In conclusion, let me return to the wider field. The Committee of Bank Supervisors in Basle is, as I have already said, inevitably limited in size: that must be so if it is to work effectively. By bringing together senior supervisors from most of the world's leading banking centres, it has acted as a crucible in the development of principles and techniques of banking supervision adequate to current problems. I hope you now, in this wider forum, will find these of relevance to the regulation of banks within the systems practised in your own countries. I hope, too, that those who have been directly involved in the work of the BIS Committee may equally gain in understanding of banking supervision as it is carried on elsewhere. I believe that the development of this mutual understanding, and of co-operation based on it, is of the greatest importance if supervisors are to respond effectively to the complex issues and patterns of behaviour which characterise today's financial markets. I wish you well in your deliberations over the next two days.