A host country perspective on the incentives for supervisory information sharing

Katia D’Hulster
1. Setting the scene
2. The supervisory task sharing
3. Incentives and conflicts of interest in supervisory information sharing
4. Policy options
   - Supervisory colleges
   - Ring-fencing – subsidiarization
   - Binding code of conduct
1. Setting the scene

“The crisis has made clear that the public sector has failed to integrate regulation, supervision and resolution as thoroughly as the private sector has integrated its operations globally.”

“A Safer World Financial System: Improving the resolution of systemic Institutions”, Claessens, Herring and Schoenmaker, pg. 23
Global Financial Crisis demonstrated lack of effective cooperation

View from a host supervisor:
1. No effective mechanism to resolve financial institutions
2. Leading role for the home supervisor
3. No mechanism to force cooperation
4. Limited international accountability
5. No mediation or conflict resolution mechanism
6. Interactions 1-5 above not addressed
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2. Supervisory task sharing

Basel Committee – Supervisory task sharing

- 1975 Basel Committee Concordat
- 2003: High level principles under Basel II
- 2006: Further clarification under Basel II
- 2010: Good practices for supervisory colleges
2. Supervisory task sharing
How does it work?

- **Home supervisor** - supervises the consolidated banking group
- **Host supervisor**
  - Bank 2 (Germany)
  - Bank 4 (Switzerland)
  - Financial institution A (Australia)
- **Host supervisor**
  - Bank 3 (Hong Kong)
  - Financial institution B (Hong Kong)

**Host supervisor** - sub consolidates Bank 2 and FI in Hong Kong

**Bank 1** (UK)
2. Supervisory task sharing

International financial banking groups

• Single name
• Global
• Interconnected
• Complex organizational structures
• Numerous branches and subsidiaries
• Frequently, integrated functions, funding & liquidity models, often also in subsidiaries
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3. Incentives and conflicts of interest in supervisory information sharing

Challenge 1

• Domestic conflicts of interest
  • Industry capture
  • Political capture
  • Self capture
Challenge 2: National mandate and limited global accountability

Global Financial Stability

Cross Border Banks

National Mandate

Claessens, Schoenmaker, Herring (2010) “A safer world financial system: Improving the resolution of systemic institutions” page 33
Challenge 3: Geographic risk profile of the banking group

Are the operations in the host jurisdiction significant to the banking group?

Are the operations systemic in the host country?

Is the banking group systemic in the home country?
<table>
<thead>
<tr>
<th>Stage of supervision</th>
<th>Preventive</th>
<th>Remedial</th>
<th>Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supervision of institutions</td>
<td>Licensing</td>
<td>Risk management changes</td>
<td>Private sector resolution</td>
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<td>Ongoing supervision</td>
<td>Management changes</td>
<td>Bankruptcy/restructuring</td>
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<td></td>
<td>Other restrictions</td>
<td>Public sector resolution</td>
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<td>Leading actors</td>
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<td>Supervisory colleges</td>
<td>(Supervisory college)</td>
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<td>Resolution authority</td>
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<td>Courts</td>
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<td></td>
<td></td>
<td></td>
<td>Crisis management</td>
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<td></td>
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<td>groups</td>
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</tbody>
</table>
3. Incentives and conflicts of interest in supervisory information sharing

Many other Challenges:

- Confidentiality concerns
- Legal constraints
- Lack of common terminology
- Legal framework
- Prudential reporting systems
- Quality of supervision
- Legal mandate
- Tolerance for failure
3. Incentives and conflicts of interest in supervisory information sharing

Scenarios

• Preventative stage
• Move to remedial stage

Deterioration in the health of the
  - parent
  - subsidiary
3. Incentives and conflicts of interest in supervisory information sharing

I. Preventative stage

*Home to host*: Incentives for information sharing from home to host decrease with the materiality of host to group operations.

*Host to home*: Incentives to share information with home increase as the operations in the host country become more systemic.
3. Incentives and conflicts of interest in supervisory information sharing

II. Remedial stage

Scenario 1: Deteriorating health of the parent

*Home to host:* Incentives to minimize and delay information sharing regarding any remedial action by home

*Host to home:* Incentives to ring-fence increase as the operations become more systemic in the host jurisdiction.
II. Remedial stage

Scenario 2: Deteriorating health of the subsidiary

*Host to home:* Incentives to overstate problems in host operations increase as the operations in the host jurisdiction become less material to the group.

*Home to host:* Incentives for information sharing from home to host decrease with the materiality of host to group operations.
Outline

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4. Policy option: Better cooperation in supervisory colleges

**Basel Good practice paper on supervisory colleges**

8 Principles

1. College objectives
2. College structures
3. Information sharing
4. Communication channels
5. Collaborative work
6. Interaction with the institution
7. Crisis management
8. Macro-prudential work
Policy option: Better cooperation in supervisory colleges

Unitary college

Variable structure

General College

Liquidity Working Group

Core College

Trading Book Working Group

Home Supervisor
Policy option: Better cooperation in supervisory colleges

Low significance of the operations in the host jurisdiction the the banking group

Intense and frequent information exchange
4. Policy option: Better cooperation

<table>
<thead>
<tr>
<th>Information</th>
<th>Universal College</th>
<th>Core College</th>
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<tbody>
<tr>
<td>Recommended</td>
<td>• High level supervisory risk assessment</td>
<td>• Detailed supervisory risk assessments and significant findings from relevant risk reports</td>
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<tr>
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<td>• A summary of priority risks across business, geographic and key risk dimensions</td>
<td>• Extracts from (enterprise-wide) risk reports covering: priority risks across business and</td>
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<td>• A summary of the economic environment in relevant/material jurisdictions/markets, as well as results of stress tests</td>
<td>geographic lines, as well as credit, market and operational risks</td>
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<td>• Supervisory plan</td>
<td>• Analysis of the economic environment of material/relevant jurisdictions/markets and results of stress tests</td>
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<td>• Organisation charts</td>
<td>• Supervisory plan</td>
</tr>
<tr>
<td></td>
<td>• A summary of relevant financial reports/statements including highlights of financial position and prospects</td>
<td>• Detailed organisation charts</td>
</tr>
<tr>
<td></td>
<td>• Capital position/plan</td>
<td>• Key financial reports/statements of financial position and prospects</td>
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<td>• Liquidity position/plan</td>
<td>• Capital position/plan</td>
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<td>• Key supervisory contact list for both day-to-day supervisory and crisis management purposes</td>
<td>• Liquidity position/plan</td>
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<tr>
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<td></td>
<td>• Strategic summary</td>
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<tr>
<td></td>
<td></td>
<td>• Crisis management plan</td>
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<td>• Summary of remuneration practices</td>
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Policy option: Ring-fencing & subsidization

- What?
- Scope
- Forms
- Timing
Policy option: Ring-fencing and subsidiarization

Benefits

- Protection of local depositors
- Subsidiary - branches

Drawbacks

- Cost
- Impact on economy
- Can increase stress on banking group
Policy option: Ring-fencing and subsidiarization

Issues

• Legal power
• Independence
• Supervisory capacity
• Legal protection
Policy option: Ring-fencing and subsidiarization

Reliance on home supervisor

Host supervisory powers
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Policy option: Binding code of conduct

- Risk assessment
- Remedial actions
- Ex ante burden-sharing agreement
- Enforceable

➤ Not achievable in the short term BUT could work at regional level or at bank level
An intermediate option

• Review of incentives for supervisory information sharing
• Reassess framework
• In the meantime....
Questions?

Thank you for your attention

For more information, questions or suggestions

kdhulster@worldbank.org