

**PRINCIPLES FOR THE SUPERVISION OF  
BANKS' FOREIGN ESTABLISHMENTS  
(May 1983)**

**I. Introduction**

This report<sup>1</sup> sets out certain principles which the Committee believes should govern the supervision of banks' foreign establishments by parent and host authorities. It replaces the 1975 "Concordat" and reformulates some of its provisions, most particularly to take account of the subsequent acceptance by the Governors of the principle that banking supervisory authorities cannot be fully satisfied about the soundness of individual banks unless they can examine the totality of each bank's business worldwide through the technique of consolidation.

The report deals exclusively with the responsibilities of banking supervisory authorities for monitoring the prudential conduct and soundness of the business of banks' foreign establishments. It does not address itself to lender-of-last-resort aspects of the role of central banks.

The principles set out in the report are not necessarily embodied in the laws of the countries represented on the Committee. Rather they are recommended guidelines of best practices in this area, which all members have undertaken to work towards implementing, according to the means available to them.

Adequate supervision of banks' foreign establishments calls not only for an appropriate allocation of responsibilities between parent and host supervisory authorities but also for contact and cooperation between them. It has been, and remains, one of the Committee's principal purposes to foster such cooperation both among its member countries and more widely. The Committee has been encouraged by the like-minded approach of other groups of supervisors and it hopes to continue to strengthen its relationships with these other groups and to develop new ones. It strongly commends the principles set out in this report as being of general validity for all those who are responsible for the supervision of banks which conduct international business and hopes that they will be progressively accepted and implemented by supervisors worldwide. Where situations arise which do not appear to be covered by the principles set out in this report, parent and host authorities should explore together ways of ensuring that adequate supervision of banks' foreign establishments is effected.

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1 This document is known as the Basle Concordat.

## II. Types of banks' foreign establishments

Banks operating internationally may have interests in the following types of foreign banking establishment:

1. **Branches:** operating entities which do not have a separate legal status and are thus integral parts of the foreign parent bank;
2. **Subsidiaries:** legally independent institutions, wholly-owned or majority-owned, by a bank which is incorporated in a country other than that of the subsidiary;
3. **Joint ventures or Consortia:** legally independent institutions incorporated in the country where their principal operations are conducted and controlled by two or more parent institutions, most of which are usually foreign and not all of which are necessarily banks. While the pattern of shareholdings may give effective control to one parent institution, with others in a minority, joint ventures are, most typically, owned by a collection of minority shareholders.

In addition, the structure of international banking groups may derive from an ultimate holding company which is not itself a bank. Such a holding company can be an industrial or commercial company, or a company the majority of whose assets consists of shares in banks. These groups may also include intermediate non-bank holding companies or other non-banking companies.

Banks may also have minority participations in foreign banking or non-banking companies, other than those in joint ventures, which may be held to be part of their overall foreign banking operations. This report does not cover the appropriate supervisory treatment of these participations, but they should be taken into account by the relevant supervisory authorities.

## III. General principles governing the supervision of banks' foreign establishments

Effective cooperation between host and parent authorities is a central prerequisite for the supervision of banks' international operations. In relation to the supervision of banks' foreign establishments there are two basic principles which are fundamental to such cooperation and which call for consultation and contacts between respective host and parent authorities: firstly, that no foreign banking establishment should escape supervision; and secondly, that the supervision should be adequate. In giving effect to these principles, host authorities should ensure that parent authorities are informed immediately of any serious problems which arise in a parent bank's foreign establishment. Similarly, parent authorities should inform host authorities when problems arise in a parent bank which are likely to affect the parent bank's foreign establishment.

Acceptance of these principles will not, however, of itself preclude there being gaps and inadequacies in the supervision of banks' foreign establishments. These may occur for various reasons. Firstly, while **there should be a presumption that host authorities are**

**in a position** to fulfil their supervisory obligations adequately with respect to all foreign bank establishments operating in their territories, this may not always be the case. Problems may, for instance, arise when a foreign establishment is classified as a bank by its parent banking supervisory authority but not by its host authority. In such cases it is the responsibility of the parent authority to ascertain whether the host authority is able to undertake adequate supervision and the host authority should inform the parent authority if it is not in a position to undertake such supervision.

In cases where host authority supervision is inadequate, the parent authority should either extend its supervision, to the degree that it is practicable, or it should be prepared to discourage the parent bank from continuing to operate the establishment in question.

Secondly, problems may arise where the host authority considers that supervision of the parent institutions of foreign bank establishments operating in its territory is inadequate or non-existent. In such cases the host authority should discourage or, if it is in a position to do so, forbid the operation in its territory of such foreign establishments. Alternatively, the host authority could impose specific conditions governing the conduct of the business of such establishments.

Thirdly, gaps in supervision can arise out of structural features of international banking groups. For example, the existence of holding companies either at the head, or in the middle, of such groups may constitute an impediment to adequate supervision. Furthermore, particular supervisory problems may arise where such holding companies, while not themselves banks, have substantial liabilities to the international banking system. Where holding companies are at the head of groups that include separately incorporated banks operating in different countries, the authorities responsible for supervising those banks should endeavour to coordinate their supervision of those banks, taking account of the overall structure of the group in question. Where a bank is the parent company of a group that contains intermediate holding companies, the parent authority should make sure that such holding companies and their subsidiaries are covered by adequate supervision. Alternatively, the parent authority should not allow the parent bank to operate such intermediate holding companies.

Where groups contain both banks and non-bank organisations, there should, where possible, be liaison between the banking supervisory authorities and any authorities which have responsibilities for supervising these non-banking organisations, particularly where the non-banking activities are of a financial character. Banking supervisors, in their overall supervision of banking groups, should take account of these groups' non-banking activities; and if these activities cannot be adequately supervised, banking supervisors should aim at minimising the risks to the banking business from the non-banking activities of such groups.

The implementation of the second basic principle, namely that the supervision of all foreign banking establishments should be adequate, requires the positive participation of both host and parent authorities. Host authorities are responsible for the foreign bank establishments operating in their territories as individual institutions while parent authorities are responsible for them as parts of larger banking groups, where a general supervisory responsibility exists in respect of their worldwide consolidated activities. These responsibilities of host and parent authorities are both complementary and overlapping.

The principle of consolidated supervision is that parent banks and parent supervisory authorities monitor the risk exposure - including a perspective of concentrations of risk and of the quality of assets - of the banks or banking groups for which they are responsible, as well as the adequacy of their capital, on the basis of the totality of their business wherever conducted. This principle does not imply any lessening of host authorities' responsibilities for supervising foreign bank establishments that operate in their territories, although it is recognised that the full implementation of the consolidation principle may well lead to some extension of parental responsibility. Consolidation is only one of a range of techniques, albeit an important one, at the disposal of the supervisory authorities and it should not be applied to the exclusion of supervision of individual banking establishments on an unconsolidated basis by parent and host authorities. Moreover, the implementation of the principle of consolidated supervision presupposes that parent banks and parent authorities have access to all the relevant information about the operations of their banks' foreign establishments, although existing banking secrecy provisions in some countries may present a constraint on comprehensive consolidated parental supervision.

#### **IV. Aspects of the supervision of banks' foreign establishments**

The supervision of banks' foreign establishments is considered in this report from three different aspects: solvency, liquidity, and foreign exchange operations and positions. These aspects overlap to some extent. For instance, liquidity and solvency questions can shade into one another. Moreover, both liquidity and solvency considerations arise in the supervision of banks' foreign exchange operations and positions.

##### **1. Solvency**

The allocation of responsibilities for the supervision of the solvency of banks' foreign establishments between parent and host authorities will depend upon the type of establishment concerned.

For branches, their solvency is indistinguishable from that of the parent bank as a whole. So, while there is a general responsibility on the host authority to monitor the financial soundness of foreign branches, supervision of solvency is primarily a matter for the parent authority. The "dotation de capital" requirements imposed by certain host authorities on foreign branches operating in their countries do not negate this principle. They exist firstly to

oblige foreign branches that set up in business in those countries to make and to sustain a certain minimum investment in them, and secondly, to help equalise competitive conditions between foreign branches and domestic banks.

For subsidiaries, the supervision of solvency is a joint responsibility of both host and parent authorities. Host authorities have responsibility for supervising the solvency of all foreign subsidiaries operating in their territories. Their approach to the task of supervising subsidiaries is from the standpoint that these establishments are separate entities, legally incorporated in the country of the host authority. At the same time parent authorities, in the context of consolidated supervision of the parent banks, need to assess whether the parent institutions' solvency is being affected by the operations of their foreign subsidiaries. Parental supervision on a consolidated basis is needed for two reasons: because the solvency of parent banks cannot be adequately judged without taking account of all their foreign establishments; and because parent banks cannot be indifferent to the situation of their foreign subsidiaries.

For joint ventures, the supervision of solvency should normally, for practical reasons, be primarily the responsibility of the authorities in the country of incorporation. Banks which are shareholders in consortium banks cannot, however, be indifferent to the situation of their joint ventures and may have commitments to these establishments beyond the legal commitments which arise from their shareholdings, for example through comfort letters. All these commitments must be taken into account by the parent authorities of the shareholder banks when supervising their solvency. Depending on the pattern of shareholdings in joint ventures, and particularly when one bank is a dominant shareholder, there can also be circumstances in which the supervision of their solvency should be the joint responsibility of the authorities in the country of incorporation and the parent authorities of the shareholder banks.

## **2. Liquidity**

References to supervision of liquidity in this section do not relate to central banks' functions as lenders of last resort, but to the responsibility of supervisory authorities for monitoring the control systems and procedures established by their banks which enable them to meet their obligations as they fall due including, as necessary, those of their foreign establishments.

The allocation of responsibilities for the supervision of the liquidity of banks' foreign establishments between parent and host authorities will depend, as with solvency, upon the type of establishment concerned. The host authority has responsibility for monitoring the liquidity of the foreign bank's establishments in its country; the parent authority has responsibility for monitoring the liquidity of the banking group as a whole.

For branches, the initial presumption should be that primary responsibility for supervising liquidity rests with the host authority. Host authorities will often be best equipped to supervise liquidity as it relates to local practices and regulations and the functioning of

their domestic money markets. At the same time, the liquidity of all foreign branches will always be a matter of concern to the parent authorities, since a branch's liquidity is frequently controlled directly by the parent bank and cannot be viewed in isolation from that of the whole bank of which it is a part. Parent authorities need to be aware of parent banks' control systems and need to take account of calls that may be made on the resources of parent banks by their foreign branches. Host and parent authorities should always consult each other if there are any doubts in particular cases about where responsibilities for supervising the liquidity of foreign branches should lie.

For subsidiaries, primary responsibility for supervising liquidity should rest with the host authority. Parent authorities should take account of any standby or other facilities granted as well as any other commitments, for example through comfort letters, by parent banks to these establishments. Host authorities should inform the parent authorities of the importance they attach to such facilities and commitments, so as to ensure that full account is taken of them in the supervision of the parent bank. Where the host authority has difficulties in supervising the liquidity, especially in foreign currency, of foreign banks' subsidiaries, it will be expected to inform the parent authorities and appropriate arrangements will have to be agreed so as to ensure adequate supervision.

For joint ventures, primary responsibility for supervising liquidity should rest with the authorities in the country of incorporation. The parent authorities of shareholders in joint ventures should take account of any standby or other facilities granted, as well as any other commitments, for example through comfort letters, by shareholder banks to those establishments. The authorities in the country of incorporation of joint ventures should inform the parent authorities of shareholder banks of the importance they attach to such facilities and commitments so as to ensure that full account is taken of them in the supervision of the shareholder bank.

Within the framework of consolidated supervision, parent authorities have a general responsibility for overseeing the liquidity control systems employed by the banking groups they supervise and for ensuring that these systems and the overall liquidity position of such groups are adequate. It is recognised, however, that full consolidation may not always be practicable as a technique for supervising liquidity, because of differences of local regulations and market situations and the complications of banks operating in different time zones and different currencies. Parent authorities should consult with host authorities to ensure that the latter are aware of the overall systems within which the foreign establishments are operating. Host authorities have a duty to ensure that the parent authority is immediately informed of any serious liquidity inadequacy in a parent bank's foreign establishment.

### **3. Foreign exchange operations and positions**

As regards the supervision of banks' foreign exchange operations and positions, there should be a joint responsibility of parent and host authorities. It is particularly important

for parent banks to have in place systems for monitoring their group's overall foreign exchange exposure and for parent authorities to monitor those systems. Host authorities should be in a position to monitor the foreign exchange exposure of foreign establishments in their territories and should inform themselves of the nature and extent of the supervision of these establishments being undertaken by the parent authorities.