



Review of Cross-Border Supervision Arrangements and Coordinated Host-Home Country Supervision in South-East Europe

Draft Terms of Reference

Background and Objectives

The purpose of this review is an examination of cross-border supervision issues, as seen from the confidential perspective of senior host country authorities in South-East European countries¹. Those financial systems are characterized by a high degree of foreign ownership, as compared to just 20% in Western Europe, with most foreign-owned banks originating from EU countries.

There is a widespread perception, corroborated by confidential feedback from individual host country authorities, that collaboration with home country authorities is not sufficiently well-structured to allow host country authorities to discharge themselves satisfactorily from their supervisory duties in relation to financial and monetary stability.

Even in presence of formal memoranda of understanding (MOUs) or letters of exchange between home and host country authorities, the objective of synchronizing prudential techniques and procedures between these countries, which will acquire increased importance with the Basel II requirements, is not yet within reach.

The absence of effective and efficient information-sharing routines between host and home country authorities prompt the former to take precautionary measures that are sometimes judged as being excessive by market participants. Occasionally, authorities may refrain from taking remedial actions on the assumption that the parent bank and home country authorities will intervene should a problem materialize. More generally, this imperfect cross-border interface adds to the reporting requirements, which are onerous and disparate across host country jurisdictions, increasing the costs of doing business for international banks and hampering operational integration across the European banking system.

The benefit of the review is expected to be three-fold: (a) to help host country authorities refine their collective view of common regional issues faced in relation with home country authorities and of practical policy constraints faced as a result of an imperfect collaboration; (b) to provide a third-party assessment of these issues as a basis for an informal bilateral engagement with selected home country authorities by a neutral entity, such as “Convergence”; (c) to establish a comparative basis that will encourage host country authorities to harmonize reporting and supervisory practices – as a first step towards a “single rule book” for large EU banks.

Project Scope

The review will be undertaken in four steps:

First: To gather information via confidential one-on-one meetings with senior local authorities. To seek the views of selected major European financial sector strategic investors.

¹ The countries will be: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, Serbia and Montenegro.



- Second: To create a platform of issues for discussion to be shared among host country authorities.
- Third: To sketch proposals on potential harmonization of reporting obligations of individual banks and host country authorities converging towards EU practices. .
- Fourth: To approach informally one or two home country authorities and relevant international institutions with a “no paper” describing the issues as seen from the perspectives of host country authorities. Be ready to play a low-key facilitation role should a dialogue be possible.

Content

The review will cover the following areas:

1. Analysis of the prevailing supervision standards and regulations pertinent to foreign branch/subsidiary bank establishment and type of supervisory authority (inside or outside the central bank) adopted by the South-East European countries; any proposed plans by the host country authorities to review or amend in the short-run the legislation or regulation in relation to supervision.
2. Analysis of the reporting requirements and supervisory practices as seen from the perspective of an EU-based parent bank with affiliates and subsidiaries in several South-East Europe countries.
3. Examination of the current status of cross-border supervision collaborative efforts in respective countries. Types of techniques, instruments and procedures exercised by host country and home country authorities to ensure the safety and soundness of their banking system. Are on-site supervision visits from home supervisors allowed? How often do they occur?
4. Identification of impediments to effective consolidated cross-border supervision (*access to information, collection and verification of supervisory data*) in terms of legislative, cultural barriers, technology and human resources deficiencies, as well as concerning transparency, compatibility, confidentiality issues, lack of trust, etc. This should be assessed from both host and home supervisors perspectives.
5. Outlining the possible instruments to improve consolidated supervision. Making proposals on adoption and implementation of a standard routine for conducting cross-border supervision and characteristics of information exchange the counterparties may use to satisfy their needs for effective ongoing consolidated supervision.
6. Sketching recommendations on harmonization of host country supervisory regulations, standards and any legislative acts with those of home countries (in the context of convergence to EU practices).
7. Assessing the impact of the introduction of Basel II in the home countries on the regulations and supervisory practices in the host countries.

The review will be completed by the end of year 2005. It is intended to make it available to Central Banks, bank regulators and market participants throughout the Convergence region of operations. It is intended to be disseminated at appropriate World Bank seminars, such as the WB-Banque de France Annual Banking Supervision Conference.



Output

1. A structured summary of the interviews conducted with host country supervisory authorities, outlining a possible work agenda for a regional supervisor working group.
 - a. An Annex with a description of regulatory and reporting requirements faced by international banks in the region.
 - b. An executive summary for the attention of host country governors.
 - c. A two/three-page “no paper” for the attention of home country supervisors.
2. Technical notes, even in table format, on the findings on types of collaborative efforts between host and home country supervisors, of impediments, and of possible improvements (Issues listed under 3, 4 and 5 of “Content”).

Criteria of selection for the Consultants

It is envisaged to retain two high-level experts to undertake this assignment, given its scope and sensitivity. They will have joint responsibility for the output. They may be later assisted by an analyst to compile and summarize the data gathered.

The First Consultant needs to have the following characteristics:

- To have considerable experience in the European financial and banking sector and/or the economic academic field;
- To enjoy very high personal and professional standing with European authorities and market participants;
- To be knowledgeable of the Basel Committee work on Banking Supervision
- To have a significant history of writing on financial, banking or economic matters.

He/she will have the opportunity to be assisted by a small group of peer reviewers, possibly drawn from the authorities, banks and other independent policy analysis centers.

In addition to having the above characteristics, the Second Consultant will have the following complementary features:

- To have gained considerable central banking experience, most preferably in the Convergence region;
- To enjoy very high personal and professional standing with South-East European authorities and market participants;

The Consultants will collaborate closely with the Convergence team. Mr. Shkelqim Cani, a World Bank consultant contracted to undertake pre-implementation work for Convergence, will be their primary contact. Mr. Luigi Passamonti, World Bank Convergence Task Manager, will provide overall oversight.

The World Bank and Convergence will assist the Consultant to gain access to relevant host country authorities and to the selected financial sector strategic investors in the region.