

GAO

Report to the Comptroller of the Currency
and Chairmen of the Federal Reserve
System and the Federal Deposit Insurance
Corporation

July 1986

INTERNATIONAL
BANKING

U.S. Banking
Supervision and
International
Supervisory Principles



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United States
General Accounting Office
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National Security and
International Affairs Division

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July 25, 1986

The Honorable Robert Clarke
Comptroller of the Currency

The Honorable Paul Volcker, Chairman
Board of Governors
Federal Reserve System

The Honorable William Seidman, Chairman
Federal Deposit Insurance Corporation

This is our report comparing the consistency of U.S. banking agency regulations, policies, and procedures with Basle Committee principles.

This report contains recommendations. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken to address our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget, to the cognizant congressional committees and subcommittees, and to other interested parties.

We want to thank you for your cooperation in this review.

Frank C. Conahan
Director

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Executive Summary

Purpose

To improve the supervision of international banking, the United States and 11 other countries participate in a group which coordinates bank supervision. This group, known as the Basle Committee, has agreed on number of principles designed to ensure that international banking is adequately supervised.

In this report, GAO identifies the extent to which the regulations, policies, and procedures of U.S. bank regulatory agencies are consistent with the principles agreed to by the Basle Committee.

Background

The Basle Committee has been the main forum for international coordination of bank supervision since its inception in 1974. It has agreed on ways to improve the supervision of banks' international activities. It has allocated responsibility for supervising the foreign offices of banks between countries where the offices are located (host countries) and those in which the banks are headquartered (parent countries). It has also indicated that bank supervisors need to ensure that foreign banks are adequately supervised in their home countries when considering these banks' applications for overseas offices. And it has made other recommendations concerning capital adequacy, country risk, foreign exchange risk, and consolidated supervision.

The Committee is an advisory body whose recommendations require unanimous agreement of all its representatives. It has no power to require implementation of its agreements in the laws or regulations of its member nations. However, U.S. federal bank supervisory agencies, well as the bank supervisory agencies of other member countries have committed themselves to work to implement Committee principles.

The United States is represented on the Committee by the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC). State banking agencies, however, are not represented on the Committee. State as well as federal agencies may approve U.S. offices of foreign banks.

Results in Brief

U.S. federal banking agencies' regulations, policies, and procedures are in many ways consistent with the Basle Committee international supervisory principles. The Committee's concern with the decreasing capital positions of banks, its endorsement of the consolidation principle, and its emphasis on assessing country and foreign exchange risk are

addressed in U.S. banking laws or regulations. In some instances, the U.S. agencies addressed supervisory issues before the Committee did.

However, some concerns which the Committee believes are important to the supervision of banks' international activities, are insufficiently stressed by U.S. banking agencies. For example, in over 70 percent of foreign banks' applications to open U.S. offices that GAO examined, federal and state bank supervisory agencies did not assess the adequacy of parent countries' supervision of foreign banks.

Principal Findings

U.S. Supervision Consistent With Basle Committee Guidelines

Banking supervision principles used by the federal bank regulatory agencies are in many respects consistent with Basle Committee principles. Since the Committee raised concerns about the deterioration in banks' capital positions, the U.S. agencies have set and then increased minimum capital requirements for U.S. multinational banks. Before the Committee's strong endorsement of supervision of all domestic and foreign affiliates of banks, i.e., consolidated supervision, the U.S. agencies had already begun supervising U.S. banks in this manner. Similarly, U.S. bank supervisors were examining for the risk in international bank lending before the Committee recommended that it be done. The federal bank regulatory agencies also contact foreign supervisors when considering applications of foreign banks for U.S. offices, thereby establishing a basis of cooperation for supervising foreign banks' U.S. offices.

Differences Between U.S. Supervision and Basle Committee Principles

The major difference between Committee principles and the regulations, policies, and procedures of U.S. banking agencies is the limited attention federal and state agencies give to identifying the nature and adequacy of foreign bank supervision. The financial well-being of a U.S. office of a foreign bank may depend on that of the parent bank, which is under foreign supervision.

Only 7 of the 30 applications made to the Federal Reserve for establishing or purchasing U.S. subsidiary banks or for establishing Edge Act corporations which GAO examined had any type of assessment about parent country supervision. Furthermore, at least 17 of the 25 FDIC insurance applications for U.S. branches of foreign banks which GAO examined had information on practices of foreign bank supervisors; yet,

the FDIC did not prepare assessments of the adequacy of parent supervision for 15 of these applications.

In addition, some state banking agencies infrequently contact foreign supervisors when considering applications of foreign banks for U.S. offices.

State banking agencies are not represented on the Committee and are generally less familiar with its activities and with foreign bank supervision than federal agencies. They do not, in most instances, ask the Federal Reserve, which is represented on the Committee and gathers information on foreign bank supervision, to supply such information when they are considering applications by foreign banks to establish U.S. offices.

Recommendations

The Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Federal Deposit Insurance Corporation should:

- Ensure that their agencies evaluate the adequacy of foreign bank supervision and consider economic conditions in the home country when foreign banks apply to establish U.S. banking offices and encourage state banking agencies to do so.
- Encourage state banking agencies to notify parent supervisory agencies when they receive foreign bank applications to establish U.S. banking offices.
- Arrange to periodically brief state banking officials about the activities of the Basle Committee.

The Chairman of the Board of Governors of the Federal Reserve System should establish a central repository of information on foreign bank supervision and make known the availability of this information to other banking agencies to use when they receive applications from foreign banks to establish U.S. offices.

Agency Comments

A draft of this report was provided to the Federal Reserve, FDIC, OCC, and the banking departments of California, Florida, Georgia, Illinois, and New York for their review and comment. The federal agencies, the Florida Division of Banking, and the New York State Banking Department submitted comments. OCC, the New York Banking Department, and the Florida Division of Banking generally agreed with GAO's findings.

The Federal Reserve, FDIC, and the New York State Banking Department stated that they assess the adequacy of foreign bank supervision, although there may be no written record of the assessments. OCC said that it assesses parent country supervision only for the initial application from any bank in a particular country. GAO's conclusion that limited attention is given to the adequacy of foreign banking supervision is supported by its work and is based on the general absence of documentation on this subject in application files. In addition, interviews with officials of these agencies indicated that assessments of foreign banking supervision are not routinely made.

GAO recognizes that lack of documentation does not mean that the agencies have not given any attention to this matter. However, without such documentation it is impossible to know whether it has received sufficient attention. GAO feels that because the Basle Committee has stressed the need to assess the adequacy of foreign bank supervision, U.S. banking supervisory agencies should ensure that this issue routinely receives systematic treatment.

As a result of GAO's recommendation, the New York State Banking Department stated it is now requiring complete documentation of foreign banking supervision and FDIC has agreed to make greater efforts to more explicitly address this issue in examinations.

Both the Federal Reserve and FDIC expressed their willingness to encourage state banking agencies to evaluate and communicate with foreign supervisors when considering applications.

The Federal Reserve and FDIC agreed with GAO's recommendation that federal banking agencies should arrange to brief state banking officials on the results of Basle Committee activities.

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Abbreviations

FDIC	Federal Deposit Insurance Corporation
GAO	General Accounting Office
IBA	International Banking Act of 1978
OCC	Office of the Comptroller of the Currency

The Basle Committee and International Coordination of Bank Supervision

The past several decades have witnessed substantial growth in the foreign presence and activity of financial institutions. The threat to bank safety and soundness from weakly regulated overseas bank offices as well as the actual failure of several banks operating in the international marketplace in the early 1970's prompted bank supervisory authorities to improve the coordination among themselves. The Basle Committee, an advisory body of bank supervisors and central bankers, was created in 1974 to help foster greater coordination. Its members, including bank supervisory agencies from the United States, other Group of Ten (G-10) nations, and Switzerland, have agreed on principles to improve supervision of the international operations of banks and their overseas offices. These principles are especially important to U.S. bank supervisory agencies in light of the substantial growth in the number of foreign bank offices in this country in the past decade, including growth in recent years in those from nations not represented on the Basle Committee and therefore subject to supervisory standards less familiar to U.S. supervisors.

The Committee is an advisory body whose recommendations require unanimous agreement of all its representatives. It has no power to require implementation of its principles in the laws or regulations of its member nations. However, U.S. federal bank supervisory agencies, as well as the bank supervisory agencies of other member countries, have committed themselves to work to implement Committee principles.

Questions about the international coordination of bank supervision were raised in hearings on international bank regulation held before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance & Urban Affairs, in the spring of 1983.

Subsequently, in the International Lending Supervision Act of 1983 (Public Law 98-181), Section 911 provided that GAO may conduct "a review or evaluation of the international regulation, supervision and examination activities" of the Federal banking agencies, "including the coordination of such activities with similar activities of regulatory authorities of a foreign government or international organization." We therefore initiated a review to determine the progress and current status of efforts to improve international coordination of bank supervision.

¹These countries actually number 11 (Belgium, Canada, France, Italy, Japan, Luxembourg, the Netherlands, Sweden, United Kingdom, United States, and West Germany).

The results of that effort are provided in our February 1986 report² which focuses on the Basle Committee, the preeminent body in international coordination, including its accomplishments and important issues still on its agenda. This report compares U.S. supervisory agencies' policies and procedures in international banking with principles agreed to by the United States and other Committee members.

Basle Committee Accomplishments

In the more than 10 years since its formation, the Committee has addressed sensitive bank supervisory issues, especially those that have arisen because of the spread of banks' foreign offices. In two agreements known as the Basle Concordats, the Committee has allocated responsibility for supervising the foreign offices of banks between countries where the offices are located (host countries) and those in which the banks are headquartered (parent countries). By agreeing to share responsibilities in this manner, the Committee has made it less likely that foreign offices will not be supervised. And to further ensure supervision, the Committee has stressed that these responsibilities should extend to all offices of a banking organization, even those not viewed as banks by some nations.

The Committee has also agreed that supervision of foreign offices should be adequate, as judged by bank supervisory agencies in both the parent and host countries. This requires that, before allowing a foreign bank to conduct business within its borders, a country must be satisfied with the supervision exercised by the parent country.

The Committee has recommended that banking supervisors use the consolidation principle in supervising the international operations of their banks. Through such an approach, a bank's worldwide activity is measured against the regulatory standards in place in its home country. Banks should thereby be less attracted to weakly regulated financial centers, since their operations in such locations would still be subject to their home country's regulations.

The Committee has also addressed other specific prudential issues that arise when banks operate internationally. It has called for national authorities to resist the general downward trend in banks' capital positions. It stressed that bank supervisors should assure that banks have adequate systems for controlling concentrations of loans to individual countries (country risk). And it gave alternative approaches for bank

²International Coordination of Bank Supervision: The Record to Date, (GAO/NSIAD-86-40)

supervisors to use in monitoring and controlling banks' foreign exchange activities.

U.S. Participation in the Basle Committee

At Committee meetings the United States is currently represented by four bank regulatory officials—two from the Federal Reserve, and one each from the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). The Federal Reserve Board has designated an Associate Director in its Banking Supervision and Regulation Division as its representative. This individual has attended Committee meetings since their inception in early 1975. The Federal Reserve Bank of New York, given its responsibilities in money markets, was added as a U.S. representative in late 1975. It has sent different individuals, but has always been represented by a senior official of its foreign department.

OCC was added as a representative in 1978. A deputy Comptroller has usually been its representative, although on occasion the Comptroller has attended. In 1984, FDIC became the third federal bank regulatory agency represented at Committee meetings. This was shortly after the Congress, in the International Lending Supervision Act of 1983, asked that FDIC be given equal representation with the other agencies. It has been represented by the Director of its Division of Bank Supervision.

Objectives, Scope, and Methodology

We initiated this review to compare U.S. supervisory policies and procedures with the principles agreed to by the Basle Committee. In comparing federal supervisory policies with international guidelines, we reviewed banking laws and regulations and interviewed agency officials to determine their procedures for supervisory matters addressed by the Basle Committee, such as capital adequacy, country risk, foreign exchange risk, and authorization and examinations of banks' foreign offices.

We paid special attention to the ways that U.S. supervisory agencies ensure that foreign banks with U.S. offices are adequately supervised by their parent countries. The safety and soundness of a bank's overseas offices may be strongly influenced by the condition of its parent bank, and therefore supervision of that institution is an important consideration. This is why the Basle Committee recommended that host supervisors judge their counterpart parent supervisors in the original Concordat in 1975, and amplified the recommendation in a revised Concordat and in another document, both issued in 1983.

We specifically examined whether these judgments were made when foreign banks apply for U.S. offices, since the Basle Committee states this is an appropriate time to assess parent supervisors. As foreign banks can open offices in the United States with either state or federal approval, we expanded our efforts in reviewing foreign bank applications to include several state banking agencies.

We reviewed 169 of the 251 applications by foreign banks for U.S. offices for the period January 1, 1980, to June 30, 1984,³ made to the OCC, FDIC,⁴ the Federal Reserve Banks of New York, Atlanta, Chicago, and San Francisco, and the states of New York, California, Florida, Georgia, and Illinois.⁵

We concentrated on applications from non-G-10 countries (129 of 169) because less is known about banking supervision in these nations. The five states we reviewed contained over 90 per cent of the state-approved foreign bank offices in the United States as of June 30, 1984. For these applications, we examined the extent of communication between the U.S. banking agencies and foreign supervisors and the extent to which the U.S. banking agencies assessed the adequacy of supervision by the parent countries.

We also determined whether the U.S. agencies gathered data about the parent supervisors that could be used to support judgments on their adequacy, specifically their procedures or regulations for the four supervisory dimensions.

1. Capital adequacy standards imposed on banks.
2. Controls over excessive concentrations of risks by banks.

³While part of this period is before the Committee's most specific pronouncements on judging supervisory adequacy and economic condition, the application policies of the agencies reviewed, with one exception, have not changed with respect to these matters during 1980-84; one state agency reduced the information it required some applicants to submit on their parent supervisors, and the effect of this change is to overstate this agency's present conformance to Committee guidelines.

⁴Applications to FDIC were for insurance, not licenses or charters.

⁵For the Federal Reserve Bank of San Francisco and the state of California, applications reviewed were for the period beginning January 1, 1981. For several agencies the ending date of the period of our review varied, as follows.

Federal Reserve Bank of New York, New York State - Dec. 31, 1984
FDIC - Nov. 30, 1984
Illinois - June 1, 1984
California - May 18, 1984
OCC - Jan 31, 1984
Federal Reserve Bank of Atlanta (subsidiaries only) - Dec. 31, 1983

3. Monitoring of bank exposures to individual countries.
4. Consolidation of all of a bank's activities in imposing supervisory standards.

We selected these four dimensions because of the emphasis given to them in Committee documents and by Committee representatives in our discussions with them. We believe they are fundamental to assuring the safety and soundness of financial institutions.

After our review of application files was nearly complete, the Committee issued a questionnaire for supervisory authorities to use in obtaining basic information needed to judge the supervisory capabilities of other nations. The four dimensions used in our analysis represent most of the supervisory issues addressed in the questionnaire.

We also reviewed foreign bank application files to determine whether U.S. agencies considered economic conditions in the home country, as recommended by the Committee.

We identified information available at the Federal Reserve Board regarding foreign bank supervisory systems because of the Board's residual authority over all U.S. banking operations of foreign banks⁶ and determined to what extent this information was shared with or requested by other U.S. agencies. Finally, we determined the extent to which the Federal Reserve assessed foreign host supervisors in its deliberations on the applications of U.S. banks for overseas offices.

Our review was conducted in accordance with generally accepted government auditing standards.

⁶This authority, given to the Federal Reserve by the International Banking Act of 1978, permits it to review the domestic activities of U.S. offices of foreign banks with multi-state operations

Policies and Procedures of U.S. Federal Bank Supervisory Agencies Consistent With International Supervisory Guidelines

In the past decade, numerous legislative and regulatory initiatives have addressed many of the supervisory issues that arise because of the international activities of U.S. banks and the U.S. activities of foreign banks. Some of these issues parallel guidelines recommended by the Basle Committee. Consolidated supervision, strongly supported by the Committee, has long been practiced by federal supervisory agencies. For a number of years, these agencies have also evaluated and commented on country risk exposures of U.S. banks. Procedures for assessing the internal controls over banks' foreign exchange transactions have also been adopted by the federal agencies. In addition, the agencies, with the support of the Congress, have strengthened the minimum capital requirements for U.S. multinational banks.

Capital Requirements Strengthened

In recent years, the Basle Committee has been concerned with the capital adequacy of banks, especially in light of their international activities. It was particularly troubled by a general downward trend in the capital positions of banks in many nations. To date, its main effort has been a 1982 paper in which it concluded that national supervisors should resist any further decline in capital positions.

Since 1982, U.S. regulatory agencies, with the support of the Congress, have increasingly emphasized strengthening the capital bases of U.S. banking institutions. In 1983, specific capital adequacy guidelines were set for the first time by the Federal Reserve and OCC for U.S. multinational banks.¹ At a minimum, these banks were expected to maintain a ratio of primary capital to total assets of at least 5 percent.²

In 1983, the Congress emphasized its concern about the capital positions of U.S. banks by granting the federal banking agencies specific statutory authority (12 U.S.C. 3907) to establish minimum capital levels and requiring the agencies to impose these minimum standards.

In 1985, the federal banking agencies increased the minimum capital requirements for U.S. multinational banks. While the agencies' new requirements differ somewhat as to the specifics involved in calculating capital ratios, all raise the minimum primary capital level to 5.5 percent

¹Multinational banks are large financial institutions with significant international activity. They are designated as being multinational by their respective U.S. supervisory agencies.

²Primary capital includes common stock, perpetual preferred stock, capital surplus, undivided profits, and reserves for loan losses. It does not include limited-life preferred stock or subordinated debt.

of total assets, with the minimum total capital, including the elements of capital not considered primary capital, set at 6 percent of total assets.

Consolidated Supervision Practiced

The Basle Committee has strongly endorsed the principle of consolidated supervision. Consolidated supervision calls for a parent bank supervisor to assess banks for prudential purposes in light of their total worldwide business, wherever conducted and whatever the structure of their organization. Using this approach, all the assets and liabilities of all parts of a bank (branches or subsidiaries) are aggregated, with any intrabank transactions netted against each other. With such consolidated data, the Basle Committee believes that supervisory authorities can "most satisfactorily" monitor the capital adequacy and risk exposure of banks and has called for supervisors to include in this consolidation all branches of a bank and all wholly or majority-owned subsidiaries.

The federal bank regulatory agencies supervise U.S. banks on a consolidated basis. Their requirements for consolidation are generally consistent with the recommendations of the Basle Committee. Since 1969, the federal agencies have required U.S. insured banks to consolidate all domestic majority-owned subsidiaries in their quarterly reports to the agencies. This consolidation requirement was expanded in 1976 to include the income and expenses of foreign subsidiaries. Beginning in 1978 the balance sheets of significant majority-owned foreign subsidiaries were also required to be consolidated.

The federal agencies do not require banks to consolidate non-significant majority-owned subsidiaries—those whose income is less than 5 percent of the parent bank's income and whose parent bank investment is less than 5 percent of the capital of the parent bank. The Federal Reserve Board's representative to the Basle Committee stated that this difference between the Committee's recommendation and U.S. practice was relatively minor, since there are few unconsolidated majority-owned subsidiaries. An assistant chief examiner of the Federal Reserve Bank of New York stated that even if not consolidated, non-significant, majority-owned subsidiaries are reviewed by federal bank examiners during examinations of their parent banks.

Country Risk Monitored

The Basle Committee distributed a paper in 1981 to supervisory authorities and banks throughout the world offering guidance on the assessment and supervision of country risk—the risk that political, economic,

or social phenomena may prevent borrowers from a particular country from repaying their international indebtedness entirely or in a timely fashion. The Committee paper calls for bank supervisors to ensure that their banks have adequate methods of assessing, measuring, and controlling country exposures but does not prescribe a specific measurement system for doing so.

The federal bank regulatory agencies began examining the country risk to U.S. banks with relatively large foreign lending in 1979, several years before the Committee issued its paper. The agencies have adopted a uniform examination system for country risk, which consists of identifying countries with actual or potential debt-servicing problems, calling loans to these countries to the attention of bank management in examination reports, and evaluating bank internal country exposure management systems.³

Bank Controls Over Foreign Exchange Risk Reviewed

The Basle Committee has also issued a paper describing the risks in foreign exchange transactions and the appropriate role of banks and their supervisors in managing these risks. It indicated that a supervisor's review of foreign exchange activity could include any combination of the following approaches.

- Examining banks' internal control procedures for foreign exchange transactions.
- Monitoring banks' foreign exchange positions.
- Setting formal or informal limits on these positions.

The federal bank regulatory agencies' supervision of foreign exchange risk combines the first two approaches. These agencies have issued examination procedures for foreign exchange which require the agencies to ensure that internal controls for banks' foreign exchange dealings exist and function effectively. The agencies also monitor the open foreign exchange positions of banks.⁴

³In our Sept. 2, 1982 report, Bank Examination for Country Risk and International Lending, (GAO/ID-82-52), we identified improvements needed in the examination system. The agencies have subsequently modified their system and we plan to examine this modified system.

⁴We are separately examining the prudential controls over U.S. banks' foreign exchange transactions.

Communication With Foreign Supervisors on Foreign Bank Applications

The Basle Committee has emphasized that adequate supervision of banks' foreign offices requires close contact and cooperation among bank supervisory authorities. In particular, it has called on host authorities to contact the parent supervisory authority upon receipt of a bank's application to establish an office in its country. These contacts should (1) aid in fostering future cooperation in supervising the bank and its new foreign office and (2) enable the host authority to ensure that the parent authority is aware of and has given formal authorization for the foreign office. Host authorities should also use these contacts as a means to identify the extent to which the parent bank and its proposed office are supervised by the parent authority and, in particular, whether that supervision is undertaken on a consolidated basis.

Federal banking agencies' procedures are generally consistent with these Committee recommendations. Over 90 percent of the applications to establish offices that we reviewed contained requests for comments sent to and/or responses received from the appropriate parent supervisory authorities.⁵ The responses normally gave assurance that the parent supervisor authorized the proposed new office of the parent bank or at least was aware of it. On occasion, the parent supervisory authority commented on the applicant's financial or managerial structure. These comments were sometimes amplified by telephone contacts and/or meetings with foreign supervisory officials when uncertainties in applications necessitated them. Less than 3 percent of the comments, however, addressed whether the proposed office would be supervised on a consolidated basis by the parent authority.

Conclusions

Banking supervision principles used by the federal bank regulatory agencies are in many respects consistent with Basle Committee principles. The Committee's concern with the decreasing capital positions of banks, its endorsement of the consolidation principle, and its emphasis on assessing country and foreign exchange risk are addressed in U.S. banking laws or regulations. Indeed, in several instances, U.S. agencies addressed these supervisory issues before Committee actions.

⁵ A Federal Reserve policy statement issued in 1979 requires that it request the views of parent authorities of foreign banks seeking to acquire U.S. banks

Differences Between U.S. Banking Agency Policies and Procedures and International Supervisory Principles

Differences between U.S. banking agencies' supervisory regulations, policies, and procedures and Basle Committee principles mostly result from U.S. agencies' general lack of evaluation of the adequacy of banking supervision in other countries, especially in judging applications by foreign banks to open offices in the United States. Adequate banking supervision by foreign authorities of banks in their countries can be critical to the safety and soundness of U.S. offices of these banks. The financial health of the latter can in part depend on the financial health of their parent banks, and adequate supervision of parent banks should help to prevent them from becoming unsafe and unsound.

U.S. Supervisory Agencies' Assessments of Foreign Supervisors

Federal and State Banking Agencies Authorize U.S. Offices of Foreign Banks

Foreign banks can operate in the United States through three major types of offices: agencies, branches and subsidiaries. Agencies and branches are most closely linked to foreign parent banks; they have no separate legal identity but are merely extensions of parent banks operating in the United States. The main distinction between agencies and branches is that the former cannot accept deposits. Subsidiaries, in which the foreign parent bank has a total or partial interest, are identical to banks owned by U.S. residents and are subject to the same regulatory restrictions.¹ The form of office chosen by a foreign bank can depend on the business the bank expects to do in the United States and is also influenced by state and federal laws which control the establishment of these offices.

Foreign banking organizations may operate in the United States through a subsidiary by either acquiring an existing bank or establishing a new subsidiary. In applying to open a new subsidiary bank, a foreign bank can seek either a federal charter from the OCC or a charter from one of the states. In any case, if the foreign bank will own or control at least 25 percent of the subsidiary, the Federal Reserve must also approve the foreign parent bank as a bank holding company. In these decisions, the Federal Reserve considers the foreign bank's ability to be a source of

¹ Foreign banks also received authority to establish Edge Act corporations in 1978. These subsidiaries, like domestic-owned Edge Act corporations, are limited to transactions supporting international business.

financial and managerial strength and support to the U.S. subsidiary bank, the future prospects of the bank being acquired, community needs, and the competitive effects of the proposed bank.²

Until 1978, foreign banks wanting to establish branches or agencies in the United States could apply only to states that authorized such foreign owned offices. The International Banking Act (IBA) passed that year, however, authorized the OCC to grant federal licenses for these offices. In approving such branches and agencies of foreign banks, the Federal Reserve's role (including the entire federal role in the case of state-licensed branches and agencies) is limited primarily to determining whether the parent bank of the branch or agency undertakes proscribed nonbanking activities.

Assessments of Parent Supervisory Agencies

As stated in chapter 1, one of the Basle Committee's principles is that prior to allowing a foreign bank to conduct business within its borders, a country needs to assure itself as to the adequacy of supervision exercised by the bank's parent country. We examined applications of foreign banks for establishing U.S. offices to determine whether such assessments were made. We considered any type of evaluative statement as indicating that an assessment had been made.

In over 70 percent of the applications for U.S. offices that we examined, federal and state bank supervisory agencies did not assess the adequacy of parent countries' supervision of foreign banks. (See table 3.1.) The general lack of assessment existed for banks from non-G-10 as well as G-10 countries. It is perhaps more troubling for the former group, since U.S. supervisors have not participated with these countries in frequent international coordination discussions and thereby gained familiarity with their supervisory approaches, as they have with G-10 countries, through Basle Committee meetings.

²The Federal Reserve is the sole regulator of Edge Act corporations, including approving applications of foreign banks to establish these offices.

**Chapter 3
Differences Between U.S. Banking Agency
Policies and Procedures and International
Supervisory Principles**

**Table 3.1: U.S. Banking Agencies'
Assessments of Parent Supervisory
Authorities**

Agency	Foreign Bank Applications Reviewed		
	G-10^a	Non- G-10^b	Total
OCC	4	47	51
Federal Reserve	8	22	30
FDIC ^c	1	24	25
State Banking agencies	27	36	63
	40	129	169

**Chapter 3
Differences Between U.S. Banking Agency
Policies and Procedures and International
Supervisory Principles**

Assessments Made						Assessments Not Made					
Number			Data on critical supervisory dimensions^a			Number			Data on critical supervisory dimensions^a		
G-10^a	Non-G-10^b	Total	G-10^a	Non-G-10^b	Total	G-10^a	Non-G-10^b	Total	G-10^a	Non-G-10^b	Total
2	18	20	2	6	8	2	29	31	2	8	10
1	6	7	1	4	5	7	16	23	3	8	11
0	10	10	0	9 ^c	9	1	14	15	0	8 ^c	8
5	6	11	4	5	9	22	30	52	6	10	16
8	40	48	7	24	31	32	89	121	11	34	45

^aG-10 countries and Switzerland

^bOther Than G-10 countries and Switzerland

^cNumber of applications for which information was obtained on at least one of the following: capital adequacy standards, risk concentration standards, consolidated supervision, and country risk supervision

^dApplications were for insurance, not licenses or charters

^eWe were unable to obtain complete files for some of these applications, including the initial submission by the applicant; these documents may have addressed critical supervisory issues

Furthermore, most U.S. supervisors do not obtain information on the practices of parent supervisors that would be of significant value in judging their adequacy, i.e., the use of consolidation in supervision, the existence of some form of capital adequacy and risk concentration standards, and the monitoring of country exposures. Information obtained is garnered primarily from the applicant, with little or no verification by the U.S. supervisory agency.

Lack of assessments about foreign supervisors relates to branches, agencies, and subsidiaries. For branches and agencies, however, lack of supervisory assessment is more critical, because U.S. branches or agencies, not being U.S. chartered banks, do not have an independent legal existence in this country or their own capital; therefore, they are likely to be more dependent on their foreign parent banks for management and financial control. In these instances, therefore, the United States is more dependent on foreign supervisors who regulate foreign banks.

In considering foreign bank applications, U.S. state and federal agencies focus on statutory criteria for granting charters or licenses. These generally require consideration of the financial and managerial resources of the applicant and the impact on meeting community needs. OCC and Federal Reserve officials mentioned that, despite the Basle Committee's recommendation, these laws do not require an assessment of the parent bank's supervisory agency. While federal statutes are silent on this issue, in our opinion their language gives the agencies sufficient authority and discretion to consider the adequacy of supervision in the parent country. In addition, our examination of the language of statutes of states included in our review revealed nothing that would prohibit those state supervisory agencies from considering this factor.

Some state and federal bank supervisory officials stated that although individual application files may not disclose significant data on foreign supervisors, institutional knowledge exists about these bodies. Some of these officials stated, though, that this knowledge was not necessarily current or existing for all countries whose banks are applying for U.S. offices.

Other officials stated that their agencies made little effort to gather data on foreign supervisors or to assess their adequacy. Some said that a more consistent approach was needed to do this but cautioned that gathering such information is not an easy task. Laws or regulations or organization charts of supervisory agencies do not necessarily correspond with how they operate in practice. Some state banking agency officials noted that they have more difficulty than federal officials in gaining information because they do not participate in many of the bilateral and multilateral discussions that occur among central banks and national bank supervisory agencies. Finally, two officials pointed to political sensitivities involving any unfavorable assessment a U.S. banking agency might make about another country's supervisory system.

OCC

In reviewing most applications by foreign banks to establish federally licensed branches or agencies, OCC infrequently addresses to any significant degree the nature and adequacy of banking supervision existing in the home countries. For the 51 applications we reviewed, OCC obtained little beyond general background information about the parent bank's supervisory authority directly from the applicant, gathered less information about such supervision itself, and in most cases did not make any evaluation or reach any conclusion about the adequacy of parent supervisory authority.³

We found evidence of some sort of OCC evaluation or conclusion on the adequacy of supervision by the parent authority in only 20 of the 51 applications reviewed. Many of these were brief general statements, such as "supervision appears adequate," "banking operations are highly regulated," and "the supervision of Bank X is acceptable." Only 8 of the 20 applications with evaluations addressed at least one of the four supervisory dimensions we identified as important in judging parent supervisory agencies—consolidated supervision, supervision of risk concentrations, supervision of country risk, and standards for capital adequacy.

OCC does routinely obtain some data on the parent country supervision of foreign banks applying for a federal license. It requires applicants to "provide a brief description of the bank regulatory system" in their home country, including the

- powers and functions of bank supervisory authorities,
- frequency and scope of supervisory examinations, and
- functions of the central bank.

In virtually all cases we reviewed, these descriptions were provided to OCC. They were brief and usually described the frequency of supervisory examinations in the home country and occasionally their scope. However, the applicant banks offered little discussion as to the nature of specific supervisory standards used by their supervisors. For example, in only 7 of the 51 applications did the applicants indicate whether their parent supervisory authorities practice consolidated supervision, thereby including all the worldwide business of financial institutions under their supervisory standards.

³Comments from OCC's bank supervision division were included in all 51 application files

The nature of the parent authorities' supervision of capital adequacy, risk concentrations, or country risk was also infrequently discussed.

OCC rarely added its own analysis of supervisory practices of the parent authorities to the limited data provided by the applicants. Internal memorandums describing the supervision usually restated in part what the applicants had submitted, with few independent comments by OCC.

In a few cases, OCC made significant efforts to assure itself that supervision in the home countries was adequate. In fact, one application was denied (the only branch or agency application denied by OCC during the period covered by our review) because OCC did not consider the supervision by the applicant's parent authority to be acceptable. In approving another application, OCC determined that (1) the parent bank would receive limited supervision by the home country supervisor, and (2) the bank was not required to maintain reserves or observe formal liquidity ratios. OCC considered these and other supervisory issues in its deliberations on this application.

In another case, OCC assured itself of the existence of a parent supervisory agency, but not its adequacy. A subsidiary of a bank applied to OCC to open a federal branch. The Federal Reserve Board, in commenting on the application, questioned whether the subsidiary was supervised. OCC subsequently determined that the subsidiary was not subject to any indigenous supervision in its home country. The Federal Reserve Board and OCC discussed whether approving such an "unsupervised" application would contravene Basle Committee principles. OCC subsequently obtained the commitment of the supervisory authority of the subsidiary's parent bank to include the subsidiary's activities in its consolidated supervision of the parent bank. In this way, OCC assured itself that the subsidiary would be supervised. However, it did not identify how adequate that supervision would be, although indications existed that the parent supervisory authority was weak and was only developing its capabilities.

OCC officials stated that the nature of the parent authorities' supervision was not a major consideration in its decisions on granting federal licenses. As a result, one official stated that OCC does not conduct any significant individual assessments or analyses to determine the adequacy of parent country supervision. He added that identifying the nature of bank supervision in foreign countries was a difficult task, especially since laws, regulations, or policies might not indicate how a supervisory system operates in practice. At the same time, he saw merit

in OCC obtaining more information on some of the critical supervisory standards used by foreign parent supervisors so that OCC could take any deficiencies into account in its supervision of U.S. branches or agencies.

Federal Reserve

The Federal Reserve frequently does not examine the adequacy of parent authority supervision in reviewing applications of foreign banks to establish or purchase U.S. subsidiary banks or to establish Edge Act corporations. Only 7 of the 30 applications we reviewed contained any sort of assessment or judgment about parent authority supervision.

Among the Federal Reserve banks we visited, virtually all the assessments of parent supervisory agencies we saw were made by the Federal Reserve Bank of New York. It discussed the adequacy of parent country supervisors in 5 of 17 applications we reviewed, and it obtained data on at least one of the supervisory dimensions we saw as critical in assessing supervisory agencies for four of these five instances. The other Federal Reserve Banks (Atlanta, Chicago, and San Francisco) offered conclusions on the parent country supervisors in only one of the 13 applications we examined.

Several officials at these latter Federal Reserve Banks said that they did not assess parent supervisory authority in reviewing applications. Relationships with foreign supervisory bodies were primarily the responsibility of the Board of Governors, they maintained. The Board, in fact, makes the final decision on applications for initial acquisition of an existing U.S. bank by a foreign bank.⁴ Our subsequent review at the Board of 9 of the above 13 applications, however, showed only one assessment of a parent supervisory agency. In this instance, the Board helped to make a judgment on the parent supervisor by sending a telex to the supervisor for confirmation that it supervised on a consolidated basis.

Although the Federal Reserve and Board of Governors do not generally assess foreign bank supervisory agencies, the Federal Reserve Banks and Board of Governors frequently obtained information on these agencies' supervisory practices; in 16 of the 30 applications we reviewed, this information addressed at least one of the four critical supervisory dimensions.

⁴It may also decide on applications by foreign banks for establishing subsidiaries or Edge Act corporations

An official of the Federal Reserve Board stated that the Board's inconsistency in addressing the nature of the parent authority's supervision has been a problem. He also said that knowledge of whether a country supervises on a consolidated basis is extremely valuable but that the Federal Reserve sometimes does not have such information when approving applications. He cautioned, however, that gaining information on the supervisory systems in some nations can be difficult, especially for those with few overseas offices.

Officials of the Federal Reserve Bank of New York stated that they do attempt to gather information on the supervision of parent banks, especially when the banks are not well known in the banking community. They believe that the threat resulting from a weak parent supervisor is not as great for subsidiaries, which are subject to the same U.S. regulatory standards as domestic banks and have their own capital, as it is for U.S. branches and agencies of foreign banks.

FDIC

The International Banking Act of 1978 permits branches of foreign banks to obtain federal deposit insurance and requires that those branches engaging in retail banking business apply for this insurance. In considering insurance applications, FDIC solicits more data on the home countries' banking supervisors than do other federal or state agencies when they weigh applications to open an office of a foreign bank. For at least 17 of the 25 insurance applications we reviewed, FDIC obtained data on at least one critical supervisory dimension and frequently addressed several. Yet, for 15 of these applications, it did not prepare assessments of parent supervisor adequacy.

In addition to a general description of the powers and functions of home country supervisors, the FDIC requires U.S. branches of foreign banks seeking insurance to identify

- the frequency, scope, and purpose of supervisory examinations of banks in the parent country;
- the nature of lender-of-last-resort support existing in the parent country; and
- the parent country's regulatory standards for capital adequacy, liquidity, foreign exchange exposure, risk concentration, and insider transactions.

We reviewed the seven insurance applications FDIC received since 1983,⁵ and all the applicants provided information along these lines. All seven discussed the parent authority's standards on risk concentrations, and most also addressed capital adequacy standards.

Information on parent country supervision obtained by FDIC is usually included in a memorandum sent by the staff to FDIC's Board of Directors. Of 25 applications we reviewed, these memoranda discussed capital adequacy standards in 11 instances and risk concentration standards in 10.

An FDIC official told us that the agency is more likely to be concerned about foreign bank regulation in applications where the parent bank is relatively unknown or has suspected weaknesses or where little is already known about its banking supervisor. We saw evidence of this in FDIC's response when a U.S. branch of a foreign bank from a developing country submitted sketchy information on the parent supervisor's policies and procedures. FDIC requested additional information on banking supervision in the parent country and the applicant responded in detail.

FDIC officials stated that the data it obtains on the nature of foreign bank supervision does not play a major role in its decisions on insurance applications. Other safeguards exist, they maintain, such as restrictions on the country exposures of branches, asset maintenance provisions, and FDIC examinations of foreign branches, to guarantee that the FDIC insurance fund will not be unduly exposed.

State Banking Agencies

In approving foreign bank applications for state-licensed branches or agencies, the state banking agencies included in our review evidenced little concern for the adequacy of banking supervision in the applicant's home country. We examined 63 such applications at five state banking agencies. These states represent major centers of foreign banking activity in the United States. For only 11 of these applications did the state agencies prepare assessments or judgments about the parent supervisory authorities. In 9 of these 11 cases, the state agencies gathered information on at least one of the critical supervisory dimensions.

For the remaining 52 applications we reviewed at state agencies, there was seldom any discussion of these critical supervisory dimensions.

⁵We were not able to obtain the complete files for the 18 applications made before 1983. Our analysis for these applications, therefore, is based on staff memoranda to the FDIC Board, which were present in all applications.

Only three applicants, for example, discussed whether they were supervised on a consolidated basis; only 10 indicated the risk concentration standards; 11 indicated the capital adequacy standards of their parent supervisors, and one mentioned how its supervisory agency monitors country risk. State banking agencies even more infrequently provide their own comments on these critical supervisory issues in application files. Only 16 of the 52 applications contained any discussion by applicants or agencies of at least one of the critical supervisory dimensions.

Some information on the parent supervisory authorities was normally obtained by the state agencies. All except one of the states we visited required or at least suggested that foreign banks applying for licenses describe the nature of their home countries' supervision. This requirement or suggestion, however, did not include any specifics regarding the regulatory or supervisory standards used in the home country, except in some cases a discussion of the nature of bank examinations conducted. In the applications we reviewed, most foreign bank applicants followed these requirements or suggestions, giving brief descriptions of their supervisory agencies.

One state agency accounted for most of the assessments. It rendered judgments on the parent supervisors' adequacy in 8 of the 24 applications we reviewed, obtaining information on at least one critical supervisory dimension in 7 of these 8 instances. In 8 other applications where a conclusion was not made about the parent supervisor, the agency still gathered data on at least one of the supervisory practices.

For one application, this state agency was concerned because the bank applying to operate a U.S. agency was in turn owned by a foreign holding company which had banking activities spread throughout the world. The state agency determined that the parent country was authorized to supervise the applicant bank but not its holding company. The state agency discussed supervision of the holding company with the banking supervisor in the parent country, and understood that the parent supervisor was nearing agreement with the holding company on procedures that would permit consolidated supervision. Not until our inquiries on this application, over a year after these discussions, however, did the state agency determine that such supervision was taking place and thereby ascertain that only about 85 percent of the holding company's activities were included in the consolidated supervision.

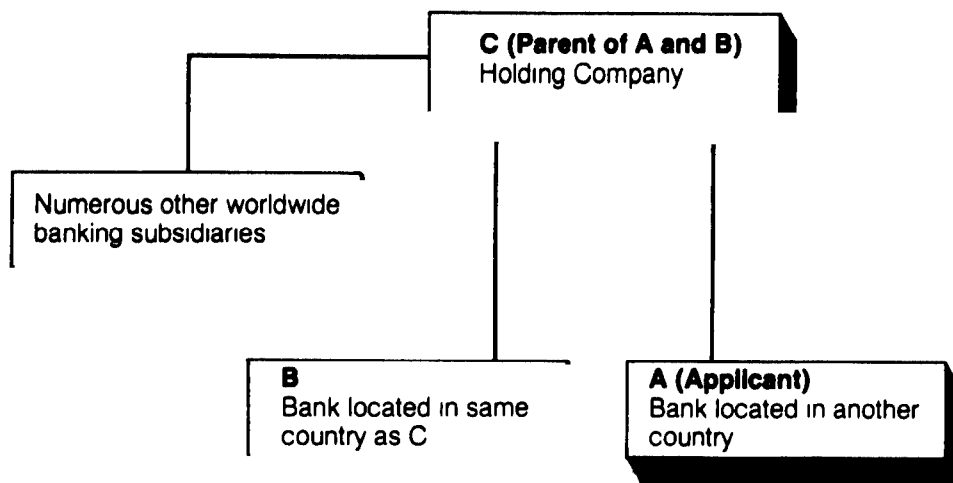
Officials at this agency agreed that they did not assess parent country supervision in all cases, because lack of agency resources prevents a

comprehensive assessment of foreign bank supervision. In addition, the agency's deputy superintendent stated that the state banking agencies do not have the opportunity to develop relationships with officials in foreign supervisory agencies as close as those of the federal agencies. These relationships, he felt, can aid in gaining insight into foreign bank supervisory practices.

Officials at two other state banking agencies, whose comments in application files indicated substantially less focus on the parent supervisor, maintained that parent country supervision of the applicant is a factor in application decisions, although of less significance than the financial soundness of the applicant. One of these agencies did offer conclusions on parent country supervision in 3 of 11 applications. It also discussed at least one critical supervisory dimension in most of the applications for which it did not provide conclusions. The chief deputy superintendent of this agency explained that its concern was primarily whether a parent banking supervisor of the foreign bank existed, not whether that supervision was adequate. The other agency did not reach any conclusion on parent country supervision or obtain any data on critical supervisory dimensions in the 16 applications we reviewed.

In separate applications to each of these two state agencies by the same foreign bank, concerns about the parent supervisor were raised in both instances, but their resolution was different. The organization structure of the applicant and its associated entities is shown in figure 3.1.

Figure 3.1: Organization Structure of
Applicant Bank A



The state agency which had no comments in applicant files delayed approval of this application, according to its senior international banking official, until it satisfied itself about the supervision in the country where the applicant bank (A) was located. This was done by contacting a long-established foreign bank supervisory agency.

An application by the same bank to the other state agency was found not acceptable based on the lack of supervision in the country where the applicant bank was located. The application was later approved when it was amended so that another subsidiary bank (B) of the holding company applied instead. In this way, the parent bank was subject to the supervision existing in B's country. However, the agency did not determine the extent to which the holding company, which had numerous worldwide banking subsidiaries, would be supervised.

Officials of the two other state agencies we visited said that they placed little weight on the nature of foreign supervisory systems in application decisions. One of these agencies does not require applicants to provide information on their banking supervisors; a senior official of the other

agency stated that such data as it did obtain was used solely for background purposes. Neither agency offered any assessments of the adequacy of parent supervisory agencies in the 12 applications we reviewed.

Assessments of Host Supervisory Agencies

The Basle Committee does not consider judgments of supervisory adequacy to be solely a responsibility of host authorities. The Committee maintains that a parent supervisory authority should also assure itself that overseas offices proposed by its banks will be subject to adequate supervision by local (host) supervisory agencies. Consolidated supervision by the parent authority, important as it is, cannot be a substitute, the Committee believes, for adequate supervision of such aspects of the overseas office's operations as liquidity that are the primary responsibility of the host authority. Furthermore, if the parent authority considers the supervision of the host authority inadequate, the Committee recommends that the parent authority either extend its supervision or be prepared to discourage the parent bank from operating the overseas office. Finally, the Committee also believes that parent authorities should satisfy themselves that they will receive regular information on the operation and condition of overseas offices before permitting their opening.

The Federal Reserve has primary regulatory authority over the applications of U.S. national and state member banks for establishing overseas offices. Applications by these banks to establish foreign branches or to invest in foreign subsidiaries are subject to review by the Federal Reserve.⁶ For overseas branches, the type of review depends upon the prior experience of the U.S. bank with overseas offices. The initial branch of a U.S. bank in each of any two foreign countries must be approved by the Federal Reserve. Thereafter, for branch applications by the bank to other nations, the Federal Reserve need only be notified 60 days in advance. Additional branches of the bank in countries where one has already been approved can be opened without prior approval or notice.

For investment by U.S. banks in overseas subsidiaries, the nature of review by the Federal Reserve depends upon the size of the investment. Specific approval is generally required if the U.S. bank is investing 10 percent or more of its capital and surplus. If the investment is between 5

⁶OCC is also generally required to be notified when national banks apply to establish foreign branches or to invest in foreign subsidiaries.

and 10 percent of the bank's capital and surplus, prior notification to the Board is normally required, not its approval. For an investment less than both \$15 million and 5 percent of the bank's capital and surplus, no prior notice or approval of the Board is required. Regardless of the size of the investment, however, a bank's first investment in an overseas subsidiary must be approved by the Board.

According to officials at the Federal Reserve Board and the Federal Reserve Banks of New York and San Francisco, the Federal Reserve is not normally concerned with the nature of banking supervision in the host country. Our review of several applications by U.S. banks for overseas offices filed with the Federal Reserve Banks of New York and San Francisco did not show any discussion of the supervisory practices of the host authorities. According to a senior Federal Reserve Board official, host authority supervision is not very significant to U.S. banking agencies because these agencies conduct their own on-site examinations overseas.

Federal Reserve officials do attempt to ensure that they will be able to obtain data on the overseas offices of U.S. banks. Federal Reserve regulations require U.S. banks to make available to bank examiners information on the activity and condition of these offices. According to a Federal Reserve official, previous difficulties of examiners in obtaining sufficient financial data on banking operations in some countries have led the agency to require that U.S. banks applying for offices in these countries provide assurances that this data will be available. All but one of nine such applications we reviewed at the Federal Reserve Banks of New York and San Francisco contained such assurances.

State Banking Agencies' Communication With Foreign Supervisors

While federal banking agencies generally were consistent with Basle Committee recommendations for communicating with parent supervisors when banks from their countries applied for U.S. offices (see p. 19), state banking agencies were more varied in the extent of these contacts. Two of the five states we visited consistently contacted the parent banks' supervisors and most of the parent supervisors' responses reflected their authorization of the proposed offices. One of these states in several instances pursued supervisory uncertainties with foreign supervisors, and its records evidenced many contacts with these agencies on different matters.

For the three other states, we saw no direct communication between parent supervisors and these state banking agencies in any of the 33

applications we reviewed. These agencies did, however, require parent banks to submit copies of authorizations from their home countries in the applications.

U.S. Supervisory Agencies' Assessments of Economic Conditions in Parent Country

For applications by banks foreign offices, the Basle Committee has stated that host authorities should review "general economic background" in the parent countries. While the Committee has not indicated what action is advisable if economic conditions are poor, a U.S. representative to the Committee explained the intent of the principle to be that a host country should be especially cautious when the applying bank comes from a country with a history of economic troubles. Such economic difficulties might well affect the parent bank and cast doubt on its ability to support the foreign office in the host country.

Federal and state bank regulatory agencies differ in the extent to which they address these economic issues in foreign bank applications. Of the three federal agencies, only FDIC, regularly prepares detailed analyses of the economic and financial conditions in the banks' parent countries. The Federal Reserve addressed economic issues in about half the applications we reviewed, while OCC focused on these matters less frequently. OCC's comments on economic matters were sometimes very brief, such as a comment that a country's economy is characterized by low taxation, free port facilities, and little red tape, with foreign capital and trade consistently attracted to it, or indirect, such as an explanation that the applicant bank's growth can be explained by the parent country's rate of inflation exceeding 50 percent.

Three of the five state banking agencies we visited request the applicant bank to provide a profile of economic conditions in the home country. This includes a discussion of the country's foreign trade activity, including its balance of payments position, and any foreign exchange restrictions it imposes. While most applicants in these states submitted such information, details varied greatly from case to case. Some applications contained only a few pages describing the country's economic system and current conditions, while others were 10 to 15 pages in length. Furthermore, two of the three state agencies did not analyze or prepare independent assessments of the data provided by applicants; an official of one of these agencies said the economic data was collected only for informational purposes. The other state agency requiring applicant comments did prepare, in 9 of 24 cases, its own assessments of the countries' economy. An official of this agency stated, and our review of applications confirmed, that these analyses were made mostly for non-

G-10 countries, where existing economic conditions might be a matter of concern. One of the most recent analyses by this agency we reviewed was especially rigorous, revealing potential uncertainties in the country's economic future. This led the banking agency to impose special restrictions before granting a branch license to the applicant.

The two remaining states did not require applicants to address the status of the economy in their home countries. Officials of one of these states stated that they nonetheless reviewed home country economic indicators, including trade relationships and inflation. Only 4 of the 11 foreign branch applications we reviewed at this state, however, indicated any form of economic analysis. An official of the other state said it did not consider home country economic conditions in deciding on foreign bank applications.

State Banking Agencies and the Basle Committee

State banking agencies do not participate in Basle Committee discussions, although they have a significant role in supervising overseas offices of some U.S. banks and U.S. offices of foreign banks and an almost exclusive role in approving some applications of foreign banks for U.S. offices. State and federal officials told us that, since four U.S. representatives already attend Committee meetings in contrast to only two representatives from other nations, other member countries would be reluctant to further expand the U.S. contingent by including state representatives.

Officials of four state banking agencies we visited have little familiarity with Committee principles or guidelines. Several believe its purpose of encouraging greater cooperation and communication among supervisory agencies is a good one. Others were not knowledgeable enough to express an opinion on the Committee's usefulness. They have been provided with few Committee papers and receive no regular briefings on its progress by federal officials. Officials of several of these agencies have attended international conferences of bank supervisors, although only one state representative attended the most recent (1984) conference in Rome.

One state agency was well informed on Committee activities. The Deputy Superintendent of this agency maintained an up-to-date file of Committee documents and received periodic briefings on Committee meetings by one of the U.S. representatives.

Several state banking officials were disturbed at the exclusion of states from participation in the Committee. An official of the Conference of State Bank Supervisors suggested that states could attend on a rotating basis, thereby not significantly increasing U.S. representation. He also stated that the Federal Reserve has shared only limited data on the Committee with his organization.

Coordination Between State and Federal Agencies on Foreign Bank Applications

Several state officials told us that their relationships with foreign supervisory agencies were not as developed as those they believed federal agencies had with these supervisors. Hence, state supervisory agencies may find it difficult to obtain data about the nature of parent country bank supervision.

The Federal Reserve can be an especially valuable source of data on foreign supervisors for state banking agencies, not only because of relationships its officials have developed with other supervisors but also because it has monitored developments in foreign banking systems. However, only one of the five state banking agencies we visited solicits comments from federal banking agencies; this state agency, in fact, sends much of the application itself to the local Federal Reserve bank for comment. None of the other four generally asks the Federal Reserve for comment on branch or agency applications, although three do notify the Federal Reserve about these applications by sending copies of applications correspondence or listing the applications in a publication of activities they send to interested parties.

Federal Reserve Board Analysis of Supervisory Systems

As part of its increased responsibilities under the IBA, the Federal Reserve Board recognized that it needed to upgrade and formalize its monitoring of foreign banking in the United States and of the banking and supervisory systems of countries whose banks have offices in the United States. In response to that need, it established a Foreign Bank Analysis Unit in early 1980. This unit has prepared banking studies of about 25 countries which, in part, discuss banking supervision in these nations. In preparing these studies, Federal Reserve analysts use existing Federal Reserve files and periodicals, supplemented by contacts with U.S. embassy officials and discussions with foreign regulators visiting the Board. We reviewed 11 of these studies and found that, although banking supervision or regulatory standards were not always comprehensively addressed, the studies frequently did provide some information on significant supervisory standards used in the country. For example, 10 of the studies provided some information on how the

countries assess concentrations of risk and 7 addressed their capital adequacy standards.

A Federal Reserve official stated that, since most of the studies were prepared in 1982 or earlier, some may need to be updated. In addition, an official of the unit indicated that studies do not exist for all countries with one or more U.S. banking offices (numbering 56 as of December 31, 1984) nor for those nations that are anticipated to enter the U.S market soon.

Conclusions

Differences exist between Basle Committee principles and the regulations, policies, and procedures of U.S. banking supervisory agencies. The major difference is the limited attention given by federal and state agencies to identify how adequately foreign banks applying for U.S. offices are supervised by their home country. The Federal Reserve, OCC, and some state agencies also do not regularly consider economic conditions in the applicant bank's home country. In addition, some state banking agencies do not contact foreign supervisors when considering foreign bank applications.

Less familiarity with Basle Committee activities and with foreign bank supervision may in part account for the limited attention given by state agencies to foreign bank supervision. State agencies do not, in most instances, ask the Federal Reserve, which is represented on the Committee and gathers information on foreign bank supervision, to supply such information for applications by foreign banks to establish U.S. offices.

Recommendations

We recommend that the Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Federal Deposit Insurance Corporation:

- Ensure that their agencies evaluate the adequacy of foreign bank supervision and consider economic conditions in the home country when a foreign bank applies to establish a U.S. banking office and encourage state banking agencies to do the same.
- Encourage state banking agencies to notify foreign parent supervisory agencies when they receive foreign bank applications to establish U.S. banking offices.
- Arrange to periodically brief state banking officials about the activities of the Basle Committee.

In addition, we recommend that the Chairman of the Board of Governors of the Federal Reserve System establish a central repository of information on foreign bank supervision and make known the availability of this information to other banking agencies to use when they receive applications from foreign banks to establish U. S. offices.

Agency Comments

A draft of this report was provided to the Federal Reserve, FDIC, OCC, and the banking departments of California, Florida, Georgia, Illinois, and New York for their review and comment. The federal agencies, the Florida Division of Banking, and the New York State Banking Department submitted comments.

OCC and the New York State Banking Department generally agreed with our findings. The Florida Division of Banking generally agreed with our recommendations, which it believes should improve the supervision of international banking and inform state banking regulators about the activities of the Basle Committee on a more systematic basis.

The Federal Reserve, FDIC, and New York State Banking Department believe they give foreign banking supervision sufficient attention when considering applications of foreign banks for U.S. offices, although there may not be any explicit evaluation, i.e., written record.⁷ Our conclusion that federal and state banking agencies do not generally assess the adequacy of foreign banking supervision is supported by our work and is based on the general absence of documentation on this subject in the application files for banks wanting to establish U.S. offices. In addition, interviews with officials of these agencies also indicated that assessments of foreign banking supervision are not routinely made.

We recognize that lack of documentation does not mean that the agencies have not given any attention to this matter. However, without such documentation it is impossible to know whether it has received sufficient attention. We feel that because the Basle Committee has stressed the need to assess the adequacy of foreign bank supervision, U.S. banking supervisory agencies should ensure that this issue routinely receives systematic treatment.

As a result of our recommendation, the New York State Banking Department stated it is now requiring complete documentation of foreign

⁷The Federal Reserve makes a similar point about assessments of economic conditions of the parent country.

banking supervision and FDIC has agreed to make greater efforts to more explicitly address this issue in examinations.

OCC stated that its prevailing practice is to assess parent country supervision only for the first application received from any bank in a particular country. There is no indication in the materials we reviewed that OCC generally considered this issue in such initial applications. OCC also stated that it recognized that conditions in a particular country change over time and therefore it proposed to do a status check on parent country supervision for future applications.

Both the Federal Reserve and FDIC expressed their willingness to encourage state banking agencies to evaluate and communicate with foreign supervisors when considering applications; however, the initiative should come from the state agencies. Since the federal agencies are the only U.S. agencies responsible for Basle Committee principles, we believe that they should assume the initiative for encouraging state agencies to implement Basle Committee principles.

Both agencies also agreed with our recommendation that federal banking agencies should arrange to brief state banking officials on the results of Basle Committee activities. The New York State Banking Department noted that it is already informally briefed on Basle Committee activities. While the Department found this helpful, given the important role of state licensing of U.S. offices of foreign banks, it believes we should recommend that states be allowed to directly participate in the Basle Committee through a state representative at Committee meetings.

None of the other state agencies we interviewed received regular briefings on Basle Committee activities. We believe that such briefings of the other state agencies should be held before the issue of state representation on the Basle Committee is addressed. If the briefings do not satisfy the states' needs for involvement with the Basle Committee, the state agencies may want to explore the feasibility of greater state participation.

OCC expressed concern that its use of Federal Reserve information sources would be inconsistent with its primary licensing function of federal branches and agencies. It suggested that we recommend that the three federal agencies establish their own repositories. The sharing of data alone should not conflict with the existing statutory and regulatory responsibilities of the federal banking agencies. Using the Federal

Reserve as a central repository of information on foreign bank supervision seems appropriate, since in the International Banking Act of 1978 it was the only federal agency given some authority over all banking operations of foreign banks in the United States. To alleviate any concern that OCC may have that our recommendation would require it to avail itself of Federal Reserve information, we have clarified the recommendation to indicate that the extent of the Federal Reserve's responsibility would be to make known the availability of such information to U.S. banking agencies.

The Florida Division of Banking believes that evaluation of foreign economic conditions can be effectively implemented only if country economic information is available through a central U.S. repository. The federal banking agencies already develop and collect information on country economic conditions as part of their monitoring of country risks in international bank lending. The Florida agency and other state banking agencies may wish to contact federal agencies about the availability of this information.

The Federal Reserve and OCC were concerned with our use of the term "agreements" in referring to Basle Committee activities. They felt that this term could mislead a casual reader to conclude that principles agreed to by Basle Committee representatives are binding on the member countries. We have modified the report to reduce the possibility of any misconception about the Committee's role. We have also considered the other technical comments made by the federal agencies and made appropriate changes to the report.

Comments From the Board of Governors of Federal Reserve System



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20561

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 7, 1986

Mr. William J. Anderson
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson,

The Board has reviewed the draft report prepared by your Office entitled, "Comparison of U.S. Banking Supervision with International Agreements." This letter conveys the Board's general comments on the report and its recommendations. Technical comments are being submitted separately by the Board's staff.

The report is concerned with the consistency of U.S. banking supervisory practices and regulations with the results of international consultative arrangements in recent years aimed at improving the international coordination of bank supervision. In particular, the work of the Basle Supervisors Committee is employed as the standard for comparison. The report notes that U.S. practices and regulations are broadly consistent with those results in many instances but goes on to identify some differences. The report lays special emphasis on the absence of formal evaluations of foreign supervisory systems in actions by federal and state banking agencies on applications by foreign banks to establish operations in the United States.

In the Board's judgment, the report suffers from a fundamental misconception of the role of the Basle Supervisors Committee and of how it works. This misconception is reflected in the reference in the title of the report to "international agreements." In the text, too, conclusions reached within the Basle Committee are virtually always referred to as "agreements." Even though the report does contain a reservation about the limited authority of the Basle Committee, the general reader is likely to come away with an impression that the Committee makes decisions about supervisory practices that are in effect binding on the member countries. In truth, the Committee is purely an advisory and consultative body at the technical level. It seeks to promote international cooperation and coordination within the bank supervisory field and generally to improve bank supervisory standards in the international banking system. Its views are achieved through consensus among the participating national representatives and as such are more in the way of general principles than detailed recommendations. The limited role and authority of the Committee are far better described and more appropriately characterized on pages 12-14 of your draft report entitled, "International Coordination of Bank Supervision."

**Appendix I
Comments From the Board of Governors of
Federal Reserve System**

Mr. William J. Anderson

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The major part of the report is concerned with the extent to which federal and state agencies evaluate the adequacy of bank supervision in the parent country when acting on applications by foreign banks to conduct operations in the United States. The report notes that the so-called Basle Concordat propounded the general principle that member countries should assure themselves of the adequacy of bank supervision in the countries from which foreign banks come, and it is with that principle that U.S. supervisory practice is compared. Specifically, an examination was made of whether federal and state agencies obtained information on foreign supervisory rules about capital adequacy, concentrations of risk, country risk exposure, and consolidated supervision. The report notes that the record of the majority of applications does not contain such an assessment.

The absence of an explicit evaluation of a foreign supervisory authority in the record of an application by a foreign bank should not be taken as evidence that no consideration was given to the supervision afforded the foreign bank. A considerable body of knowledge and information about foreign bank supervisory systems has been accumulated and is available within the Federal Reserve to staff processing applications and analyzing foreign banking systems. In most instances, this background knowledge is sufficient to allow a determination that the nature of the supervisory system in the foreign country is not an impediment to action on the application. While considerable progress has been made, the Federal Reserve is continuing its efforts to enlarge and improve its knowledge and understanding of foreign supervisory systems. Those efforts are being pursued through careful analysis of developments in foreign banks and foreign bank supervisory systems, and through the development of closer contacts with foreign bank supervisors by means of participation in international consultative groups and otherwise.

More generally, it should be remembered that the Basle Concordat calls for member countries to assure themselves generally about supervision in foreign countries. It does not set the standards to be employed nor does it establish the elements of supervision to be evaluated. Further, the Concordat carefully avoids a recommendation that a bank supervisor in one country should "judge" a bank supervisor in another country. The Federal Reserve is concerned about the nature and adequacy of supervision in foreign countries and is supportive of efforts to improve supervision abroad. Nevertheless, its primary concern in acting on applications involving foreign banks must be the strength and condition of the foreign bank and its ability to support and manage its U.S. operations.

The report is also critical of the absence of explicit evaluations of economic conditions in the home country of a foreign bank seeking to enter the United States. There is a fleeting reference in one of the Basle Committee documents that host authorities "will wish to take into account" economic conditions in the home country of a foreign bank. To the extent those conditions are relevant to a decision on an individual application, they can be considered by drawing upon existing resources and knowledge within the Federal Reserve. No special critical study is necessary.

With respect to the first recommendation contained in the report, the procedures in place within the Federal Reserve seem generally sufficient to assure that suitable consideration of foreign supervisory systems takes place

Appendix I
Comments From the Board of Governors of
Federal Reserve System

Mr. William J. Anderson

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In the application process without the institution of a formal evaluation procedure. Consultations do take place with the relevant foreign supervisor on each application involving foreign banks, and, as already noted, the Federal Reserve is continuing its efforts to improve its knowledge of foreign supervisory systems.

On the question of encouraging state banking agencies to evaluate foreign supervisors and to consult with them on applications, the Federal Reserve stands ready to assist with the information at its disposal and with the lines of communications it has established with foreign bank supervisors. It needs to be emphasized that there is no statutory obligation on state banking agencies to consult with the Federal Reserve or other federal banking agencies on applications by foreign banks. The Federal Reserve has encouraged such consultations since the passage of the International Banking Act of 1978 but, as the report notes, only one state banking agency does so on a regular basis.

The suggestion of periodic briefings of state banking officials about the activities of the Basle Committee is a meritorious idea but less easy to put into practice. A number of these officials were invited to and did attend the International Conference of Bank Supervisors held in Washington in 1981. Since then, there have been less formal contacts with these officials by Federal Reserve personnel where topics of international coordination have been discussed. It was recently decided that the annual report of the Basle Committee is to be more widely available, and the Federal Reserve is attempting to arrange its distribution to interested state banking officials.

Finally, the report recommends that a central repository of information on foreign bank supervision be established at the Federal Reserve Board and be available to other banking agencies. There is already a considerable body of knowledge and information that has been accumulated within the Federal Reserve, and, as noted earlier, efforts are continuing to enlarge and extend those resources. In this connection, it may be noted that the Basle Committee is developing a repository of basic information about supervisory systems around the world. The Federal Reserve has traditionally been ready to share its information resources with other federal and state banking agencies.

Very truly yours,



William W. Wiles
Secretary of the Board

Comments From the Comptroller of the Currency



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

March 5, 1986

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson,

This will acknowledge the GAO draft report: "Comparison of U.S. Banking Supervision With International Agreements".

We have reviewed the draft and generally concur with its findings. Technical comments have been given to your staff. However, there are three concerns we have about the draft that we especially wish to relate.

Use of the word "agreements" in the title and in the body of the report significantly would misrepresent the role and activities of the Committee. The term "agreements" implies a formal, binding arrangement to which member countries must comply. The Committee works instead to develop consensus on principles or guidelines which member countries may adopt and follow voluntarily. The activity of the Committee is not formal or binding. The report does qualify its use of "agreement" on Page 10. However, the casual reader could easily misconceive the role of the Committee by the general and frequent use of "agreement" early on in the report.

Another concern relates to the section of the draft, beginning on Page 30, that discusses our process for reviewing applications from foreign banks to establish a federally licensed branch or agency. This section needs additional explanation. The draft concludes that the Office of the Comptroller of the Currency does not adequately address the nature and adequacy of banking supervision existing in the home country. Our prevailing practice has been to make such an assessment in connection with the first application received from banks in a particular country. Thus, when other banks from the same country applied, no new assessment was done. However, we recognize that conditions in a particular country may change over time, so we propose to make a status check in each future case.

Appendix II
Comments From the Comptroller of
the Currency

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To facilitate our consideration of the adequacy of supervision in the parent country, we rely on comment, evaluation, and information available from our own bank supervision division. In this way we fulfill our statutory obligations for licensing under the International Banking Act. During the past three years in response to the International Lending Supervision Act, we have had underway an active program of correspondent relations with foreign supervisors in the G-10 as well as in Asia, Latin America, the Caribbean, and throughout the OECD.

Finally, the draft recommends the Federal Reserve Board establish a repository of information on foreign supervision. While we know we could avail ourselves of needed information from that proposed source, the approach is inconsistent with our primary licensing function for federal branches and agencies as well as other responsibilities and obligations we have in international supervision. Accordingly, a more consistent recommendation would be that the three federal banking agencies establish repositories of information.

We appreciate the opportunity to comment on the draft report.

Sincerely,



H. Joe Selby
Senior Deputy Comptroller
for Bank Supervision

Comments From the Federal Deposit Insurance Corporation



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20420

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

February 27, 1986

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

Your letter of January 27 submitted for our review and comment a draft GAO report entitled "Comparison of U.S. Banking Supervision with International Agreements (Code 483397)." The report deals generally with the application of Basle Committee guidelines by the federal banking agencies.

The report found that while the federal agencies' regulations, policies, and procedures are in many ways consistent with the Basle Committee guidelines, the agencies nevertheless fail to give sufficient attention to identifying the nature and adequacy of foreign bank supervision when deciding foreign bank applications for U.S. banking offices. In addition, some state banking agencies were found to contact foreign supervisors infrequently when considering applications of foreign banks for U.S. offices.

As a result, the GAO recommends that the federal banking agencies:

- Evaluate the adequacy of foreign bank supervision when foreign banks apply to establish U.S. banking offices;
- Encourage state banking agencies to evaluate the adequacy of foreign bank supervision when foreign banks apply to establish U.S. banking offices;
- Encourage state banking agencies to notify parent supervisory agencies when they receive foreign bank applications to establish U.S. banking offices; and,
- Arrange to periodically brief state banking officials about the activities of the Basle Committee.

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We disagree with the finding that the FDIC fails to give sufficient attention to identifying the nature and adequacy of foreign bank supervision when deciding insurance applications for U.S. offices. In general, we believe we afford this element the attention that is necessary and practical in the specific context of the insurance applications we process.

At the outset, we would point out that the GAO's conclusion seems to be based, at least in part, on the absence of an explicit statement regarding foreign bank supervision in the records of various applications processed by the FDIC. We would caution, however, that the absence of such a statement does not necessarily mean that the adequacy of foreign bank supervision was not considered. We agree with the GAO that the adequacy of foreign bank supervision is important and we normally consider this element to a greater or lesser extent whether or not an explicit reference is made in the record.

As the GAO correctly noted, we are more likely to be concerned about foreign bank regulation and supervision where the parent bank is relatively unknown or has suspected weakness, or where little is already known about its banking supervisor. In these cases, we are more likely to develop additional information and explicitly address the issue of foreign bank supervision. It must be remembered, however, that the adequacy of foreign bank supervision is simply one element among several considered in processing any foreign bank application and all must be weighted in context. For our purposes, other safeguards exist as well, such as restrictions on the country exposures of branches, asset maintenance provisions, and FDIC examination of foreign branches, to guarantee that the FDIC insurance fund will not be unduly exposed.

With regard to the specific recommendations, we do not believe our evaluative process for foreign bank applications is deficient and we expect to continue to consider the nature and adequacy of foreign bank supervision in context when foreign banks apply to establish U.S. banking offices. We will, however, make a greater effort to explicitly address the issue in terms in the application record.

Should any state banking agency raise the issue, we are certainly prepared to encourage them to evaluate the adequacy of foreign bank supervision when considering an application for a U.S. banking office, as well as to notify the parent supervisory agency when a foreign bank application is received. We wholeheartedly support the concept of frank and complete communications among supervisory agencies, both domestic and foreign, with mutual interests and concerns.

We are prepared to participate in some type of joint effort among the federal banking agencies to periodically brief, perhaps through an appointed representative, state banking officials about the activities of the Basle Committee. We will raise the issue among our counterparts in the near future as to just how this might practically be accomplished on a regular basis.

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On a technical level, we wish to suggest a correction to Chapter 3 (page 45) where the Federal Reserve is described as the primary regulatory authority over the applications of the U.S. banks for overseas offices. The FDIC is the primary federal regulatory authority over the applications of insured state nonmember banks for overseas branches and investments in foreign banks or other financial entities. (Refer to Sections 347.3 and 347.4 of the FDIC Rules and Regulations.)

Sincerely,


Robert V. Shumway
Director

Comments From the New York State Banking Department



STATE OF NEW YORK
BANKING DEPARTMENT
TWO RECTOR STREET
NEW YORK, N.Y. 10006

JILL M. CONSIDINE
SUPERINTENDENT OF BANKS

February 28, 1986

Mr. William J. Anderson
Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

Re: Draft Report, "Comparison of U.S. Banking Supervision with International Agreements." (Code 483397)

Thank you for sending us a copy of the captioned report for our review and comment. While we agree with a substantial portion of the paper, there is an aspect that requires clarification. This is offered below, as well as an endorsement and a recommendation.

1. The report states that, "Federal and state bank supervisory agencies generally do not assess the adequacy of parent countries' supervision of foreign banks that apply for U.S. banking offices." Your representatives pointed this out during their exit discussion at which time we agreed that our documentation was lacking on this issue, but that such an assessment had been undertaken and done in most cases. However, as a result of that discussion, we now require that documentation be made complete in this respect by giving full reference to our sources of information.
2. The report recommends that the Chairman of the Federal Reserve System "should establish a central repository of information on foreign bank supervision and encourage other banking agencies to use such information..." Information on foreign bank supervision, particularly in-depth information, is not

always easily developed. We have traditionally used four sources in addition to the information presented in the application. Relying on a federal repository for such information would facilitate the undertaking considerably. We warmly support the recommendation.

3. Finally, we are concerned that no state banking representatives participate in Basle Committee meetings. The United States is represented by four federal bank regulatory officials: two from the Federal Reserve, and one each from the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. We in New York are informally and orally briefed by our colleagues at the Federal Reserve Bank of New York. While this briefing is helpful, it does not provide the basis for adequate input by our agency or other state agencies.

A computer report generated by the Federal Reserve System entitled "Structure Data for U.S. Offices of Foreign Banks by Type of Institution" dated September 30, 1985 shows that approximately 81 percent of the branches and agencies of foreign banks doing business in the U.S. operate under license and supervision of State banking authorities and that 19 percent operate under the charter and supervision of the Comptroller of the Currency. Moreover, as noted in your report, State banking authorities play a significant role in approving and supervising overseas offices of U.S. banks.

In view of the significance of State supervisory responsibility over both U.S. offices of foreign banks and foreign offices of U.S. banks, we urge that you recommend in your report inclusion of a State banking authority representative on the Basle Committee. We note in your report that an official of The Conference of State Bank Supervisors has expressed interest in such representation and for our part, we would be willing to cooperate with the Conference in the selection of a representative. This representative would be responsible for keeping all State banking authorities informed on matters coming before the Committee and for providing input in the formulation of the U.S. position on such matters.

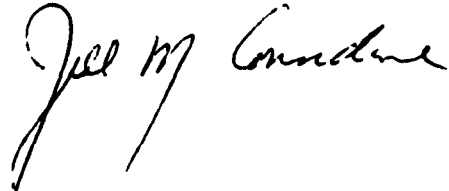
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Although your report indicates that other member countries might be reluctant to further expand the U.S. contingent by including State representatives, it is our opinion that the make-up of the current U.S. representation does not take into account the unique dual banking system operating in the U.S.

If addition of a State representative should expand the U.S. contingent beyond what is considered acceptable by other members of the Committee, it would seem that an offset by way of reduction in the Federal representation should be made to accommodate state participation.

We appreciate the opportunity to offer comments on the report and we wish to commend your representatives for their professional conduct during their visit with us here in New York.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Joel M. Condit". The signature is written in dark ink and is positioned below the typed name.

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