

Consolidated Supervision: Achieving a 360 Degree View of Bank Risk

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1. Background and Introduction

In recent decades, the landscape of the banking industry has significantly transformed as banks seek to expand their geographic reach, realise economies of scale and scope, diversify their risks and revenue sources, respond to competition, and meet the needs of their clientele. In a 2003 IMF working paper, these trends have been described as the consolidation, internationalisation and conglomeration of banks,² whereby banks are increasingly becoming part of large, multi-tiered groups with complex organisational/ownership structures with international operations.

These groups include:

- a. Banking groups, which provide traditional banking services focused on deposit-taking and lending; and
- b. Financial conglomerates, which conduct banking business while also engaging in other financial activities such as insurance and investment banking.

For purposes of this paper, these two groups will be collectively termed as ‘financial groups’. In addition to financial groups, mixed activity groups – where a bank or a financial group is part of a wider group undertaking commercial activities – also exist, although they may be limited by regulation or less common in some jurisdictions. While many of the issues discussed in this paper are applicable across both types of groups, some are more relevant in the context of mixed activity groups, which are further discussed below in the context of conflicts of interest and the permissibility of non-financial activities in groups.

The spectrum of activities undertaken by financial groups can thus be very broad; some may be under the oversight of certain authorities, while others may be unregulated. Furthermore, given the frequently multinational nature of large groups, their size and inter-linkages may make them systemically important at the global level, and also domestically in individual jurisdictions.

Gaps or weaknesses in the supervisory oversight of both banking and non-bank affiliates, lack of information on cross-border banks and non-bank affiliates, unregulated activities, or other opacities within a financial group may inhibit the timely detection of financial weaknesses or excessive risks, or present opportunities for regulatory arbitrage. Also, there is scope for contagion risk, whereby problems in non-bank affiliates may spread and adversely impact the prudential soundness of other constituent entities, including the bank within the financial group.

Consolidated supervision of financial groups to which banks belong is a long-standing principle of effective banking supervision. In order to effectively identify,

measure, assess and control risks in these typically complex organisations, bank supervisors require:

- a. Access to timely, reliable information on the risks, potential threats and vulnerabilities to banks' safety and soundness posed by affiliate relationships;
- b. The ability to examine the activities of affiliates to understand their nature of business and the risks they pose;
- c. Legal authority to collaborate and exchange confidential supervisory information with relevant domestic and foreign authorities; and
- d. Legal authority to prevent or correct unsafe or unsound practices or conditions arising from affiliate transactions and relationships.

Asia-Pacific countries are both home and host jurisdictions for large, geographically dispersed banks that are part of financial groups operating extensive networks in the region. The effective implementation of consolidated supervision by national authorities is therefore important in promoting regional financial stability.

The IMF has previously expressed concerns about weaknesses in countries' practices related to consolidated supervision identified during their Financial Sector Assessment Program (FSAP) country reviews.³ Improvement opportunities in this area continue to be cited in FSAP reports.

2. Objectives

This article provides a brief historical review of the evolution of international standards relating to consolidated supervision and highlights key policy considerations and challenges in implementing consolidated supervision.

3. Evolution of International Standards for Consolidated Supervision

Before the advent of the international standards covering the key elements of a consolidated supervision framework, national authorities typically relied on national laws and supervisory approaches to address risks arising from a bank's affiliate relationships. The risks were controlled through various mechanisms, including the exercise of examination and inspection authority of bank affiliates, and restrictions on transactions between and among banks and their affiliates.

For example, in the United States, Sections 23A and 23B of the Federal Reserve Act, originally enacted in 1933 and 1987, respectively,⁴ regulate transactions between banks and their affiliates. These laws, which have been revised over the years, include individual and aggregate size limits on affiliate transactions relative to a bank's capital levels, and require that transactions be supported by high quality collateral with conservative margins of protection. Affiliate transactions are also required to be at 'arm's length', that is, on non-preferential terms and conditions, as available in comparable transactions with unaffiliated third parties. Transfers of low quality assets to and between bank affiliates are also prohibited.

Affiliate transaction limitations in the U.S. have been supplemented by providing bank regulators with broad discretionary powers to conduct examinations of any affiliate, or entity deemed to be an affiliate, in order to fully understand the nature of the affiliate relationships, and risks posed by transactions between banks and their affiliates.

Over the last forty years, however, various international supervisory standard-setters, primarily the Basel Committee on Banking Supervision (BCBS) and the Joint Forum have collaborated on developing standards and sound practices related to consolidated supervision. A background summary of their major work follows.

Basel Committee on Banking Supervision – Early Work Related to Consolidated Supervision

The Basel Committee, founded in late 1974, is the international standard setting body for prudential regulation and supervision of the banking industry. The Basel Committee is hosted by the Bank for International Settlements (BIS), Basel, Switzerland, which is owned by the world's central banks and monetary authorities.

One impetus for the founding of the Basel Committee, which was originally known as the Committee on Banking Regulations and Supervisory Practices, was the mid-1974 failure of Bankhaus Herstatt, Cologne, Germany, which had significant cross-border spillovers. Counterparty banks in multiple jurisdictions sustained substantial losses on open foreign exchange contracts that were not settled at the time of its demise.

The lessons from the Herstatt debacle are evident in the Basel Committee's September 1975 "Report on the supervision of foreign establishments – Concordat", known as the Basel Concordat.⁵ One of the Basel Committee's earliest pronouncements, the main objective of the Concordat was "...to set out certain guidelines for cooperation between national authorities in the supervision of banks' foreign establishments" to ensure that no foreign banking establishment escapes supervision. The Concordat also outlined early principles for home and host country information-sharing and cooperation in the supervision of cross-border banks.

The Basel Committee issued a March 1979 paper⁶ entitled "Consolidated supervision of banks' international activities", which expanded on the 1975 Concordat, emphasising the importance of both consolidated and legal entity views of risk, stating:

"...it should be a basic principle of banking supervision that the authorities responsible for carrying it out cannot be fully satisfied about the soundness of individual banks unless they are in a position to examine the totality of each bank's business worldwide. At the same time the Basel Committee recognises that supervisors will also need to continue to look at banks' accounts on a non-consolidated basis."

a. *The Joint Forum on Financial Conglomerates*

The Joint Forum on Financial Conglomerates (renamed the Joint Forum in 1999) was established in 1996 by the Basel Committee, the International Association of Insurance Supervisors (BIS-hosted standard setter for insurance supervision), and the International Organisation of Securities Commissions. The Joint Forum's mandate is to identify impediments to, and ways of achieving, effective cross-sectoral, cross-border information-sharing, enhanced supervisory coordination among the various regulators of financial groups, and the development of "principles toward the more effective supervision of regulated firms within financial groups."

The Joint Forum's work spanned several years and involved extensive public and industry consultation. A paper entitled "Supervision of Financial Conglomerates," representing a compendium of the Joint Forum's substantial work, was jointly endorsed and issued by the sponsoring committees in February 1999. That paper, supplemented by additional papers published in December 1999, together formed what is known as the Joint Forum's "1999 Principles."

b. *Basel Committee's Expanding Coverage of Consolidated Supervision*

The Basel Committee is perhaps best known for its substantial and ongoing work on the development and promulgation of international capital standards. However, the Basel Committee has done important work in identifying the essential preconditions necessary for regulatory jurisdictions to have effective bank supervision programs in producing the "Core Principles for Effective Supervision" (known as the Basel Core Principles or BCP), originally issued in 1997, and revised in 2006 and 2012.⁷

The 1997 BCP identified "twenty-five basic Principles that need to be in place for a supervisory system to be effective." Core Principle (CP) 20 states that "An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis." Other CPs in that pronouncement also covered key considerations related to conducting consolidated supervision.⁸

Countries were encouraged to perform BCP self-assessments to identify and remedy any gaps in their supervisory processes. The IMF and the World Bank commenced their Financial Stability Assessment Program (FSAP) reviews in 1999, which included detailed reviews of countries' compliance with the BCP.

The BCP were updated in October 2006, retaining the same number of CPs, to acknowledge changes in banking regulations, new regulatory insights, identified gaps in regulation and experience in applying the BCP during FSAP reviews. CP 20 from the 1997 BCP, covering Consolidated Supervision, was expanded into two CPs:

CP 24	Consolidated supervision: An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide
CP 25	Home-host relationships: Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required for domestic institutions

The BCPs were revised again in September 2012, incorporating lessons learned from the global financial crisis of 2007-08. The number of CPs was expanded from 25 to 29. The text of CP 24, Consolidated Supervision, has been retained verbatim, except it has been reordered and is now CP 12.

Each of the CPs specifies Essential Criteria (EC) and Additional Criteria (AC) to be considered in assessing compliance. “Essential criteria set out minimum baseline requirements for sound supervisory practices and are of universal applicability to all countries”.⁹ While the EC are mandatory, “...countries undergoing FSAP assessments by the IMF and/or World Bank can elect to be graded against the essential and additional criteria”¹⁰ The references for the detailed EC and AC pertaining to CPs 12 and 13 are provided in the endnotes.¹¹

At the same time, other CPs also acknowledge the importance of banking groups and supervisors in assessing the effectiveness of the risk management framework on a group-wide basis to cover exposures undertaken by the bank and its affiliates, including entities which operate as part of the wider group. This includes ensuring that processes which facilitate group-wide monitoring and control of risks (e.g. credit, market, liquidity and operational risks) are in place and are consistent with the risk profile, risk appetite and systemic importance of the bank and the group to which it belongs.

4. Regulatory Performance in Implementing Consolidated Supervision

The development of the BCPs has enabled a global overview of progress towards developing an effective consolidated supervision framework across jurisdictions. In this respect, a September 2008 IMF paper reviewed the results of 136 FSAP assessments of countries’ compliance with the original (1997) version of the BCPs. The 1997 BCPs require, under CP 20, Consolidated Supervision, that “...supervisors have the ability to supervise the banking group on a consolidated basis, whereby all risks run by a banking group are taken into account, wherever they are booked.” Regarding CP 20, the IMF review stated that:

“Although 44 percent of the assessed countries are rated noncompliant,¹² the figure could be greater as another 20 percent were not assessed on this principle or this was deemed to be ‘not applicable’ to their financial systems on the grounds that formal structures were not present. Commonly-cited deficiencies were the lack of reliable consolidated information or legal powers to examine and supervise some activities, including those of offshore banks; inability to have direct access to nonconsolidated subsidiaries and to the holding company; no capital allocation to cover risks on a consolidated basis; no framework to evaluate risks presented by non-bank entities within a group; no provisions or arrangement to share information with other supervisors (domestic or foreign) of group entities; no legal requirements to consolidate the operations of all subsidiaries and report the accounts and exposure on a consolidated basis; and no requirement to report prudential requirements on a consolidated basis.”¹³

Twenty-three BCP assessments were published by the IMF/World Bank during 2012 and 2013 which were based on the 2006 BCP assessment criteria. Assessed countries were diverse with respect to their size and stage of development; many of the countries had undergone one or more previous FSAP assessments. Surprisingly, the assessments disclosed noncompliance with some basic standards contained in CPs 12 and 13, for example:

- a. The lack of legal authority to review the overall activities of a banking group;
- b. No legal authority to exchange confidential supervisory information with foreign supervisors;
- c. Possessing, but not exercising, legal authority to review group information; and
- d. The absence of information-sharing arrangements, such as Memorandums of Understanding (MOUs), despite significant overseas operations and significant foreign bank presence in the home country.

There have been six IMF/World Bank BCP assessments published to date, beginning in late 2013, which were based on the 2012 BCP revised assessment criteria.¹⁴ These recent assessments reflect that the reviewed jurisdictions are mostly “compliant” and at least “largely compliant” with CPs 12 and 13.¹⁵

5. Key Policy Considerations

While the overarching principles of an effective consolidated supervision framework have been continually enhanced by international standard setters, national regulatory and supervisory authorities remain confronted with the challenge of translating these broad concepts into policies which are appropriate within their respective jurisdictions.

In recent years, overcoming this challenge has become increasingly important due to the expansion in both scale and scope of the activities carried out by banks

across the globe. As national authorities seek to accelerate efforts to strengthen their oversight of banks, particularly in emerging markets where such trends are likely to further materialise at a rapid pace, having a clear understanding of key policy considerations will be crucial to the successful implementation of consolidated supervision.

Risks that Consolidated Supervision Seeks to Control

Consolidated supervision seeks to ensure that supervisors are able to develop a more comprehensive group-wide assessment of risks arising from the activities of a bank's affiliates while ensuring that these risks are prudently managed. The following discussion illustrates how affiliate relationships and transactions can lead to serious problems if they are not properly monitored and controlled.

a. Excessive Leverage and Double-leveraging of Capital

At a very fundamental level, leverage is the extent to which an entity borrows to fund its assets. Leverage gives rise to debt servicing obligations, which can place substantial strain on the finances of an entity in stressed conditions. The risks associated with excessive leverage can therefore be intensified within the context of banks, as their role as credit intermediaries requires them to borrow – at a magnitude unlike other real sector businesses – from surplus savers to enable the provision of credit in the real economy.¹⁶

One of the supervisory tools in managing this risk is the application of capital adequacy requirements or prudential limits on the banking entity. On its own, however, an entity-focused approach to assessing the balance sheet leverage of the bank is often inadequate. Where a bank operates as part of a wider financial group, there may be circumstances whereby such an assessment may not fully capture the effective leverage being undertaken by the bank due to the potentially numerous and complex relationships with its affiliates.

These circumstances have been described at length by the Joint Forum¹⁷ as the following:

i. Where the bank is a subsidiary of an unregulated firm

In this situation, the parent company may issue debt – or other instruments not acceptable as regulatory capital – and down-stream or pass the proceeds to the subsidiary in the form of equity or other elements of regulatory capital.

While this type of leverage is not necessarily unsafe or unsound, it may pose material risks for the bank if undue stress is placed on the bank arising from obligations of the capital issuer to service its debts, or where there is a discrepancy between the quality of capital instruments issued by the parent and those which it downstreams to the bank.

Additionally, excessive leverage can create undue pressures on the bank to sustain high dividend payments to service an excessive debt load of an upstream affiliates, which may, in turn, induce banks to pursue excessively risky or unsafe and unsound business strategies in an attempt to maximise profitability. This risk might be elevated in situations where effective governance might be compromised due to conflicts of interest, which is discussed below.

- ii. *Where one entity holds regulatory capital issued by another entity within the same financial group (i.e. double or multiple leveraging)*

Within the context of the constituent bank, although this amount will count towards its capital and therefore reduce its balance sheet leverage, the same capital is being used simultaneously to buffer against risks in at least two entities within the financial group. Effectively, the leverage of the bank is being potentially understated.

Instances of double or multiple leveraging can therefore be easily obscured in overly complex organisational or ownership structures, which may not be uncommon among large, cross-border financial groups. The key issue, however, is not the organisational or ownership structure per se, but the consequences of the structure for the assessment of the financial group's group-wide capital, which could ultimately reduce the supervisability of the financial group.

- iii. *Where there are unregulated affiliates within the financial group*

There is also a need to consider risks undertaken by other unregulated non-bank affiliates, such as its sister companies, special purpose vehicles and other off-balance sheet entities. Notwithstanding the establishment of firewalls within the financial group, the activities undertaken by non-bank affiliates may be a channel for contagion (discussed further below). Again, the balance sheet approach to assessing leverage fails to fully consider such a situation.

For these reasons, the BCBS requires the Basel capital framework to be applied on a consolidated basis to banking groups, including those headed by holding companies and also at every tier within a banking group. At the same time, banking entities are also expected to be adequately capitalised on a standalone basis.¹⁸

b. Contagion Risk

Contagion risk refers to the transmission of risks across entities in the group through different forms of economic linkages. From the perspective of a banking supervisor, this is a key concern as losses or adverse events affecting an affiliate may result in difficulties for an otherwise prudent and sound bank.

A key channel for contagion risk are financial relationships arising from intra-group transactions, exposures and legal arrangements between the bank and its

affiliates. Centralised liquidity management can be such an example. The pooling of liquidity and funding arrangements suggest that such risk-sharing arrangements allow financial groups to manage liquidity risk more efficiently, as compared to a situation where liquidity pools are ‘trapped’ in subsidiaries. Nonetheless, these benefits have to be weighed against other concerns, including that of moral hazard, which are discussed in the following sections. For instance, the recent Eurozone crisis demonstrated that parent companies of cross-border financial groups may have a tendency to transfer funds from financially healthy subsidiaries to affiliates facing liquidity problems.¹⁹

Reputational associations may also be a potentially material channel of contagion, as legal and operational demarcations may not be immediately apparent to market participants, such as the general public and credit ratings agencies. Depositors, for example, may – whether rightly or wrongly – associate the financial position of a bank with that of its affiliates due to shared branding. To a large extent, assessments by credit rating agencies of entities within a financial group, such as the holding company, are also influenced by the risk profile of the constituent bank. Likewise, problems or concerns with such affiliates may also weigh down the credit ratings of a bank which is otherwise sound on a standalone basis.

From the perspective of the bank and its parent company, reputational associations may incentivise management to exert efforts to protect the franchise value of the shared branding. In this case, there may be a need to safeguard and protect the financial group’s reputation, and to preserve longstanding customer relationships. This further intensifies the need for intra-group support even if this comes at the expense of the constituent bank.

Other financial arrangements which interlock the safety and soundness of a bank with the operations of its affiliates include guarantees provided by the constituent bank to its affiliates as well as cross-default clauses that are incorporated into the terms of issuance of debt obligations and derivative contracts by any entities within the group. Loan participations originated and sold to affiliated banks can also be a source of contagion in the event of deterioration in a borrower’s ability to repay or other adverse developments impacting collectability.

c. Conflicts of Interest May Undermine Corporate Governance or Induce Excessive Risk-taking

The sheer breadth in the scope of activities undertaken by a financial group expands the avenues for conflicts of interest, as the financial group will have to consider interests of not just the constituent bank, but also those of other subsidiaries or affiliates. Central to this issue are situations whereby the bank’s interests – and hence, possibly the public’s interests – may be compromised in order to advance the financial group’s overarching business strategy or profitability.

Potential conflicts of interest are likely to surface when there is a significant amount of intra-group transactions and exposures, such as through:

- i. Lending on terms and conditions or prices which are not at arm's length with the intention of providing financial support to an affiliate;
- ii. The payment of royalties and fees for services provided by an affiliate; and
- iii. Self-dealing, whereby a constituent entity in the financial group acting as a fiduciary is a party to a transaction with itself or its affiliates (e.g. different entities within the same financial group providing brokerage advice to a client as well as executing the trading of securities on which advice is being given).

The magnitude of conflicts of interest within a financial group may escalate as more complex intra-group relationships are established to fully realise the synergies arising from different businesses within the group. Such interlocking relationships may obscure the lines of accountability and the mechanisms by which control is exercised over entities within the group, including the constituent bank. For example, reporting lines and information flows between the bank, its parent company and/or other subsidiaries may not be sufficiently clear for supervisors to develop an adequate view on whether internal controls and processes are robust enough to mitigate conflicts of interest and to form an overall conclusion of the risk profile of the financial group.

Conflicts of interest may also arise within the context of a cross-border banking financial group which has separately capitalised banking subsidiaries in multiple countries. This may happen when the corporate governance practices within the group are weak or where the regulatory requirements, such as those relating to connected party lending and large exposure limits, are not adequately applied at the consolidated level. Under such circumstances, the parent bank within the financial group could potentially circumvent lending limits imposed by the home supervisory authorities by mandating the participation of its affiliated banks in other jurisdictions in a particular financing scheme.

This is particularly relevant in circumstances where certain scope of decisions are made by a centralised credit approval committee either at a regional or global level, instead of the individual affiliated bank operating in the host jurisdiction. Some internationally-active financial groups, for example, subject loan applications above certain thresholds to such an approval process. These actions may be incongruent with the banking subsidiary's own risk appetite or may undermine the fiduciary duties and responsibilities of the board of directors to act in the best interests of each banking subsidiary's depositors, minority shareholders and other creditors.

Where a bank belongs to a mixed activity group with material non-financial undertakings, such as an industrial conglomerate, the risk for conflicts of interest may also be heightened. In particular, the role of the constituent bank in the group's overall business strategy may be to primarily support the interests of the other entities carrying

out commercial activities, particularly where such activities – rather than those of the bank – are the underlying drivers of the group's profitability and growth.

While such a setup is intended to realise the resultant synergies of having a bank in the group – there can be instances where serving the commercial or strategic interests of the group comes at the expense of the bank's and that of its depositors. For example, the constituent bank may be unduly pressured by the parent company to provide financing to commercial affiliates at preferential rates. Strong informal relationships with the management of other affiliates may also result in a lack of impartiality in the bank's credit decisions due to strong informal relationships. Applying effective consolidated supervision for such a group structure would be more challenging. For this reason, many jurisdictions have taken measures to restrict such structures, as set out in the subsequent section, "Defining the Perimeter of Consolidated Supervision."

d. Oversight of Excessive Risk-taking by Affiliates Arising from Moral Hazard

Non-bank affiliates may wrongly perceive that, given the substantial economic inter-linkages between their operations and the bank, the central bank's lender-of-last-resort facilities are likely to be extended to them in times of stress, whether directly or indirectly. This could create incentives for non-bank or unregulated affiliates within the group to undertake excessive risks, which is a situation described as moral hazard. This is more likely where the financial group or the bank in question is considered as being systemically important or 'too-big-to-fail.'

Identifying this risk is however not easy in practice. Entity-level regulation and supervisory oversight may not be adequate to help bank supervisors detect excessive accumulation of risks at non-regulated affiliates at a sufficiently early stage to facilitate supervisory intervention. This is therefore the argument in advancing a consolidated supervision framework to allow bank supervisors to have a group-wide view of the financial group and adopt a more proactive approach to supervision. At some level, the application of prudential regulation on a consolidated basis may also provide incentives within the financial group to better align the group business strategies to be consistent with the risk-taking capacity of the individual constituent entities, including non-bank or non-regulated entities.

Defining the Perimeter of Consolidated Supervision

Given the wide array of risks to banks arising from the operations undertaken by its affiliates, it is imperative that supervisors clearly define the appropriate regulatory and supervisory perimeter of financial groups. Conceptually, this perimeter should capture any affiliates which may potentially give rise to the aforementioned risks. In practice, this is likely to entail tracing the lines of ownership to the top of the shareholding structure, namely the controlling entity or ultimate parent company of the group in which a bank resides. In this case, the parent company and all its downstream entities

will be defined to be within the perimeter of consolidated supervision. Additional considerations, however, may emerge due to the potentially significant variations in the way groups are structured.

a. Permissibility of Non-financial Activities

One such consideration arises in the context of mixed activity groups, namely where a bank is part of a wider group with undertakings in non-financial activities, such as an industrial conglomerate engaging in real sector activities or a sovereign wealth fund with significant investments in non-financial firms. In this instance, tracing the lines of ownership to the top of the shareholding structure could result in expanding the scope of oversight to cover activities which may not be traditionally under the ambit of any prudential authority, be it in banking, insurance or securities.

Where these non-financial activities are material and share significant economic relationships with the bank, there may be a need to assess the extent to which such activities are permissible in the banking group. In particular, supervisors will have to weigh the potential benefits of allowing banks to be affiliated with a wider scope of activities – such as operational synergies that offer greater growth potential for business and customers, as well as diversification benefits from allowing banks to be affiliated with a wider scope of activities – vis-à-vis key supervisory and market competition concerns.

These concerns which reflect risks mentioned in previous section may include, but are not limited to:

- i. Greater scope for contagion risk, which may arise from increased pressure by shareholders to support non-financial affiliates;
- ii. Potential exposure to political influence, particularly where financial groups carrying out non-financial activities are large and affiliated with the government or other special interest groups;
- iii. Potential impact on market competition in the non-financial activities undertaken within the group given the position or significant roles of the affiliated banks in the economy;
- iv. Potential inherent limitations in supervisory capacity to develop comprehensive assessments of commercial risks, compounded by a more dynamic and complex environment;
- v. The challenge to determining adequate prudential safeguards to limit spillover of risks arising from non-financial activities to the bank without materially eroding the synergies of operating within such an ownership structure in the first place; and
- vi. Complexity of resolution and recovery planning for the affiliate banks when non-financial activities are involved.

The complexity in balancing these trade-offs is illustrated by the lack of clear consensus or common regulatory policies on whether involvement in non-

financial activities should be explicitly allowed, restricted or prohibited. The exercise of supervisory discretion in determining appropriate policy responses in this area reflects the delicate situation and unique circumstances faced by supervisors in individual jurisdictions. In many jurisdictions where prudential restrictions or limits are applied, these are primarily intended to avoid risk concentration and do not distinguish between the different types of non-financial activities in which banks may be engaged (Table 1). To some extent, such restrictions may therefore be used by supervisors to limit the exposures of banks to risks from other commercial risks undertaken by the group.

Table 1²⁰

Jurisdiction	Investments Made by Banks	Ownership in Banks
Australia	Subject to limits	Subject to approval
Canada	Subject to limits	Subject to limits
China	Subject to limits and approval	Subject to approval at the 5 percent threshold
European Union	Subject to limits	No general restrictions, but subject to approval at the 10 percent threshold
Hong Kong	Subject to limits	Subject to approval at the 10 percent threshold
Japan	Subject to limits	Subject to approval at the 20 percent threshold
Malaysia	Subject to limits	Subject to approval at the 5 percent threshold
Phillippines	Subject to limits	Permitted but subject to limits
Singapore	Subject to limits on individual investments and subject to approval at the 10 percent threshold	Subject to approval at 5 percent, 12 percent and 20 percent threshold
United Kingdom	Subject to supervisory consultations	No statutory prohibition
United States	Subject to limits and regulatory restrictions	Permitted to make non-controlling investments

In addition, some countries have also developed more robust legal frameworks and regulatory policies to impose some restrictions on individuals, groups of individuals or corporations that own or control a bank. These measures may be aimed at addressing potential risks arising from the ownership of a bank by a shareholder significantly involved in non-financial activities. For example, some jurisdictions have extended the supervisory reach by adopting a wider legal definitions of ownership 'control' to which prudential limits may be applied to include situations where such controllers do not even have 100 percent equity ownership or even a majority of voting shares. In the United States, for example, the threshold for controlling ownership is 25 percent under the Bank Holding Company Act of 1956.

Similarly, individuals whose personal shareholdings do not meet defined control thresholds may nevertheless be deemed to exercise a “controlling interest” or be part of a group based on a regulatory determination that the group members, acting in concert, exercise a controlling influence.

To the extent that non-financial activities are allowed to be undertaken by the wider corporate group (i.e. outside the financial group subject to consolidated supervision), there remains the need for supervisors to assess risks arising from such activities.²¹ As prudential supervision is not typically applied on non-financial activities, substantial capacity building efforts may be required to broaden the supervisory scope of knowledge to cover commercial activities carried out by the bank’s affiliates. This entails developing a comprehensive understanding of the nature of these activities to identify risk channels through which the safety and soundness of the constituent bank may be affected. Furthermore, supervisors will have to put in place adequate arrangements which enable access to critical information on these commercial activities to facilitate early identification of risks and intervention actions where appropriate.

b. Foreign-owned Groups

Within the context of internationally active groups, concerns may also exist from the perspective of host supervisory authorities, in view of the Basel Concordat which accords the home supervisory authority the role of consolidated supervisor. Notwithstanding the international regulatory framework, supervisors in their capacity as host authorities may view that there is a need to conduct consolidated supervision over operations by the bank and its affiliates which are undertaken in the host jurisdiction, particularly if these operations are collectively assessed to be systemically important to the stability of the local financial system or if equivalent prudential oversight by home authorities is not deemed to be equivalent (see Table 2).

Beginning 2015, the United States, for example, will require the formation of an intermediate holding company, effectively subjecting the group’s operations in the United States to the Federal Reserve’s consolidated supervision, if the global assets of the group exceed \$50 billion and if non-branch assets in the United States exceed \$50 billion.

Table 2

Authority	Treatment of Foreign-owned Groups
Australia	Does not require formation of locally-incorporated holding companies
European Union	<ul style="list-style-type: none"> • Requires the verification of equivalent home supervision • In the absence of equivalent home supervision, consolidated supervision will apply on the foreign group • Will designate a locally-incorporated holding company if any

Authority	Treatment of Foreign-owned Groups
Malaysia	<ul style="list-style-type: none"> • In general, does not require formation of locally-incorporated holding companies • Subject to an assessment of existing prudential arrangements and the systemic importance of the foreign-owned group's local operations
Singapore	<ul style="list-style-type: none"> • In general, does not require formation of locally-incorporated holding companies • Subject to an assessment of the significance of local operations to the local financial system or the global financial group, and the extent of group-wide supervision by home supervisory authorities
United States	<ul style="list-style-type: none"> • Subject to US enhanced prudential standards if global assets of foreign banking group exceed US\$50 billion • Requires formation of intermediate holding company if non-branch US assets exceed US\$50 billion

c. *Scope of Regulatory Consolidation*

There is also the need to determine the appropriate scope of consolidation. In this regard, international accounting standards provide a useful baseline in defining the appropriate scope of consolidation (and hence, the entities which should be captured within the perimeter). In particular, the concept of control underlying accounting consolidation, which requires the establishment of the investor's power over and rights to variable returns from the investee, are likely to allow supervisors to cast a sufficiently broad net to capture the relevant entities for consolidated supervision.

Nonetheless, there might be circumstances where accounting consolidation may not sufficiently reflect the range of relationships or magnitude of certain types of risks within the financial group which may be relevant for purposes of supervisory assessments. Robust supervisory oversight therefore requires an in-depth understanding of the economic relationships embedded between a bank and its affiliates, including those in the wider group,²² and how these relationships may translate to become potential risk channels. For instance, accounting consolidation may not capture the reputational risks arising from brand associations that could potentially undermine an otherwise prudent and sound bank. While such situations may be very remote, supervisors may need to expand the scope of consolidated supervision in order to obtain additional information, impose specific restrictions or conduct examinations of any affiliates that may pose potential risks to the bank.

d. *Amplification of Moral Hazard*

The potential for moral hazard arising from the association of non-bank or non-regulated entities with banks may be further amplified by the policy to draw clear boundaries for consolidated supervision. The explicit definition of the scope of oversight under consolidated supervision – whether by legal powers, regulatory requirements or supervisory activities – may have implications on public perception,

which, if not properly managed, can be counterproductive to the one of the intended objectives of consolidated supervision, namely to address moral hazard itself.

In practice, the moral hazard problem could be amplified by way of public and investor expectations relating to the relationship between the bank supervisor and non-bank affiliates. Where once there was merely a perceived extension of the public sector safety net to non-bank affiliates, the establishment of a consolidated supervision framework with a clearly-defined scope of group-wide oversight may be understood by the public as a confirmation of this relationship. This, in turn, can create further misconceptions that, moving forward, non-bank affiliates will be under the same rigour and magnitude of oversight as that applied to banks, thus creating an unfair advantage for the non-bank affiliates. For example, when non-bank affiliates undertake capital-raising activities, the funding provided to them may be underpriced as investors and credit ratings agencies assume an equivalent risk profile between the bank and its non-bank affiliates. This could be further compounded in the context of internationally-active groups, as home authorities may be expected to expand the coverage of the public sector safety net, such as deposit insurance or emergency liquidity assistance, to banking operations being undertaken in host jurisdictions. It should be noted, however, that historically, there is no strong precedent of a cross-border extension of any of these safety nets.

It is therefore important that regulatory and supervisory authorities take appropriate steps to ensure sufficient policy clarity in communicating the intent and focus of consolidated supervision to the financial groups, market participants as well as the public at large. In this respect, it should be clear that the oversight of a bank's affiliates is only relevant to the extent that it serves to safeguard the interests of the public, namely depositors and insurance policyholders.

Adequate Legal Powers, Inter-agency Arrangements and Supervisory Capacity to Conduct Consolidated Supervision

While defining the regulatory and supervisory perimeter provides clarity on the scope of consolidated supervision, adequate legal authority is most critical in enabling supervisors to conduct such group supervision effectively. Of particular importance is the need for clear and explicit powers to identify sources of material risks to the bank or financial system stability and to undertake corrective actions in a timely manner.

Since regulatory and supervisory powers have traditionally been focused on the regulated bank and its subsidiaries, consolidated supervision will require oversight powers of the legal framework to be extended, in particular to the parent or holding company of the banks to enable supervisors to develop a more complete understanding of the relationships and risks within the entire group.

Such broad powers typically entail provisions to regulate and supervise the holding company which exercises control over banks and their affiliates, particularly in cases where the ultimate parent company of the bank is a non-regulated entity. The

specific approach in achieving these oversight powers, however, does not necessarily have to be identical across jurisdictions for consolidated supervision to work. Supervisors in Singapore, for example, may designate financial holding companies through which consolidated supervision is conducted. Meanwhile, in Malaysia, holding companies of licensed institutions, including banks, need to be approved under the law, which effectively subjects them to regulatory and supervisory oversight.

Notwithstanding the differences in the legal framework, the intended outcome is achieved where the holding company serves as a supervisory point of entry to access information on other entities within the financial group – which in turn guides supervisors in forming a group-wide risk assessment – as well as to implement group-wide prudential rules on a consolidated basis. In ensuring that the potential opacity or complexity of group structures does not impede a clear view by supervisors of the global and consolidated operations of a group – hence the consolidated supervision perimeter – powers to require restructuring may also support the implementation of regulatory requirements and supervisory activities.

It is also particularly vital to ensure that supervisors and other relevant authorities have sufficient capacity to provide for the resolution of banks within the context of financial groups.²³ The level of such capacity may be greater than traditionally required to resolve banks on a standalone basis. This may arise due to the added complexity arising from, among others:

- i. The operational dependencies of the constituent bank with affiliates carrying out centralised functions for the group;
- ii. The cross-border nature of a financial group's operations, legal constraints on the exchange of information among constituent entities of a financial group; and
- iii. The potentially higher degree of interconnectedness with the financial system.

These challenges have prompted further debate among policymakers on how the building blocks of national resolution regimes should be strengthened within the context of financial groups. Some have suggested the adoption of 'single point of entry' solutions, where resolution powers – such as bail-in or transfer tools – are applied at the holding company level by a single resolution authority and losses incurred in the group are absorbed by the holding company.²⁴ Nonetheless, others maintain that a 'multiple point of entry' approach, where subsidiaries are individually resolved by various resolution authorities, remains appropriate.

Given the wide span of activities undertaken by a financial group, it is crucial that there is a clear delineation of formal roles and responsibilities of the different authorities, both domestically and internationally.

In the domestic context, the pertinence of developing arrangements to facilitate consolidated supervision largely depends on whether both banking and insurance sectors are under the oversight of a single prudential authority. This is the case in jurisdictions such as Australia, Singapore, Indonesia and Malaysia. However, where

banking institutions and insurers are under the ambit of different oversight authorities – such as in Thailand, Hong Kong, China and the Philippines – there will be a need to clearly establish which authority is primarily responsible for conducting consolidated supervision while setting out the roles and functions of other authorities in the overall framework for group oversight, particularly with regard to information sharing arrangements as highlighted by the Joint Forum.²⁵ The division of responsibilities may be legislated (as is the case in Europe and the United States), although a similar outcome can also be achieved through a Memorandum of Understanding between the relevant authorities.

In this regard, the institutional arrangements in the United States are instructive. For example, the Federal Reserve has important oversight responsibilities over deposit-taking institutions, while also acting as the ‘umbrella supervisor’ for purposes of consolidated supervision. In its capacity as the lead regulator, the Federal Reserve focuses on the holding company on a consolidated basis, while placing reliance on ‘functional regulators’ (e.g. the Securities Exchange Commission, Commodities Futures Trading Commission, etc.) to provide information on non-depository affiliates under their oversight. The Federal Reserve also closely coordinates with the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, the primary regulators for the banks under their jurisdiction, to share information on banks that have holding company affiliations or are systemically important.

Nonetheless, formal arrangements alone are insufficient, as demonstrated by the experience of the United Kingdom during the crisis, whereby the Memorandum of Understanding between the Bank of England, Financial Services Authority and HM Treasury – better known as the tripartite arrangement – was not able to facilitate adequate intervention to effectively fulfill its financial stability objectives. This experience highlights the crucial need for adequate powers and tools to directly enforce timely corrective actions on any constituent entities of the financial group, if they have been assessed to be unduly exposing the bank or financial system stability to material risks.²⁶

For financial groups with significant cross-border operations, effective home-host arrangements are crucial.²⁷ While practices in this area have evolved over the recent years to facilitate the sharing of experience among supervisors globally, practical impediments may surface for many supervisors in emerging economies, preventing them from fully leveraging on these arrangements. This can occur where a financial group’s activities in a host jurisdiction are insignificant to the home authority but systemically important to the host authority. This is not uncommon in emerging markets, in which many large internationally-active financial groups operate. In this instance, the host authority may be excluded from, or unable to participate meaningfully in, appropriate platforms such as supervisory college meetings or crisis management groups to escalate its local supervisory concerns, especially those relating to risks from non-bank affiliates.

Hence, formal home-host arrangements need to be complemented with a strong underlying relationship. The development of such a relationship demands that a culture

of mutual trust and reciprocity exists and is being continuously nurtured to encourage the sharing of critical supervisory information which can, at times, be highly sensitive or confidential in nature. This, in turn, requires continuous engagements over time. As financial groups continue to expand at a rapid pace, supervisors too should continue to advance efforts to cement both existing and new home-host relationships through frequent and comprehensive cross-border engagements.

Enhancements to the existing gateways for information-sharing should, however, be pursued to ensure that formal home-host arrangements continue to be relevant in the increasingly dynamic and evolving financial landscape of internationally-active financial groups. This may include putting in place operational capabilities and procedures that facilitate and coordinate the sharing of critical information. Considerations may also be given to the advancement of collective efforts at the international level, such as through the development of multilateral arrangements which provide a framework for international cooperation and coordination. An example of this is in the securities sector where the International Organisation of Securities Commissions (IOSCO) has developed a Multilateral Memorandum of Understanding (MMoU) which sets out general principles related to the scope, nature and operationalisation of cross-border inter-agency cooperation.

In respect of technical capacity, the intensity of consolidated supervision may also require the agency that assumes the role of lead agency to upgrade its supervisory resources. In particular, supervisory teams may need to expand their technical knowledge of risks beyond the traditional realm of banking activities, particularly those carried out by unregulated entities in the financial group. To the extent that these activities are under the oversight of another authority, the lead agency should leverage as much as possible on inter-agency arrangements. The available supervisory infrastructure should also be commensurate with the size of a financial group's operations, which may increase the need for more sophisticated data management capability. This may include the development of, or enhancements to, a centralised system which integrates key supervisory information.

Role and Approach of Entity-level Supervision vis-à-vis Consolidated Supervision

Finally, with a consolidated supervision framework in place, supervisors may need to reassess the appropriateness of the role and approach of entity-level regulation and supervision. From the perspective of global standards, the broad principles related to consolidated supervision so far are articulated within the context of regulating a bank or an insurer – this may suggest a supporting role for consolidated supervision, whereby group-wide requirements are developed as a complement to, not a substitute for, entity-level requirements.²⁸

One may argue that there might be instances where regulatory requirements imposed at the consolidated level could be considered as an adequate substitute for the requirements imposed at the entity level. For example, the case for retaining prudential limits on large exposures to a single counterparty at the entity level could be reviewed

if such limits are already applied on a consolidated basis. Similarly, when applying requirements on capital adequacy or liquidity on a consolidated basis, supervisors' lack of preference over the location and distribution of such resources within the group could suggest the confidence and willingness to rely on rules observed at the consolidated level. Some jurisdictions, such as the European Union, for instance, do provide for the exemption of entity-level liquidity requirements if those requirements are applied on a consolidated basis.²⁹ Likewise, in Brazil, capital requirements are applied on a consolidated basis and do not require a separate test on the capitalisation of individual banks within a financial group.³⁰

While it is incumbent upon supervisors to continually assess the complementarity and compatibility of prudential regulation applied at both entity and consolidated levels, lessons from the recent global crisis however suggest a continuing focus on entity-level supervision while enhancing the quality of consolidated supervision. The 'top down' approach to the assessment of risks within banks, which relies on aggregation of financial data from multiple bank affiliates and even non-bank affiliates while de-emphasising or ignoring legal entity views of risk – as advocated by some supervisors prior to the crisis – may be inadequate. While this approach provides a consolidated set of information on bank subsidiaries' condition and performance, it has shown to be insufficient to help supervisors understand the conditions of affiliated banks from a safety and soundness perspective on a stand-alone basis. A consolidated view of affiliated banks' risks may, for example, reflect adequate capital and liquidity buffers for the group as a whole, but mask the build-up of risks within banking subsidiaries on a stand-alone basis. This analytical approach erroneously assumes that capital and liquidity within a banking group is fungible, such that it can be reallocated among the various subsidiaries at will. This is not always the case due to regulatory or legal restrictions on transactions with affiliates, as well as the need for the boards of directors of affiliated banks to determine, in line with their fiduciary responsibilities, whether the transaction is in the best interests of the bank.

The complexity of banking group operations and the expanding scope of their activities do suggest that the supervisory resources should be directed towards continuously improving the quality of supervision at both the entity and consolidated level. Any policy discourse relating to consolidated supervision should be premised on the fundamental objectives of regulating institutions such as banks and insurers, and how these intended objectives could be better achieved in any manner by changing the current regulatory and supervisory approach.

Conclusions and Recommendations

Over the last decade, the Asia-Pacific region has been experiencing increasing financial integration and many close inter-linkages have developed. This will be further reinforced by regional initiatives, such as the ASEAN Banking Integration Framework, to advance the agenda of creating more competitive, open and internationalised financial sectors. As the region transitions into a more

interconnected phase of development, a key priority for central banks and other oversight authorities moving forward is therefore to ensure that the developments are anchored by regulatory and supervisory regimes which adequately acknowledge the accompanying risks and considerations.

Effective consolidated supervision is one of the central tenets of such a regime, whereby the group-wide operations of large, cross-border financial groups are subject to prudential requirements, including in areas of capital adequacy, corporate governance, risk management and prudential limits. These requirements serve to mitigate regulatory blind spots which can give rise to excessive leverage, contagion, conflicts of interest and moral hazard. Other areas of regulation such as that involving the development of crisis management and group resolution regimes, cross-border safety nets³¹ and structural bank regulation³² must also be considered in enhancing the approaches to consolidated supervision.

In advancing the objectives of effective consolidated supervision, supervisory authorities need to, at a fundamental level, assess and periodically review, given possible changing circumstances, the country's compliance with the "Essential Criteria" of Core Principles 12 and 13 of the 2012 BCP. Action should be taken to remedy any gaps or instances of less than full compliance with the EC. Other critical steps would include ensuring:

- i. Sufficient legal powers exist to allow examination and inspection of banks' affiliated entities;
- ii. Appropriate legal restrictions covering transactions between banks and their affiliates are effectively in place;
- iii. The country's legal and regulatory framework support adequate domestic and cross-border supervisory cooperation and information exchange, including with relevant non-supervisory authorities, such as finance ministries and deposit insurers;
- iv. The operating protocols for the confidential exchange of supervisory information with foreign supervisors are specified in Memoranda of Understanding, and that those agreements emphasise the extreme sensitivity and paramount obligation of all parties to the agreement to protect confidential supervisory information that they receive; and
- v. Home-host relationships are strengthened, particularly in the establishment of effective supervisory colleges by home supervisors for banks that conduct significant cross-border operations.

Each of these areas would require sustained efforts in strengthening both domestic and cross-border relationships and the establishment of structured coordination and information exchange arrangements to facilitate a better understanding of the complexity of each country's economy, legal system, stage of economic development and most importantly, the characteristics and risks of the banking system and wider financial sector.

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Endnotes

1. We wish to express our appreciation to Lee Zhi Wei for his invaluable support in respect of research and drafting of this article. We also thank Bank Negara Malaysia's Assistant Governor, Jessica Chew Cheng Lian for her constructive comments and kind suggestions. The observations, analysis and recommendations contained in the article are the perspectives of the authors and do not reflect in any way the views of Bank Negara Malaysia or The SEACEN Centre.
2. See Nicolo, G.; P. Bartholomew; J. Zaman and M. Zephirin, (2003).
3. The FSAP process is detailed in The Financial Sector Assessment Program, Factsheet, (Washington, D.C.: IMF, last updated September 24, 2013), Available at: <http://www.imf.org/external/np/exr/facts/fsap.htm> - "FSAP assessments are the joint responsibility of the IMF and World Bank in developing and emerging market countries and of the Fund alone in advanced economies, and include two major components: a financial stability assessment, which is the responsibility of the Fund and, in developing and emerging countries, a financial development assessment, the responsibility of the World Bank." With respect to assessing financial sector stability, "FSAP teams examine the soundness of the banking and other financial sectors; conduct stress tests; rate the quality of bank, insurance, and financial market supervision against accepted international standards; and evaluate the ability of supervisors, policymakers, and financial safety nets to respond effectively in case of systemic stress. While FSAPs do not evaluate the health of individual financial institutions and cannot predict or prevent financial crises, they identify the main vulnerabilities that could trigger one."
4. The laws contained in Sections 23A and 23B of the Federal Reserve Act are codified at Chapter 12, United States Code (U.S.C.) Sections 371c and 371c-1, respectively.
5. See Basel Committee on Banking Supervision, (1975) and Basel Committee on Banking Supervision, (1983).
6. See Bank for International Settlements, (1979).
7. See Basel Committee on Banking Supervision, (2012).
8. Specifically: CP 1 – arrangements for sharing information between supervisors and protecting the confidentiality of information should be in place; CP 3 – the prior consent of home country supervisors should be obtained prior to licensing foreign banks; CP 5 – ensure that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision; CP 10 – loans to related companies must be on an arm's-length basis; CP 18 – bank prudential returns and statistical reports should be on a solo and consolidated basis; CP 23

– banking supervisors must practice global consolidated supervision over their internationally-active banks, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banks worldwide, primarily at their foreign branches, joint ventures and subsidiaries; CP 24 – a key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities; and, CP 25 – banking supervisors must require local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

9. See Basel Committee on Banking Supervision, (2012).
10. See Basel Committee on Banking Supervision, (2012).
11. See “Principle 12: Consolidated Supervision” and “Principle 13: Home-host Relationships,” In Basel Committee on Banking Supervision, (2012), pp. 35-39.
12. Basel Committee on Banking Supervision, (1999), p. 53: “A ‘noncompliant’ assessment is given when no substantive progress towards compliance has been achieved.”
13. “Implementation of the Basel Core Principles for Effective Banking Supervision,” International Monetary Fund, Washington, D.C., 2 September 2008, p. 12.
14. Assessed countries were Austria, Barbados, Canada, El Salvador, Italy and Singapore.
15. The 2012 BCP describe, in pertinent part, “compliant” grades as follows: “Compliant – A country will be considered compliant with a Principle when all essential criteria applicable for this country are met without any significant deficiencies”; “Largely Compliant – A country will be considered largely compliant with a Principle when only minor shortcomings are observed that do not raise any concerns about the authority’s ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. (This grade)...can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.”
16. In the Keynote Address to the 10th Asia-Pacific High-Level Meeting on Banking Supervision, Stefan Ingves, Chairman of the Bank for International Settlements, described banks as being highly leveraged firms. Also see Bank for International Settlements, (2013).
17. See “IV. Capital Adequacy and Liquidity,” In Joint Forum, (2012), pp. 25-31.

18. See paragraphs 20-23 of the Basel Committee on Banking Supervision, (2006).
19. On 31 May 2012, in “Turmoil Frays Ties Across Continent,” the Wall Street Journal reported that UniCredit had transferred of €11.3 billion from its German subsidiary to alleviate funding difficulties faced by its Italian operations.
20. Extracted and amended from the 2013 Global Survey conducted by the Institute of International Bankers.
21. See “Principle 12: Consolidated Supervision,” in Basel Committee on Banking Supervision, (2012), pp. 35-37.
22. The Basel Committee notes “the importance of parent companies and other non-banking group entities in any assessment of the risks run by a bank or banking group [...] supervisory ‘risk perimeter’ extends beyond accounting consolidation concepts.” See paragraph 22 of Basel Committee on Banking Supervision, (2012), p. 6.
23. See Financial Stability Board, (2011).
24. See Financial Stability Board, (2013).
25. See “II. Supervisory Responsibility,” in Joint Forum, (2012), p. 12-17.
26. See HM Treasury, (2010).
27. See Zeti Akhtar Aziz, (2013) for further elaboration on the importance of cooperation and coordination arrangements across borders and its associated challenges.
28. Paragraph 23 of the BCBS’s Basel II (Risk-Weighted Assets) framework highlights that “... one of the principal objectives of supervision is the protection of depositors... supervisors should test that individual banks are adequately capitalized on a stand-alone basis” (p. 7). Similarly, essential criteria No. 7 of BCP 12 of the Basel Committee’s Core Principles of Effective Banking Supervision highlights that in addition to consolidated supervision, “the responsible supervisor supervises individual banks in one group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group” (p. 37).
29. See paragraph 77 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

30. As stated in the Basel Committee's Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III Regulations in Brazil. See Basel Committee on Banking Supervision, (2013), p.18.
31. The European Union, for example, has proposed a common framework of rules for protecting deposits and for dealing with banks in difficulty across the European Union's single market. Within Asia, a number of central banks and monetary authorities have also established cross-border collateral arrangements aimed at enhancing the availability of liquidity facilities to regionally-active financial institutions operating in multiple jurisdictions.
32. Some jurisdictions have proposed or developed measures to insulate depositors or certain types of financial activities deemed as critical for the real economy from the risks that emanate from less critical activities which may pose a higher risk. See Gambacorta and van Rixtel, (2013).

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