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Negotiating Cooperation Agreements: The Experience of the Bank of Italy

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1. Introduction

- 1.1. Market integration increases the need for information exchange among supervisory authorities. Even if many supervisory issues are discussed in multilateral forums, information is generally exchanged between two authorities and it is therefore important to establish bilateral contacts.
- 1.2. A common form of bilateral agreement is a Memorandum of Understanding (MoU). Generally speaking, an MoU (or any other formal written agreement) should not be a prerequisite for information exchange. Information exchange should be possible between any two authorities anyway: MoUs should be seen just as an instrument to facilitate the flow of information. Where there are legal, regulatory, or other practices representing obstacles to such an exchange, MoU negotiations should aim at removing the obstacles or creating appropriate gateways so that the obstacles can be overcome in appropriate circumstances. MoUs can therefore be seen as instrumental to the development of increasingly common regulatory and supervisory frameworks across countries.

2. Bank of Italy's Experience: A Flexible Approach

- 2.1. Within the member states of the European Union (EU), negotiations concerning bilateral MoUs between any two of them have been based on a common regulatory framework (banking and financial services directives). However, each MoU has been drafted taking into account the specific national supervisory approach. The bilateral format, chosen

by the banking supervisory authorities in Europe, facilitates the development of a face-to-face relationship between supervisors, a relationship that is most important for the effective application of any cooperation agreement.

- 2.2. Between 1993 and 1999, the Bank of Italy signed 10 MoUs with 10 other EU counterparts¹ following a common format that was updated according to upcoming European financial legislation. In this respect, the flexibility of MoUs' schemes has been tested practically. Over the years, the scope of the MoUs has been progressively extended in order to take into account both European Union and national regulatory developments.
- 2.3. These schemes formed the basis for the drafting of other MoUs with some EU accession countries (such as Hungary, Slovenia, and the Slovak Republic) and other Eastern European countries (such as Bulgaria and Romania) that were selected as MoU counterparts because of the size and significance of Italian banks' presence, with both branches and subsidiaries, in their territories. MoUs with these countries were signed between 2001 and 2003.
- 2.4. The content of these agreements is uniform, based on the general framework arranged by the Groupe de Contact² in the early 1990s, and they generally provide for a detailed exchange of information on the organization, operations, and balance-sheet situation of the supervised entities intending to operate abroad, either establishing a branch or a subsidiary or without physical presence (the EU term for that is "free provision of services"). They provide for periodic bilateral meetings aimed, among other things, at keeping the parties informed about important statutory and regulatory innovations regarding supervision in the respective countries; they ensure a regular exchange of information on the business concerned and the prompt information of the authorities involved when problems arise. The agreements also specify the ways in which home-country authorities can carry out inspections at the establishment in the other party's territory.

¹Austria, Belgium, France, Germany, Greece, Ireland, Luxembourg, the Netherlands, Spain, and the United Kingdom.

²The Groupe de Contact was initially established in 1972 as a working group of banking supervisors in the European Community to discuss exchange of information matters. It is now a working group of the Committee of European Banking Supervisors set up under the Lamfalussy procedure for developing financial services legislation in the EU.

- 2.5. With other non-EU countries,³ supervisory cooperation agreements entered into by the Bank of Italy took several forms besides formal MoUs, such as letters of intent, limited-scope agreements, and informal arrangements. In each case, their common principal objective has always been timely information exchange between authorities.
- 2.6. In general terms, both inside and outside the European area, the exchange of information between the Bank of Italy and its foreign counterparts is limited to supervisory matters. Other areas of criminal relevance, like financial fraud or money laundering, fall within the responsibility of law-enforcement agencies and are often the subject of existing separate bilateral mutual assistance treaties or agreements.

3. Outstanding Issues

- 3.1. In our experience, one factor influencing negotiations for cooperation agreements concerning banking and financial supervision is the scope of information exchange. In this respect, mutual trust and understanding may not be sufficient to overcome the differences between the legal frameworks governing professional and banking secrecy in force within the negotiating parties. These differences may, sometimes, jeopardize the effectiveness of cooperation, especially as concerns the protection of individual data that are at the core of the strategy of many jurisdictions. It comes to my mind, as a way out of this problem, that the matter of access of information on individual customers is covered in the Basel Committee on Banking Supervision's 2003 paper on customer due diligence for banks. This indicates that there are occasions when information regarding individual customers needs to be exchanged, but it also makes clear that safeguards are needed to ensure that information regarding individual accounts is used exclusively for supervisory purposes and can be protected by the recipient in a satisfactory manner.
- 3.2. Another factor that, in our experience, makes negotiations for formal agreements difficult is related to on-site inspections, which are the most commonly used instrument for verifying and collecting information on banks' operations. Problems may emerge when two supervisory authorities are in an asymmetric position—for example, when Country A has no foreign subsidiaries, whereas the majority or totality of its banks, which are very often systemically important in terms of market shares, are owned by foreign capital. The authorities of such jurisdic-

³Brazil, Hong Kong SAR, Japan, Singapore, and the United States.

tions, while recognizing the right of the parent bank's supervisor to perform on-site visits at the bank's subsidiaries in their country, sometimes argue that this should be conditional upon recognition of their right as host supervisors to perform on-site visits at the parent bank.

- 3.3. In fact, it is not within the present cross-border banking framework⁴ for host-country supervisors to perform on-site examination of parent banks. The reason for this is that the host supervisor has no jurisdiction over the parent bank. Responsibility for the parent bank rests with the home supervisor, which is also responsible for the consolidated supervision of the whole banking group. Host supervisors also cannot be given on-site access to parent banks for evident practical reasons: how would a large international banking group with subsidiaries in several countries operate, if the supervisors of each of these countries felt entitled to perform on-site inspections at the parent bank of the group? I think that, as a possible solution to this problem, a distinction could be drawn between the process of on-site inspections and information exchange. It would be possible—and I believe should be possible—for home supervisors to be more open with host supervisors in terms of information exchange without accepting that a host supervisor should be allowed to engage in on-site inspections of parent banks.

4. Next Steps

- 4.1. Cooperation and exchange of information are bound to evolve in view of the blurring distinctions among financial sectors, the increasing cross-border dimension of financial intermediaries, and the enhanced technical capabilities of financial intermediaries in financial risks management and measurement. In this last regard, one has to take into account the increased necessity of cooperation between home and host authorities in relation to the validation of credit and operational risk models stemming from the Basel II framework.
- 4.2. New procedures are to be envisaged to smooth information flows among supervisors of different financial sectors and different countries. They should progressively work together in order to ensure that supervision correctly considers all the aspects of supervised entities' financial activities. Efficient processes for facilitating collegial work should

⁴Reference is made to the following Basel Committee documents: "The Supervision of Cross-border Banking," 1996; "Core Principles for Effective Banking Supervision," 1997; "Core Principles Methodology," 1999; and "Essential Elements of Statement of Cooperation Between Banking Supervisors," 2001.

be designed and coordination of supervisory activities over different groups' components should avoid duplication of effort for both supervisors and supervised entities.

- 4.3. Most probably, cross-border cooperation and information exchange will keep on being managed through flexible arrangements that will be shaped in order to accommodate evolving financial markets and intermediaries.
- 4.4. The increased degree of integration among markets requires an enlarged information exchange not only on countries' economic conditions but also on single operators. In financial sectors, this flow of information is even more important, since financial intermediaries are supervised and supervisory responsibilities are clearly defined.
- 4.5. In the end, cooperation among authorities, in whatever form arranged, is essential in order to avoid circumstances in which single operators' failures jeopardize the growth of economies in which they act.