



Proceedings from an International Conference on Cross-Border Banking

Introduction

The **Federal Reserve Bank of Chicago** and the **International Association of Deposit Insurers (IADI)** co-hosted an International Banking Conference focusing on cross-border banking issues on 5-6 October 2006. This was the ninth in a series of international banking conferences sponsored by the Federal Reserve Bank of Chicago. The main theme of the Conference was "**International Financial Instability: Cross-Border Banking and National Regulation.**" The Conference was opened by **Michael H. Moskow** and **Jean Pierre Sabourin**. They said that the two organizations were pleased to hold this important international conference and they both expressed confidence that the conference would provide the participants with an international forum to discuss key issues on cross-border banking and contribute to the international cooperation among financial safety net players facing potential serious cross-border issues.

What are the main issues addressed during the conference?

The first session focused on the "**Landscape of International Banking and Financial Crises.**" **Dirk Schoenmaker** led off with a presentation on the current state of cross-border banking activities and public policy issues resulting from that growing activity. **Mr. Schoenmaker** pointed out that while regulations are increasingly based on a global (Basel-type) or regional (EU) standards in response to the internationalization of banks, supervisory authorities, who should enforce them are still nationally rooted with some elements of international and regional coordination. In this regard, he suggested that a formal supervisory structure in the European region would be beneficial to enhance legally binding cooperation between home and host authorities. **Carl-Johan Lindgren** then addressed actual and near-miss cross-border crises. His remarks were based on his experiences while at the IMF and he concluded that cross-border crises may be caused by individual bank failures or systemic banking problems, but they are far rarer than commonly believed – although the potential for such crises is growing as a result of increased capital mobility, leveraging, financial market integration, and size of global financial conglomerates.

Sander Oosterloo delivered a presentation on Financial Stability Reviews. He drew attention to questions relating to the publication of FSRs. **Luc Laeven** pointed out that the five cross-border crises mentioned by Mr. Lindgren were highly related to periods of financial liberalization and internalization. He also mentioned that the failure of a large global bank could cause an ownership as well as contagion crisis. In this regard, he said that policy cooperation among the countries concerned is critical to solve ownership crisis.

A speech delivered on behalf of **Stefan Ingves**, the head of Sveriges Riksbank, proposed a new body, which he termed the European Organization for Financial Supervision (EOFS) - to address some of the problems of coordination in gathering information and producing a coherent and consistent assessment of the risks in major cross-border banks in Europe.



SESSION II focused on "*Causes and Conditions for Cross-Border Instability Transmission and Threats to Stability*," and the session was moderated by **Craig Furfine**. In the first presentation, **Bent Vale** of Norges Bank explained the hypothetical contagion links of cross-border banking crises by examining the Nordic bank crises of the early 1990s. One important conclusion was that host countries eventually import banking instability and when combined with instability in the home country, hypothetical contagion events may happen when either a parent bank or its significant subsidiary fails.

Jon Danielsson focused on the hidden linkages between cross-border currency crises and currency trading volumes. He noted that currency volumes are an important policy variable and within a contagion model it could help identify fragility, identify inter-country linkages, understand danger of contagious failure and the scope and importance of carry trades. He was followed by **Triphon Phumiwasana** who gave a presentation on developments concerning hedge funds by analyzing data from 1981-2006. The discussant for the session was **Gary Schinasi** and he addressed some policy implications relating to oversight regimes – i.e. regulation, supervision, surveillance market discipline - for each of cross-border instability channels.

SESSION III featured "**Prudential Supervision**" and **Robert Eisenbeis** led off by examining the issues surrounding the negative externalities that may occur under a large bank failure. He noted that the regulatory concerns about systemic risk should be directed first at closing institutions promptly, at reforming bankruptcy statutes to admit special procedures for handling banking failures and to provide mechanisms to give creditors and borrowers prompt and immediate access to their funds and lines of credit. **Richard J. Herring** gave a presentation on conflicts and potential solutions between home and host country prudential supervisors. **Mr. Herring** concluded that policy perspective may differ on whether a specific crisis resulting from the failure of a cross-border bank is systemic in either parent bank or its foreign branch or subsidiary. **Paul Wright** of the UK FSA mentioned that effective (getting the job done) and efficient (minimising costs and duplication for the regulated community) cross-border supervisory collaboration is, in reality, very difficult to achieve due to differences in supervisory authority's objectives, scope, powers, approach, risk preferences, and skills and access. One important conclusion by the speaker was that it is desirable to have maximum feasible collaboration with home country regulator when host country branches or subsidiaries are systemically important and ideal to fully rely on home supervisory authority when the branches or subsidiaries are not systemic.

Sheila C. Bair, the new head of the Federal Deposit Insurance Corporation, addressed the issue of international supplemental capital measures, such as a leverage ratio. She noted that while capital helps prevent a financial crisis, an effective deposit insurance system can mitigate its effects. In addition, she pointed out that an important key to global stability and confidence should be an international strategy for large bank resolution.

SESSION IV featured a look at the "**Government Safety Nets**" and **Vitor Gaspar** from Banco de Portugal examined the classical lender of last resort role of central banks. **Mr. Gaspar** said that it is very important to think about the issues of burden sharing in cases of a financial crisis with significant cross-border effect. In this regard, he noted that Coase's Theorem might provide a good approximation, to the outcome of negotiations,



among government, officials in an environment of costly bargaining and imperfect information. The FDIC's **Michael H. Krimminger** focused on the key challenges faced by national authorities in responding to financial instability in a cross-border bank and identifying some of those practical steps. He noted that the home and host country authorities may face a mismatch between supervisory control, access to information, and responsibility for protecting the local economy.

Andrew P. Powell attempted to show by using econometric model that with local deposit insurance, in a risky environment it will be in the interest of the bank to consider its liability limited to the capital invested and maintain a very low level of capital in the relevant subsidiary. **Thorsten Beck** then looked at the interaction of the different components – i.e. Deposit Insurance System (DIS), Bank Failure Resolution (BFR) and Lender of Last Resort (LLR), with a focus on ex-ante moral hazard problems. To avoid such conflict of interest and duplicative regulation efforts among financial safety net components, **Mr. Beck** noted that it is important to have institutional links or MOUs, information sharing arrangements, consistent incentive structure among the financial safety net components.

SESSION V on Insolvency Resolution was moderated by J R LaBrosse and **Rosa Maria Lastra** explored some of the various issues at stake in the cross-border resolution of banks, as well as an analysis of the status quo concerning crisis management in the EU, which illustrates the multi-faceted and complex nature of the problems involved in the effective resolution of failing or failed banks. **David G. Mayes** of the Bank of Finland focused on how systemic risks could be reduced in a framework of large international banks whose operations run across national borders. He suggested in particular that, in the European Union, some form of international resolution agency is required.

Larry Wall noted that prompt corrective action seeks to minimize expected losses to the deposit insurer and taxpayer by limiting supervisor's ability to engage in forbearance and as well PCA also should reduce banks' incentive to engage in moral hazard behaviour by reducing or eliminating the subsidy to risk-taking provided by mispriced deposit insurance. The Bank of England's **Peter G. Brierley** commented that many suggested solutions for these international banks would require changes to legislation, bilateral deals would not really be an option, and supranational authorities as noted in the David Mayes' presentation is not yet practical. He concluded by stressing that improved cross-border co-operation may be the only realistic current option.

There was a **luncheon speech** delivered by **Raghuram G. Rajan** of the IMF said that we are experiencing a widespread phenomenon of high productivity growth, but low investment relative to desired savings, which has pushed down interest rates and pushed up asset prices. He further mentioned that with plentiful liquidity, investment managers have reduced the *premia* for risk as they search for yield.

Cross-Border Crisis Prevention: Public and Private Strategies was the focus of **Session VI**. **Arnoud W. A. Boot** explored some key issues related to supervisory arrangements in the EMU countries, and particularly those relating to the LOLR (lender of last resort) structure and crisis management, with a focus on the responsibilities and powers of individual countries vis-à-vis those at the European level (EU and ECB). One primary conclusion by the speaker was that a centralization of the LOLR function within the Euro countries is



urgent, and actually could help facilitate convergence and centralization of prudential supervisory practices. **David S. Hoelscher** of the IMF delivered an overview of cross-border banking, challenges and options going forward in the context of the supervision and crisis management mechanism. Most issues addressed by the speaker were already discussed in the previous sessions. **David Mengle** looked at private sector crisis avoidance efforts with a focus on OTC and credit derivatives.

The final session took the form of a **Policy Panel** moderated by **George Kaufman**. The panel included **Mutsuo Hatano**, **Andrei G. Melnikov**, **Arthur J. Murton**, **Guy Saint-Pierre**, and **Lawrence R. Uhlick**.

In closing, **J. P. Sabourin** looked back on IADI's past four years during dinner and he set out some future challenges for deposit insurers. He expressed deep appreciation to the participants and organizers for their efforts in making the conference a great success.

Where to get further information on the discussion paper?

For further information, please see the full text of the proceedings from Chicago conference at the following website:

<http://www.iadi.org/html/Default.aspx?MenuID=232>.

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