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NO 21**

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**CROSS-BORDER BANKING**

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**Stanislaus A. Ukeje**



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**Central Bank of Nigeria**

33 Tafawa Balewa Way

Central Business District

P.M.B. 0187

Garki, Abuja

**Phone:** +234(0)946236011

**Fax:** +234(0)946236012

**Website:** [www.cbn.gov.ng](http://www.cbn.gov.ng)

**E-mail:** [info.dmp@cbn.gov.ng](mailto:info.dmp@cbn.gov.ng)

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Enquiries concerning this publication should be forwarded to: Director, Monetary Policy Department, Central Bank of Nigeria, P.M.B. 0187, Garki, Abuja, Nigeria,  
[Email:info.dmp@cbn.gov.ng](mailto:info.dmp@cbn.gov.ng)

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- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Promote a sound financial system in Nigeria
- Act as banker and provide economic and financial advice to the Federal Government

## Vision

“By 2015, be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development”

## Mission Statement

“To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector”

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To Provide a Dynamic Evidence-based  
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## FOREWORD

The understanding monetary policy series is designed to support the communication of monetary policy by the Central Bank of Nigeria (CBN). The series therefore, provides a platform for explaining the basic concepts/operations, required to effectively understand the monetary policy of the Bank.

Monetary policy remains a very vague subject area to the vast majority of people; in spite of the abundance of literature available on the subject matter, most of which tend to adopt a formal and rigorous professional approach, typical of macroeconomic analysis. However, most public analysts tend to pontificate on what direction monetary policy should be, and are quick to identify when in their opinion, the Central Bank has taken a wrong turn in its monetary policy, often however, wrongly because they do not have the data for such back of the envelope analysis.

In this series, public policy makers, policy analysts, businessmen, politicians, public sector administrators and other professionals, who are keen to learn the basic concepts of monetary policy and some technical aspects of central banking and their applications, would be treated to a menu of key monetary policy subject areas and may also have an opportunity to enrich their knowledge base of the key issues. In order to achieve the primary objective of the series therefore, our target audience include people with little or no knowledge of macroeconomics and the science of central banking and yet are keen to follow the debate on monetary policy issues, and have a vision to extract beneficial information from the process, and the audience for whom decisions of the central bank makes them crucial stakeholders. The series will therefore, be useful not only to policy makers, businessmen, academicians and investors, but to a wide range of people from all walks of life.

As a central bank, we hope that this series will help improve the level of literacy in monetary policy as well as demystify the general idea surrounding monetary policy formulation. We welcome insights from the public as we look forward to delivering content that directly address the requirements of our readers and to ensure that the series are constantly updated as well as being widely and readily available to the stakeholders.

**Moses K. Tule**

*Director, Monetary Policy Department  
Central Bank of Nigeria*

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# CROSS - BORDER BANKING<sup>1</sup>

Stanislaus A. Ukeje<sup>2</sup>

## SECTION ONE

### Introduction

Banks are in the business of intermediation between finance-surplus and finance-deficit entities. Global financial imbalance has been with the world for a long time. Financing across national borders is termed cross-border financing and it is natural for banks to be involved. Historically, most countries discouraged the entry of foreign banks using a number of means, including discriminatory regulations, such as requiring them to hold higher capital and to submit to both home and host countries regulations and supervision. Credit institutions (commercial banks, deposit money banks (DMBs)) also found it difficult to enter foreign markets on account of language, business culture, laws and regulatory and management challenges that come with it (Berger et al, 2004).

The growth of international trade by its logic has opened the vista of international banking. Among the factors that gave this development impetus are the globalisation of the international financial system, due to the liberalisation of international capital movements and financial deregulation within countries; major technological advances in control engineering and computing, particularly in the field of data processing; and improvements in the cross-border regulatory environment through international trade treaties. Notable international trade (Common Market) agreements that have promoted international banking include the European Union (EU) and the establishment of a single currency, the euro; the North American Free Trade Area (NAFTA); and the Economic Community of West African States (ECOWAS).

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<sup>1</sup>This publication is not a product of vigorous empirical research. It is designed specifically as an educational material for enlightenment on the monetary policy of the Bank. Consequently, the Central Bank of Nigeria (CBN) does not take responsibility for the accuracy of the contents of this publication as it does not represent the official views or position of the Bank on the subject matter.

<sup>2</sup>**Stanislaus A. Ukeje** is an Assistant Director in the Monetary Policy Department, Central Bank of Nigeria

Thus, the globalisation of enterprise has affected the business of banking. European investors invested their savings in emerging markets such as the United States of America, South Africa and Hong Kong. Early in the 19<sup>th</sup> century, and from the 1960s, financial transactions between banks in industrialised countries was well under way (Committee on the Global Financial System, 2010a). In these two episodes, bonds and stocks were important vehicles for cross-border financing more than bank lending. Even then, multinational companies transferred the credit taken from home banks to their subsidiaries across national borders. But from the mid-1990s, foreign direct investment in banking business became very common place, making cross-border banking an issue.

Cross-border banking business could be conducted by a bank in three ways:

- a. By establishing a subsidiary in a host country;
- b. By establishing a branch in a host country; and
- c. Through cross-border services.

The elimination in many countries of barriers to international capital flows, together with a general relaxation of barriers to operating across geopolitical borders, has made possible the expansion of international financial institutions. New communications, information and financial technologies have helped banks to take advantage of these relaxed geopolitical barriers, by producing and delivering financial services across large distances from their home country headquarters. Also, the globalisation of financial activities has increased the demand for the services of multinational financial institutions, able to follow customers operating in foreign countries. The World Bank estimates that more than 215 million people, approximately 3 percent of the world's population, live outside their countries of birth. A large number of the migrants send back money to their homes countries, which provides opportunity for global banks to render payment services.

### 1.1 Definition of Cross-Border Banking

Cross-Border banking is a genre of international banking, which involves multinational banking. Multinational banks have physical presence for the provision of banking services, in locations (host) outside the (home) country, where the parent bank was first incorporated.

### 1.2 Reasons for Cross-Border Banking

Banks expand across borders for different reasons. One important reason, is to 'defend' their bank-client relationship through following their home-country clients into their host countries, to avoid losing them to other banks in the host

country. It is possible that a client that meets a new bank in its host country may extend the new relationship back to its home country, to the loss of the previous home country bank. This reason is also termed 'pull factor', because it arises from opportunities in host countries that make it attractive for a bank to enter the new market. The practice of following large corporate clients, was how the first foreign banks were established during colonial times in Africa, Asia and Latin America. It explains how banks from the colonial metropolis of the United Kingdom, France, Portugal and Spain were established in former colonies. Since the establishment of majority rule in South Africa, banks from that country have been following their South African business clients to establish in other African countries (Brownbridge and Harvey, 1998). Banks that expand across borders with a view to defending client relationships, may do so, via foreign direct investment (FDI), or trade relationships or both in the host country. But there is a complementary hypothesis (Walter, 1981) that foreign banks may actually be leading their home and other foreign customers into their host countries through providing them market intelligence, contacts, advice and financial services to enable them successfully enter foreign markets. Foreign countries' banking regulations may be a pull factor in cross-border banking; countries intent on attracting foreign multinational and international banks put regulations and policies in place to attract them. Typically, banks migrate from advanced economies to emerging market economies because of their relative market power in the new (host) market.. This is consistent with the Hymer-Kindleberger-Caves Theory that market imperfections of structural origin, arising from structural deviations from perfect competition in the final product market (host country) due to exclusive and permanent control of proprietary technology, privileged access to inputs, scale economies, control of distribution systems, and product differentiation, offer multinational banks advantage in emerging market and developing economies. So, market imperfection in the banking products markets is a pull factor in cross-border banking establishment, because it offers foreign banks the advantage, which enable them to overcome domestic banks' home territory advantages.

Other reasons for cross-border banking are attributed to 'push' factors, which are circumstances in the home country that influence banks to move to host countries. Important among the push factors are, declining opportunities in the home country and encouraging regulatory regimes. Declining or smaller profit opportunities in the home economy, especially relative to opportunities in potential host markets, encourage banks to move out into new markets. Also, financial liberalisation and deregulation in the home country open previously closed cross-border markets to domestic banking companies, thus, encouraging capable ones to move into new markets to take advantage of opportunities. Multinationals may be 'pushed' to set up across national borders, because of the

comparative advantages they possess from production of bank products, parent size and international experience. Banks that are able to operate at lower costs of capital, lower interest costs and lower non-interest (operating) costs are able to establish successfully offshore, at considerable advantage. Such banks are able to provide products (deposits and credit/loans) at lower costs than competitors. With comparative advantage, such banks are able to operate across borders, either through physical presence or international finance, consistent with the Heckscher-Ohlin trade theory.

### 1.3 Forms of Organisation of Cross-Border Banking

There are a number of organisational structures that a bank maintaining a physical presence offshore could adopt. Each of the forms offer distinct advantages, and have their drawbacks, but must be acceptable under the laws and regulations of the host country concerned. Among the important organisational forms are:

#### Subsidiary

A bank subsidiary is a separately incorporated bank in the host country, which the parent bank controls from the home country, provided that this form of bank/business ownership is accepted within the host country's prudential regulations. The parent bank may be the sole owner of a bank subsidiary, or may have minority shareholders from within or outside the host country.

#### Branch

A foreign branch of a parent bank is located in a different country from the country where the parent bank is incorporated. The foreign branch is itself not incorporated either in the home or host countries. It is integrated with the parent bank, and therefore, is not capitalised separately. The City of London is well known for having many foreign bank branches. Foreign bank branches operate in the host country, subject to the laws and regulations in place, fully supported by their parent bank.

#### Consortium

A joint venture bank, separately incorporated and owned by two or more shareholders who are themselves banks, commonly of different nationalities, is a consortium. A consortium enables capital and expertise to be pooled to the mutual advantage of the joint venture partners. Like is common in joint ventures, a bank consortium could be formed to service a target market segment or geographic market in the host country. A consortium bank operates in a host country under appropriate legislation, which may include obligation of the consortium to have local participation in the joint venture.

### **Correspondent Banking**

In correspondent banking, a bank in home country, agrees with other banks offshore in host countries to clear transactions between them, particularly, customers' foreign exchange and trade dealings. It is low cost method of accessing foreign banking business, without establishing a physical presence offshore, especially where establishment costs are large and regulatory barriers to entry are high.

### **Representative Office**

A representative office is a small office in a host country, set up by another bank outside its home country, to coordinate correspondent banking relationships and serve the foreign bank's customers. Representative offices are useful for gathering information about the host country market, and disseminating information about the parent bank in the host country. A representative office can neither raise liabilities nor create assets, but they are able to run on relatively low budgets. This form of cross-border banking offers easy entry and exit.

### **Agency**

Agencies are foreign banks doing business in host countries on behalf of parent banks located in home countries. They perform such tasks as issuing international letters of credit, but do not accept deposits. Agencies are like representative offices, but imply stronger commitment with the host country, even though they cannot be used to actively participate in host country banking system. Banks usually establish agencies offshore, where sufficient scale of operations exists that justify the higher investment required.

## **1.4 Benefits of Entry of Foreign Banks**

The development of the financial system is vital for the development of the economy. In Nigeria, and many developing and emerging market economies, the banking system is the dominant component of the financial system. As financial intermediaries, banks simultaneously supply credit and administer the payments system, and are also the channel for monetary policy transmission. Economic policy makers are concerned about stabilisation, but all episodes of economic crisis whether localised or globalised, have shown that the banking industry is a key actor in causing, and preventing, financial and economic crises. Part of the consequential research has focused on the role of foreign banks in the process (Goldberg and Saunders, 1981 and Walter and Gray, 1983).

Studies by Claessens, Demirgüç-Kunt, and Huizinga (2001); Crystal, Dages, and Goldberg (2002); and Caprio and Honohan (2002) have found evidence that the

entry of foreign banks generally benefits the host country, particularly in emerging markets. In host countries, it has been known that entry of foreign banks:

- i. Helps in the transfer of improved banking skills and technology to domestic banks, and the development of new banking products and management techniques;
- ii. Enhances the access to international capital into the domestic money and capital markets;
- iii. Leads to significant improvements in the quality and accessibility to financial services for host country households and firms;
- iv. Increases competition in the banking industry, thereby leading to higher efficiency for domestic banks;
- v. Introduce improvements in corporate governance, because they do not have related parties in the host country, and their widely held equity structure does not encourage insiders taking advantage of their relatedness with banks (Goldberg et al, 2000; Hanousek, 2001; IMF, 2000; La Porta et al, 2001); and
- vi. Introduces greater rigour and improvements in host country banking sector supervision and regulation (Levine, 1996 and Crystal, Dages, and Goldberg, 2002).

### 1.5 Drawbacks of Cross-Border Banking

Despite the advantages of the entry of foreign banks into emerging market and developing economies, foreign investment in the financial sector raises some concerns. Greater participation of foreign banking and financial institutions, tend to expose host economies to contagion from events taking place in other countries, where their foreign banks operate. Foreign banks serve as transmission channels for the policies adopted by their stockholders in response to shocks in their home country or in other places where they have investments. Multinational and foreign banks have access to more investment destinations, and so are more prone to “cut and run” than domestically owned banks when their investments are not performing as expected. Unlike their foreign competitors, locally owned banks usually have stakeholders (including Directors and Labour Unions) with vested interest, that prevent them from unloading their financial investments, when business conditions turn adverse, even though they generally contend with higher transactions costs than foreign banks.

## CROSS-BORDER BANKING

Foreign banks that operate in a host country principally to serve their home clients, tend to select well established businesses and individuals as customers, leaving mainly risky informal economic entities for the domestic banks to grapple with. Also, foreign banks operate at levels of sophistication and complexities beyond the capacity of local regulatory authorities. This provides them regulatory arbitrage, which their domestic counterparts do not have. Local regulators may have difficulty understanding foreign banks' new products and operations, and find it challenging to achieve effective coordination with their counterparts located in the foreign banks' home or other host countries.



## SECTION TWO

### Evolution of Cross-Border Banking

From the 1990s, there was considerable and rising presence of foreign-owned financial institutions, particularly banks, in many emerging market and developing countries, on account of reduction in barriers to trade in financial services (Eichengreen and Mussa, 1998). Foreign banks from advanced economies saw better opportunities to expand their presence, and increase their revenue in emerging market and developing economies, because they tend to have low penetration of banking services and products. This is unlike in advanced economy markets, in which banking services are more widely available. Another impetus was that multinational and international banks had access to operating infrastructure and technology platforms to book overseas transactions from a large network of local agencies, subsidiaries, and branches located in developing countries. In most economies, banks hold both domestic and foreign assets. The foreign assets include loans to foreign entities and holdings of foreign bonds and other instruments. A check of the liabilities of banks, will show that they raise offshore funding through taking deposits from non-residents, and issuing bonds and other securities, which are bought by foreign investors. Foreign banks and non-bank entities are counterparties in the foreign assets and liabilities to domestic banks.

Africa's modern financial history since colonial times has a prominent place for cross-border banking. Anti-colonial sentiments after independence caused the nationalisation of a number of foreign banks in the continent, in 1960s and 1970s. But the trend was reversed in the 1980s, when many developing and emerging market economies adopted structural adjustment policies (SAP) to combat declining growth and foreign debt overhang. As a result of the financial liberalisation component of the SAP, sub-Saharan Africa and Latin America witnessed significant increase in the number of foreign banks from the early 1990s (Allen et al., 2011). Weak State-owned and private banks in many countries were acquired mostly by global investors or multinational banks. Regional cooperation and integration programmes in different sub-regions opened the door to financial services trade, thereby encouraging cross-border banking. Deregulation of the financial services sector made possible the entry of new foreign investors in the banking sub-sector of the financial services sector in most of the countries. Thus, by the first decade of the 21<sup>st</sup> century, many African banking systems had significant foreign banks' participation. Until the start of this century, Africa was the region with the highest share of cross-border banks. But there are now more foreign banks in Africa from across the continent (especially Nigeria and South Africa) and other emerging market economies than from elsewhere. The global

financial crisis of 2008 to 2009 caused multinational European and American banks to downsize their presence and created opportunity for African banks to take the niche. Some Nigerian banks took this opportunity to expand across borders even more aggressively. In a couple of years thereafter, Nigerian banks have established their presence in more than 30 African countries.

In the fifteen years from 1995 to 2009 in Africa, the number of cross-border bank branches or subsidiaries almost doubled from 120 to 227, whereas the total number of banks stayed virtually the same (421 to 442). This showed a rise in the share of foreign banks from 29 per cent to 51 per cent. The average share of foreign banks across African countries during the same period increased from 39 percent in 1995 to 55 percent in 2009, with foreign banks holding slightly over half of total banking sector assets in African countries.

Cross-border banking also grew in Europe from about year 2000. This development was facilitated by two related policies of the European Union (EU) at the end of the 1990s. One was the introduction of the Single Banking License in 1989 through the Second Banking Directive, which authorizes a bank established in a Member State, to open branches without any other formalities or to propose its services in the partner country. The second was the introduction of the euro in 1999 which eliminated currency risk and further pushed financial integration. Both the elimination of currency risk and the legal and regulatory convergence spurred increase in cross-border financial activity in the euro area by 40% (Kalemli-Ozcan, Papaioannou and Peydró, 2009). This was how in the 2000s, the countries of Central and Eastern Europe surpassed Africa in the number of cross-border banks through mergers and acquisitions of previously State-owned mono-bank with or by foreign banks from Western Europe. The Asia-Pacific region also experienced growth in cross-border banking from the late 1980s, although the banking sector in the region is still dominated by government owned banks, especially in China.

As a result of the increase in cross-border banking evident in the general trend towards globalisation and consolidation of banks, the five largest banking groups in 2008 controlled more than 16% of global banking assets, which was more than double their market share in 1998 (Allen et al. *ibid*). Also, a small number of countries: France, Germany, the UK, the US, Switzerland and the Netherlands now dominate cross-border banking. They account for about a half of cross-border banking assets. On the other hand, the US, the UK, France, Germany, Japan and the Netherlands account for 50% of cross-border banking liabilities (Allen et al., *ibid*).

A consolidation policy introduced in 2004 required that banks in Nigeria raise their minimum capital to twenty-five (N25 bn) billion naira from two (N2 bn) billion by

end of 2005. This resulted in the emergence of twenty-four well capitalised banks from eighty-nine banks that existed before the policy. With their strong capital base, these banks started expansion into other African countries by opening subsidiaries. Within the country, there are currently five foreign-owned banks: Citibank, Ecobank, Stanbic IBTC, Standard Chartered and Nedbank. Thus, Nigeria now has a financial system where the number of Nigerian banks operating branches in other African countries far exceeds that of the foreign banks operating in the domestic market.

According to Schnabl (2010), this transition towards multinational rather than international banking has important implications for financial system stability, as credit provided through local subsidiaries and branches often have a longer maturity and are generally more stable than cross-border lending. Some cross-border banks are net cross-border liquidity providers relative to their home countries. Nigerian banks abroad are known to borrow from the Eurodollar market and then place liquidity in their subsidiaries in Africa. Foreign and multinational banks may be involved in the carry trade, borrowing under low interest rates in Europe or the United States and then placing liquidity in countries with higher interest rates (for example, buying local treasury bills or other government papers). Also, some banks may require capital to meet local CAR or minimum capital requirements, and may book some of the capital flows temporarily as capital. The magnitude and volatility of cross-border liquidity flows may complicate the operation of monetary policy, and it highlights the need for supervisors to have a full understanding of the banks' activities outside the country. Therefore, close mutual cooperation with foreign supervisors is necessary for every country's Monetary Authority.



## SECTION THREE

### Regulation of Cross-Border Banking

In July 1992, following the closure of Bank of Credit and Commerce International (BCCI), the Basle Committee on Banking Supervision outlined the Minimum Standards that G-10 supervisory authorities should undertake to observe in the supervision of international banking groups, and their cross-border establishments on the basis of four main principles (The Basle Committee on Banking Supervision, 1996):

1. All international banks should be supervised by a home country authority that capably performs consolidated supervision.
2. The creation of a cross-border banking establishment should receive the prior consent of both the host country and the home country authority.
3. Home country authorities should possess the right to gather information from their cross-border banking establishments.
4. If the host country authority determines that any of these three standards is not being met, it could impose restrictive measures or prohibit the establishment of banking offices.

The Committee subsequently invited other supervisory authorities to observe the principles. Since the enunciation of these principles, there has been a number of currency and financial crisis around the world in which cross-border banks have been implicated. Scholars and policy makers have in response, focused attention on the misalignment of geographic boundaries of banks and their supervision. Cooperation in supervision of cross-border banks have therefore, been advocated and procedures for achieving it hammered out because as Charles Goodhart and Mervyn King pointed out "cross-border banks are international in life and national in death".

The key challenge for Monetary Authorities supervising internationally active banks, has been to ensure that none of their activities escapes effective supervision, and that coordinated remedial action can be undertaken when necessary. But cross-border operation of banks can and do create a variety of difficulties for supervision. The difficulties emanate from different factors inherent in cross-border financial transactions. A prominent factor is that the creation of various types of corporate structures by multinational banks across international borders can be used to escape regulation and effective supervision. Also, the

opportunity which financial globalisation offers investors to shift their activities to offshore tax havens present a channel for cross-border banks to circumvent host and home country prudential regulations easily. A third factor, which is a source of difficulty in cross-border banking supervision, is that cross-border transactions can be used to conceal problems at domestic financial institutions by booking problem assets with subsidiaries, branches or other offshore entities, especially when accounting practices are relatively unsophisticated and disclosure laws are limited. The fourth factor, particularly in the era of money laundering, is that cross-border financial flows can be used to facilitate or commit outright fraud. This is why jurisdictions that present weak governance attract high-risk and unlawful investors because their activities can go on undetected. Nowhere are these truer than in emerging markets and developing countries, where supervisory resources are limited and accounting and legal systems are still developing.

Banks undertake foreign operations mainly in two ways: by establishing foreign subsidiaries or through branches. The key difference in supervision between subsidiaries and branches is that in the case of a subsidiary, it is the regulator in the country where the subsidiary is located (host supervisor), while in the case of a branch the supervisor in the country of the parent bank has responsibility (home supervisor). There are arguments for supra-national supervision to overcome the distorted incentives of domestic supervision. However, there are counter arguments that a supra-national supervisor, even though having the correct incentives, may make sometimes wrong decisions due to imperfect knowledge.

### **3.1 Foundations of Consolidated Cross-Border Supervision of Banks**

To implement the Minimum Standards, Memoranda of Understanding, bilateral exchanges of letters and establishment of Colleges of Supervisors for specific banks has become a common tool of cooperation across borders for cross-border banking supervision. By the early 2000s, regulatory convergence and increased supervisory cooperation had been developed. Nevertheless, important differences remained across countries in regulatory frameworks, supervisory standards and especially in bank resolution frameworks. In the face of the evidence, attempts have been made to address these deficiencies both on the national and international levels.

### **3.2 Location of the Licensing and Lead Supervisory Authority**

Supervising the global operations of a bank or banking group is responsibility the bank's home-country supervisory authority. The supervision shall be on the basis of consolidated and verifiable financial and prudential information. All entities of a bank, including any bank holding company or parent bank's direct branches

and subsidiaries, and all significant nonbank companies and financial affiliates shall be liable to the same supervision by the same home-country supervisor.

A cross-border bank's home-country is expected to be the abode of its senior management and the location of its consolidated balance sheet. If a majority of the activities appear to be conducted elsewhere, it would become difficult for the home supervisor to fulfill its obligations, and arrangements should be made with another country involved to take on the role of home supervisor.

### **3.3 Licensing of Internationally Active Banks**

As recommended by the Basle Committee, 1992 principles, both the home and host Monetary Authorities should grant their separate and explicit permission for the setting up of a bank establishment across border. Home- and host-country authorities should in considering a request to establish abroad consider the applicant bank's and banking group's organisation and operating procedures for the management of risks, internal controls, and audits, on both a domestic and cross-border basis.

The two country authorities before granting consent to the establishment of a cross-border establishment, are expected to each review their supervisory responsibilities with respect to the establishment. Where either of the authorities has any concerns about the division of responsibilities, then that authority has the responsibility to initiate consultations with the other authority so that they reach an explicit understanding on which one of them is in the best position to take primary responsibility, either generally, or in respect of specific activities. The same type of review should be undertaken by both authorities in the event of a significant change in the cross-border bank's or banking group's activities or structure.

Of course, it is the sole responsibility of the host authority to apply normal licensing procedure to a foreign bank's application to establish, and it should be expected to refuse the establishment of a branch or subsidiary of a bank from a jurisdiction, known or suspected to be inadequately regulated. In evaluating an application to establish, a host country authority should advert its mind to the level of support that the Head Office or Parent is capable of providing to the proposed establishment.

### **3.4 International Implementation of Prudential Standards**

It shall be the responsibility of the home-country supervisory authority to supervise a cross-border bank or banking group on a consolidated basis, domestically as well as internationally. Also the home supervisor will have to factor in the fact that

a multinational bank cannot always easily transfer capital from one part of a banking group to another, across international borders.

The liquidity of a cross-border banking establishment shall primarily be the responsibility of host countries, because they will be better equipped to assess liquidity in the context of local market conditions and practices, and the establishment's position in the market.

Under the Basle Concordat, there are respective responsibilities of host and home authorities but they are responsible for the solvency and supervision of subsidiaries. Host authorities are responsible for the foreign bank establishments in their territory, while home-country authorities are responsible for these establishments as parts of larger-scale activities of banks under their supervision. Despite the division of responsibilities between home and host authorities, both need to be in close contact and cooperate effectively.

### **3.5 Cross-Border Supervisory Information**

Cooperation between host and home countries is most vital with regard to information gathering and exchange. Home-country supervisors have the right to gather information from the cross-border banking establishments of their domestic banks. Similarly, host supervisory authorities should be able to obtain any necessary information from the home supervisory authority. Therefore, the assurance that a bank applying for authorisation to set up a foreign establishment, has ability to gather information should be a condition for giving consent without prejudice to appropriate safeguards for confidentiality where necessary. There should be no impediments (even when based on bank secrecy and confidentiality requirement) to the exchange of supervisory information between banking home and host supervisory authorities. This does not preclude putting in place legal arrangements to safeguard information that is exchanged, especially relating to depositors', creditors', or investors' names, against disclosure to third parties.

Differences, if any, between the prudential standards and supervisory practices of home and host supervisory authorities must be noted by each authority and brought to bear in their interactions.

Host supervisory authorities should provide access to the local establishment of a bank to auditors of the Head Office or Parent bank, and be willing to discuss the affairs of the local establishment with the auditor. The information to be shared should include both quantitative and qualitative aspects, including income or profit and loss accounts, balance sheets, prudential reports, internal control

systems, internal audit, external auditors' reports, information on shareholders and management, and any other information that can be considered necessary for the proper exercise of supervision. Armed with the information provided and exchanged, both host and home supervisors should be able to determine the bank's (or banking group's) capital adequacy ratios, large exposures or legal lending limits, and funding and deposit concentrations on a consolidated basis.

In situations where from an accounting point of view full consolidation is not technically feasible, the two supervisors, the home and the host should be able to verify the network of the bank's other affiliations or branches, financial or nonfinancial, as well as the transactions between these entities.

Law enforcement agencies and the supervisors in other countries involved should be informed as quickly as possible, when a supervisor detects a serious crime during an inspection or analysis of off-site data. The partner authorities should communicate to each other, information on substantial changes in financial situation, ownership, strategy, or any problems in establishments abroad, Head Offices, or Parent banks promptly. When assessing asset quality, supervisors would examine credit files and in the process, access information on individual clients of a bank. Such information must be treated with the highest degree of confidentiality.

### **3.6 Cross-Border Inspections**

The conduct of on-site inspections of a prudential nature of establishments on the territory of another state, requires the consent of the country receiving the inspection team, and there should be no legal barriers to the conduct of such inspections. Together with the free flow of data, such inspections are a necessary corollary of effective consolidated supervision. Protocols for the conduct of such inspection could be embodied in bilateral or multilateral (in the case of banks active in several jurisdictions) agreements. Where there are legal impediments, host supervisors should, within the limits of the country's laws and regulations take every step to assist a home supervisor desirous of conducting an inspection to do so effectively. This can be facilitated by conducting the inspection jointly.

Therefore, authorities of a host state should permit on-site inspections by a home supervisor.

### **3.7 Supervisory Action against Establishments Abroad**

Remedial or punitive action may be required as a result of information or inspection of bank establishments across borders. Differences in the legal arrangements may constrict the administration of necessary corrections, or recovery of lost values. To overcome any legal complications, supervisory

authorities in different countries should conclude arrangements to make supervisory action across borders possible, when the need arises. Among possible arrangements are providing assistance in accessing local nonsupervisory information, for example, on the legal system, on shareholders' activities, and in obtaining good legal counsel.

Cross-border bank branches are the responsibility of the Head Office in the home country. Accordingly, the home country supervisor could require the Management at the Parent bank's Head Office to remedy deficiencies in branches, and apply the full range of legal instruments and supervisory actions against the Head Office to achieve expected result. Cross-border subsidiaries are also subject to consolidated supervision, but they are subject to the jurisdiction of the host state. Nevertheless, the influence of the Parent bank and home supervisor can be brought to bear in achieving desirable improvements when such is called for.

### **3.8 Information on Supervisory Systems and Structures**

An assurance that a home state can "capably perform home country consolidated supervision" (Basle Committee, 1992) should be a condition precedent to a host state permitting foreign bank entry to its territory. Where the host supervisory authority is not satisfied that the capability exist, it may choose to either refuse entry, or stipulate that the establishment shall be supervised on a strict "stand-alone" basis.

Good inception practice would be for the supervisory authorities of both states to exchange complete information on each other's banking laws, the scope of their respective authorities, and prudential regulations applicable to the establishment on their territory. Each of the supervisory authorities should be abreast of each other's supervisory systems and practices, and have adequate powers to obtain all necessary information, including regular financial and prudential reports.

### **3.9 International Bank Liquidation**

The closure, liquidation, or insolvency of a bank which has branches across-borders must be immediately communicated by the home supervisory authority to the host supervisory authorities, who shall promptly close all the branches in their jurisdiction. All additional liabilities incurred by branches would fall within the estate of the closed bank.

Unlike branches, subsidiaries are legally separate from the parent bank because they are incorporated in the host country. However, the host supervisory authorities have to be vigilant to prevent the uploading or downloading of assets

and liabilities between the closed Parent bank and the subsidiaries. The occurrence of such transmission would severely damage the subsidiary and possibly, the host countries' banking system soundness.

The resolution of multinational bank failures is complicated because the home and host countries may have different legislations of the issue. For instance, the home country could follow a separate-entity approach and place their depositors and creditors before those of host countries, irrespective of the latter's own law. On the other hand, it could follow the single-entity approach, which considers the bank as a whole and gives equal treatment to all creditors, wherever their domicile, and whether their claim is on a domestic or foreign branch. Bank supervisors are not law makers and therefore, cannot resolve these types of issues. Indeed, the United Nations Commission on International Trade Law (UNCITRAL), has issued guidance on international insolvencies of financial institutions. Monetary Authorities, therefore, should be guided accordingly, subject to the domestication of the UNCITRAL rules by their countries.



## SECTION FOUR

### **Nigeria's Experience with Cross Banking**

In the light of the cross-border expansion of Nigerian banks, the CBN has instituted cross-border oversight by creating a unit dedicated to the supervision of cross-border institutions in the Banking Supervision Department (BSD). A Framework for the Supervision of Cross-Border Institutions, which provides guidance on the supervision of cross-border Nigerian bank subsidiaries and supervisory cooperation with host countries, has been put in place.

The CBN has entered into bilateral Memorandum of Understanding (MoUs) with a significant number of jurisdictions, where Nigerian banking presence has been established. Among the MOUs are those with all English-speaking West African countries, Bank of Ghana, COBAC, China Banking and Regulatory Commission, Bank of Uganda, FSA, South Africa Reserve Bank, National bank of Rwanda, Bank of Zambia, Central Bank of Kenya, BCEAO, Central Bank of the Gambia, Bank of Mauritius, Bank of Sierra Leone, WAMZ (the Gambia, Ghana, Guinea, and Sierra Leone), Bank Negara Malaysia, Central Bank of Liberia, and Central Bank of Guinea. The MoUs contain details on information sharing, on-site examination, confidentiality of shared information, and consolidated supervision.

There is now a College of Supervisors of the West African Monetary Zone (WAMZ), aimed at enhancing coordination, cooperation, and information exchange among supervisors in the WAMZ area. The CBN is a member of the College. The College of the WAMZ is generic and not aimed at strengthening the supervision of a specific bank or banks. The Financial Services Authority (FSA) has set up a core college for Standard Chartered Bank and the CBN participates in it. With relevant host countries, the CBN conducts joint examinations of Nigerian banks in West African countries (The Gambia, Ghana, Guinea, and Sierra Leone).

The initial experiences of the Bank with consolidated supervision of Nigerian cross-border banks have been encouraging, but it faces some serious challenges in the area of language, differences in quality of supervision, reporting requirements, and off-site monitoring systems. Some of the Nigerian banks have expanded into jurisdictions where supervisory and enforcement capacity is weak, data reliability problematic, and prudential returns are not subject to rigorous supervisory scrutiny. The CBN has opened its supervisory training program for foreign inspectors. It is also actively promoting the harmonisation of reporting requirements and off-site monitoring tools, through the adoption of Electronic Financial Analysis and Surveillance System (eFASS).



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