University of South Carolina
Scholar Commons

Faculty Publications | Law School

1992

Basle Committee minimum standards : international regulatory response to the failure of BCCI

Duncan E. Alford

Follow this and additional works at: https://scholarcommons.sc.edu/law_facpub

Part of the International Law Commons

BASLE COMMITTEE MINIMUM STANDARDS: INTERNATIONAL REGULATORY RESPONSE TO THE FAILURE OF BCCI

DUNCAN E. ALFORD*

I. INTRODUCTION

The coordinated closure of the Bank of Credit and Commerce International (BCCI) on July 5, 1991 in nations around the world rocked financial circles. The failure of the $20 billion bank was one of the largest in international banking history. Unfortunately, the failure of BCCI was the latest in a series of bank failures, including those of the Herstatt Bank in Germany in 1974 and Banco Ambrosiano in Luxembourg in 1982. International banking regulators, through the Basle Committee on Banking Supervision,[1] responded to each of these earlier failures by issuing more stringent guidelines for international bank regulation.[2] One year after the closure of BCCI and in response to weaknesses in the international financial system, the Basle Committee issued new minimum standards for international banking supervision, its third formulation of these guidelines.[3]

This Article first traces the development of the international agreements on bank supervision reached by the Basle Committee since its inception in 1975: the Concordat of 1975 and the

---

* Associate, Kilpatrick & Cody, Atlanta, Georgia. B.A. 1985, University of Virginia; J.D. 1991, University of North Carolina. Member of the Georgia and North Carolina State Bars.

1. The Basle Committee is made up of banking regulators from twelve nations: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. It is named after its usual meeting place—Basle, Switzerland. The Bank for International Settlements (BIS), also based in Basle, provides staff support for the Committee's activities. J.J. Norton, *The Work of the Basle Supervisors Committee on Bank Capital Adequacy and the July 1988 Report on "International Convergence of Capital Measurement and Capital Standards"*, 23 INT'L LAW. 245, 247-48 (1989). *See generally* James V. Hackney & Kim L. Shafer, *The Regulation of International Banking: An Assessment of International Institutions*, 11 N.C. J. INT'L L. & COM. REG. 475, 488-89 (1986); Norton, *supra*, at 247-55.

2. *See infra* text accompanying notes 32-117.

3. BASLE COMMITTEE ON BANKING SUPERVISION, MINIMUM STANDARDS FOR THE SUPERVISION OF INTERNATIONAL BANKING GROUPS AND THEIR CROSS-BORDER ESTABLISHMENTS (June 1992) (on file with *The George Washington Journal of International Law and Economics*) [hereinafter MINIMUM STANDARDS].

Revised Concordat of 1983.[4] Against the background of the BCCI failure, the Article then analyzes the Minimum Standards issued by the Basle Committee in July 1992—the Committee's latest attempt to improve international banking regulation.[5] Next, there is an examination of legislation enacted by the U.S. Congress to tighten foreign bank supervision, known as the Foreign Bank Supervision Enhancement Act (FBSEA);[6] and of efforts within the European Community to set minimum bank supervisory standards in preparation for implementation of the Europe 1992 program.[7] The Article also highlights additional proposals for changes intended to tighten international bank supervision.[8] Finally, the Article analyzes the weaknesses of the Minimum Standards (and other proposals for reform) and concludes that rather than being a leap forward, the Minimum Standards reinforce past agreements and represent the latest stage in a series of incremental agreements on international banking regulation.[9]

II. Background: U.S. Regulation of Foreign Banks

The globalization of capital markets presents new challenges to bank regulators. Increased world trade, greater economic growth in foreign nations, relaxed government restrictions on capital outflows, and technological advances, particularly in communications, have allowed capital markets to become truly global.[10] Additionally, advances in technology and transportation have decreased banks' costs of doing business, thus increasing the potential market banks can serve.[11]

---

4. *See infra* text accompanying notes 32-117.
5. *See infra* text accompanying notes 180-226.
6. Foreign Bank Supervision Enhancement Act of 1991, Pub. L. No. 102-242, secs. 201-215, 105 Stat. 2286, 2286-305 (codified at 12 U.S.C. §§ 3101-3111 (1988 & Supp. III 1992)) [hereinafter FBSEA]. *See infra* text accompanying notes 261-277.
7. *See infra* text accompanying notes 229-260. The main focus will be on Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52.

Europe 1992 is the program to create a free trade zone among the twelve member states of the European Community. *See* Alan Riding, *As Leaders Stand at Door to Future, Europe Puzzles over What's Beyond*, N.Y. Times, Nov. 25, 1991, at A12.

8. *See infra* text accompanying notes 278-322.
9. *See infra* text accompanying notes 208-260 and 323-338.
10. Patricia S. Skigen, *Globalization of Banking: Foreign Banking in the United States*, *in* 1 Seventh Annual Financial Services Institute 275, 279-80 (PLI Corp. L. & Practice Course Handbook Series No. 639, 1989).
11. H. Robert Heller, *International Economic Challenges to American Banking*, 9 Ann. Rev. Banking L. 323, 323 (1990).

In the United States, foreign banks have attained a greater share of the financial services market in recent years. In 1978, 122 foreign banks had $90 billion in assets in the United States. By 1991, 294 foreign banks, with over 700 offices, had assets of $800 billion—nearly 25% of the total amount of bank lending in the United States.[12] While banks have become more international, however, the international system of bank regulation has not kept pace. Furthermore, the amount of cooperation among bank regulators in different nations has not matched the development of international banking markets.

For instance, the regulation of foreign banks in the United States is very complex.[13] Although the Basle Committee has made significant efforts to develop a common approach to international banking regulation, there is no true international banking law. Domestic laws and regulations govern the international activities of banks. Until passage of the FBSEA,[14] the International Banking Act (IBA)[15] was the primary statute governing the regulation of foreign banks operating in the United States.

Under the IBA, a foreign bank in the United States could receive approval to operate from either federal or state banking regulators.[16] A foreign bank operating in the United States could choose among several different types of entities in setting up its U.S. operations: an agency, a representative office, a branch, a subsidiary or an Edge Act corporation.[17] An agency can make

12. S. REP. No. 167, 102d Cong., 1st Sess. 113-14 (1991). Most of the foreign bank lending in the United States is done through branches and agencies of the parent. The vast majority of these branches and agencies—94% in 1990—are licensed by the states rather than the federal government. *Id.* at 114.

13. *See* P. Nicholas Kourides, *United States Bank Regulation of International Banking Activities*, *in* INSTITUTE OF BANKING LAW AND REGULATION 1989 301, 376 (Practising Law Institute ed., 1989).

14. FBSEA, *supra* note 6.

15. International Banking Act of 1978, 12 U.S.C. §§ 3101-3108 (1988), *as amended by* FBSEA, 12 U.S.C. §§ 3101-3111 (Supp. III 1992).

16. S. REP. No. 167, *supra* note 12, at 114. *Compare* 12 U.S.C. § 3101(5), (6) (1988 & Supp. III 1992) (defining "Federal agency" and "Federal branch" as entities organized pursuant to federal law) *with id.* § 3101(11), (12) (defining "State agency" and "State branch" as entities organized pursuant to state law). *See also* Kourides, *supra* note 13, at 376. With the passage of the FBSEA, the regulatory burden on foreign banks operating in the United States will probably increase because the Federal Reserve Board (FRB) will regulate all foreign banks even if they operate in the United States under a state charter. *See infra* text accompanying notes 26-31 and 263-277.

17. Kourides, *supra* note 13, at 377-80. Edge Act corporations engage exclusively in international banking activity in the United States and are designed to further foreign trade. *See* 12 U.S.C. §§ 611-611a (1988). The FRB regulates Edge Act corporations. *Id.* § 611a. *See generally* M.A. Nunes, *Foreign Banks Come Sailing in as United States Banks Tack*

loans to customers, but cannot accept deposits,[18] and may be licensed by the federal government or a state government.[19] A representative office generally performs public relations functions for the foreign bank and merely acts as a "contact point" for the bank's local customers.[20] Under the IBA, a foreign bank was required to register a representative office with the Department of the Treasury.[21]

A branch can make loans and take deposits[22] and, as with an agency, can be licensed by the federal government or a state government.[23] Most foreign banks when operating abroad use the branch or agency entity and do not incorporate in each nation.[24] By using the branch form, all the assets of the parent bank are available to support the operations of the foreign branch.[25] In contrast, a subsidiary, because it is a separate legal entity from its parent company, cannot rely on the parent for financial support. Federal or state agencies may license subsidiaries of foreign banks.[26] The Federal Reserve Board (FRB) regulates foreign

---

Slowly Upwind, 13 Hous. J. Int'l L. 39 (1990) (discussing U.S. establishment options and the U.S. regulation of foreign bank establishments).

18. 12 U.S.C. § 3101(1) (1988 & Supp. III 1992); *see also id.* § 3102(d) (exempting Federal agencies from certain prohibited functions).

19. *See id.* § 3101(5), (11) (defining "Federal agency" and "State agency"); *see also* Nunes, *supra* note 17, at 49.

20. Nunes, *supra* note 17, at 55.

21. *See* 12 U.S.C. § 3107(a) (1988), *amended by* 12 U.S.C. § 3107 (Supp. III 1992) (requiring stricter federal approval and regulation of representative offices); *see also* Nunes, *supra* note 17, at 55 (discussing history of representative offices).

22. *See* 12 U.S.C. § 3101(3) (1988 & Supp. III 1992) (stating that a branch is an establishment of a foreign bank in the United States "at which deposits are received"); *id.* § 3102(b) (granting foreign branches the power to conduct operations "with the same rights and privileges as a national bank").

23. *See id.* § 3101(6), (12) (defining "Federal branch" and "State branch").

24. S. Rep. No. 167, *supra* note 12, at 114; Peter S. Smedresman & Andreas F. Lowenfeld, *Eurodollars, Multinational Banks, and National Laws*, 64 N.Y.U. L. Rev. 733, 741 (1989).

25. *See* Steven L. Wolfram & Michael L. Whitener, *US Tug of War Over Foreign Banks*, Int'l Fin. L. Rev., May 1992, at 20, 24.

26. *See* 12 U.S.C. § 3101(13) (1988 & Supp. III 1992) (assigning the term "subsidiary" the same meaning as used in 12 U.S.C. § 1841(d) (1988); the term, in turn, is used in 12 U.S.C. § 1846 (1988), which states that federal regulation of bank holding companies shall not be "construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to . . . subsidiaries"); *accord* Charles W. Hultman, *U.S. International Bank Supervision & the Revised Basle Concordat*, Bank Admin., Feb. 1985, at 76, 78. Determination of which agency regulates the subsidiary depends on whether the subsidiary bank is a member of the Federal Reserve System or not. *Cf. id.* at 78. *See also* Peter J. Lewarne, *A Practical Assessment of Some of the Problems Encountered by Foreign Banks Carrying On Business in the United States*, *in* Institute of Banking Law and Regulation 1990 451, 466, 471-72 (Practising Law Institute ed., 1990) (discussing state licensing of foreign bank subsidiaries).

bank holding companies.[27]

When Congress passed the IBA in 1978, it adopted the principle of national treatment for foreign banks.[28] According to this principle, foreign banks in the United States are "entitled to the same powers and subjected to the same restrictions as similarly situated [U.S.-based] banks."[29] Reciprocal national treatment was not part of this policy—the IBA did not make the entry of foreign banks into the United States contingent on how U.S. banks were treated when operating in a particular foreign country.[30] The FBSEA appears to have rejected the IBA's idea of national treatment. Under the FBSEA, foreign banks and U.S. banks are regulated differently even though they are operating in the same markets.[31] A foreign bank must receive FRB approval to operate even if it is operating under a state charter, while a state-chartered bank headquartered in the United States need not receive FRB approval.

III. The Basle Committee

A. *Development*

As in other nations, U.S. regulation of foreign banks is focused

---

27. *See* 12 U.S.C. § 1841(a) (1988) (defining "bank holding company" broadly); *accord* Hultman, *supra* note 26, at 78. *But see* 12 U.S.C. § 1841(c)(2)(A) (excepting from FRB regulation those foreign bank holding companies that would be subject to such regulation solely by virtue of their control of a bank that has "an insured or uninsured branch in the United States"). U.S. banking agencies regulate the overseas operations of U.S. banks. *See generally* Federal Reserve Act, 12 U.S.C. §§ 221 *et seq.* (1988); Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841-1850 (1988 & Supp. III 1992); International Banking Act of 1978, 12 U.S.C. §§ 3101-3108 (1988 & Supp. III 1992). Regulation K of the Federal Reserve Board requires U.S. banks to provide information to regulators on their overseas activities. 12 C.F.R. § 211 (1992) (setting forth requirements for Federal Reserve Board regulation of the international operations of U.S. banks); *see* Hultman, *supra* note 26, at 79.

28. Lewarne, *supra* note 26, at 465; *see* 12 U.S.C. §§ 3101, 3103 (1988).

29. Heller, *supra* note 11, at 327; *see* Lewarne, *supra* note 26, at 465.

30. Heller, *supra* note 11, at 327.

31. The FBSEA significantly amended portions of the IBA. For instance, every foreign bank must now receive approval from the FRB before it can open any type of banking entity in the United States. FBSEA, *supra* note 6, sec. 202 (codified at 12 U.S.C. § 3105(d)(1), (2) (Supp. III 1992)) (requiring federal approval before the opening of "foreign bank offices" in the United States and setting forth standards for approval). In comparison, U.S. banks still have the option of choosing between a federal or state charter. *E.g.*, 12 U.S.C. § 1841(c)(1)(B) (1988) (defining "bank" as "[a]n institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, Samoa, or the Virgin Islands."); *accord* 12 U.S.C. § 214(a) (1988) (defining the term "State bank"). *See infra* notes 261-277 for discussion and analysis of the treatment foreign banks receive under the FBSEA.

principally on operations by foreign banks within U.S. borders. Yet, as capital markets have become global, events in other nations can have dramatic, and sometimes devastating, effects on local economies. With the increased globalization of the banking industry, the systemic risk of a financial crisis has increased; but banking regulation among nations has not improved congruently to meet this greater risk. The Basle Committee, through its issuance of minimum standards for bank supervision, is attempting to rectify this situation.

The collapse of the Herstatt Bank in Germany in 1974 led to the creation of the Basle Committee and the issuance of the Committee's first agreement on bank supervision, known as the Basle Concordat,[32] in 1975. Due to its fraudulent bookkeeping practices, the Herstatt Bank failed and other German banks were unable to bail it out.[33] Legal claims against the Herstatt Bank were eventually settled.[34] Most of the international operations of the bank were conducted at its head office in Germany and, therefore, mainly domestic assets were involved.[35] Nevertheless, the resolution of the bank's failure—particularly the incomplete satisfaction of foreign creditors' claims—set a negative precedent for the settlement of international financial crises and demonstrated the need for greater international regulation.[36]

The Basle Committee was organized in 1975 in direct response to the Herstatt Bank failure of 1974.[37] The Committee's members consist of banking regulators from eleven major industrial-

---

32. COMMITTEE ON BANKING REGULATIONS AND SUPERVISORY PRACTICES, BASLE CONCORDAT ON PRINCIPLES FOR THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS, *reprinted in* INTERNATIONAL MONETARY FUND, OCCASIONAL PAPER NO. 7, INTERNATIONAL CAPITAL MARKETS: RECENT DEVELOPMENTS AND SHORT-TERM PROSPECTS, 1981 29-32 [hereinafter BASLE CONCORDAT]. The original Concordat was not released to the public until March 1981. *Id.* at 29.

33. Ulrich Hess, *The Banco Ambrosiano Collapse and the Luxury of National Lenders of Last Resort with International Responsibilities*, 22 N.Y.U. J. INT'L L. & POL. 181, 185-86 (1990). *See generally* Joseph D. Becker, *International Insolvency: The Case of Herstatt*, 62 A.B.A. J. 1290 (1976) (giving full account of Herstatt failure). In addition, the London branch of the Franklin National Bank suffered severe losses in the early 1970s, for which the Federal Reserve compensated with liquidity support. Franklin National Bank eventually failed anyway, illustrating the confusion of supervisory responsibilities over international banks. *See* Hess, *supra*, at 186-87.

34. West German banks received 45%, foreign banks received 55%, and other creditors received 65% of their respective claims. Hess, *supra* note 33, at 186.

35. *Id.*

36. *Id.*

37. RICHARD DALE, THE REGULATION OF INTERNATIONAL BANKING 172 (1986); Ethan B. Kapstein, *Revolving the Regulator's Dilemma: International Coordination of Banking Regulations*, 43 INT'L ORG. 323, 329 (1989); Norton, *supra* note 1, at 246-47.

ized nations and Luxembourg.[38] The purpose of the Committee is to provide "regular co-operation between its member countries on banking supervisory matters."[39] The Committee hopes to encourage the convergence of banking regulation to a common approach through the issuance of guidelines developed by consensus among its members; thus, it seeks to harmonize the banking laws of its member nations indirectly.[40] While the Basle Committee has no legal enforcement power itself, it encourages member nations to abide by these regulatory guidelines and to use whatever authority they possess to enact and enforce them.[41] The Committee has issued several guidelines for international banking supervision: the Basle Concordat of 1975;[42] the Revised Concordat;[43] and the Capital Adequacy Standards.[44] The Basle Concordat and the Revised Concordat are the main focus of this article.

B. *The Basle Concordat of 1975*

As a result of the Herstatt failure and the subsequent confusion it caused over the settlement of the bank's liabilities, the Basle Committee set as its first task the establishment of an agreement on the respective roles of home country supervisors to ensure that all international financial institutions are supervised.[45] The Committee fulfilled this task by issuing the Basle

38. Norton, *supra* note 1, at 248 n.18; *see also* Joseph J. Norton, *The Multidimensions of the Convergence Processes Regarding the Prudential Supervision of International Banking Activities—the Impact of the Basle Supervisors Committee's Efforts Upon, Within and Without the European Community*, *in* FESTSCHRIFT IN HONOR OF SIR JOSEPH GOLD 249, 259-61 (Werner F. Ebke & Joseph J. Norton eds., 1990). *See generally* Marilyn B. Cane & David A. Barclay, *Competitive Inequality: American Banking in the International Arena*, 13 B.C. INT'L & COMP. L. REV. 273, 319 n.321 (1990) (providing background on the BIS and the Basle Committee); Hackney & Shafer, *supra* note 1, at 488-89 (same).

39. Peter Cooke, *The Basle "Concordat" on Supervision of Banks' Foreign Establishments*, 39 AUSSENWIRTSCHAFT 151, 151 (1984).

40. *Id.*

41. *See id.*

42. BASLE CONCORDAT, *supra* note 32.

43. COMMITTEE ON BANKING REGULATION AND SUPERVISORY PRACTICES, REVISED BASLE CONCORDAT ON PRINCIPLES FOR THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS, *reprinted in* 20 I.L.M. 901 (1983) [hereinafter REVISED CONCORDAT] (on file with *The George Washington Journal of International Law and Economics*).

44. COMMITTEE ON BANKING REGULATIONS AND SUPERVISORY PRACTICES, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS, *reprinted in* 51 Banking Rep. (BNA) 143 (July 25, 1988) [hereinafter CAPITAL ADEQUACY STANDARDS]. *See generally* Duncan E. Alford, *Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry*, 10 DICK. J. INT'L L. 189 (1992) (analyzing the Capital Adequacy Standards and their impact on the banking industry).

45. *See* Richard Dale, *Someone Must Be in Charge*, FIN. TIMES, July 22, 1991, at 12.

Concordat,[46] a statement of principles delineating the supervisory responsibilities of home and host banking regulators over international banks.[47] The Committee entitled the document a "concordat" to indicate that the agreement did not have the legal force of a treaty.[48] Rather, the Concordat was a set of guidelines on bank supervision reached by consensus among banking regulators from many nations.[49]

The objectives of the Concordat were to ensure that the supervision of foreign banks was adequate and that no foreign bank would escape supervision.[50] The Concordat set forth five principles:

> (1) The supervision of foreign banking establishments should be the joint responsibility of host and parent authorities.
> (2) No foreign banking establishment should escape supervision, each country should ensure that foreign banking establishments are supervised, and supervision should be adequate as judged by both host and parent authorities.
> (3) The supervision of liquidity should be the primary responsibility of host authorities since foreign establishments generally have to conform to local practices for their liquidity management and must comply with local regulations.
> (4) The supervision of solvency of foreign branches should be essentially a matter for the parent authority. In the case of subsidiaries, while primary responsibility lies with the host authority, parent authorities should take account of the exposure of their domestic banks' moral commitment in this regard.
> (5) Practical cooperation would be facilitated by transfers of information between host and parent authorities and by the granting of permission for inspections by or on behalf of parent authorities on the territory of the host authority. Every effort should be made to remove any legal restraints (particularly in the field of professional secrecy or national sover-

---

46. BASLE CONCORDAT, *supra* note 32.

47. The home or parent regulator is the one responsible for supervision in the country where the "parent bank" is headquartered and licensed. The host regulator is the one responsible for supervision in the foreign country where the "parent bank" is operating an establishment. *See id.* at 30.

48. M.S. Mendelsohn, *New Basel Concordat: Main Deficiency Is Intact*, AM. BANKER, June 16, 1983, at 2.

49. *See id.* The word "concordat" refers to a "public act of agreement" (as opposed to a "contract" between private parties). *Id.* However, the text of the Concordat was not released to the public for several years following its adoption. Cooke, *supra* note 39, at 152.

50. BASLE CONCORDAT, *supra* note 32, at 29, 30; *see also* Cane & Barclay, *supra* note 38, at 321.

eignty) which might hinder these forms of cooperation.[51]

A central tenet of the Concordat was the joint responsibility of home and host banking regulators in regulating international banks.[52]

The Concordat deals primarily with the liquidity, solvency, and foreign exchange operations of foreign banks.[53] Under the Concordat the host supervisory authority was responsible for regulating liquidity, regardless of the type of banking entity established in the host nation.[54] The supervisory responsibility for solvency was allocated between host and home regulators depending on the type of foreign banking establishment involved; subsidiaries and joint ventures were the responsibility of the host regulator, while branches were the responsibility of the home regulator.[55]

The Concordat had several weaknesses. First, despite the agreement's goal of allocating supervisory responsibility, it left unclear which regulator should act in order to contain a major bank failure.[56] Also, designating the host supervisor as the primary regulator of the solvency of a foreign bank subsidiary ran counter to the principle of consolidated supervision used by bank regulators in most industrialized nations.[57] With these conflicting allocations of responsibility being made in the Concordat, there was a real danger that host regulators, following consolidated supervision, would look to parent supervisors to regulate a bank subsidiary's solvency while parent regulators, relying upon the Concordat, would look to the host supervisor to perform this task.[58]

---

51. W. Peter Cooke, *Supervising Multinational Banking Organizations: Evolving Techniques for Cooperation Among Supervisory Authorities*, 3 J. COMP. CORP. L. & SEC. REG. 244, 246 (1981) (summarizing Basle Concordat); *see also* Richard Dale, *Basle Concordat: Lessons from Ambrosiano*, BANKER, Sept. 1983, at 55, 55 (summarizing Basle Concordat).

52. Dale, *supra* note 45, at 12; *see* DALE, *supra* note 37, at 172.

53. *See* BASLE CONCORDAT, *supra* note 32, at 29, 30-31.

54. *See id.* at 30. Liquidity is a measure of a bank's ability to convert assets to cash or cash-equivalents without diminution of the assets' value.

55. *Id.* at 30-31. Solvency is a measure of a bank's ability to generate cash flow sufficient to satisfy its liabilities as they mature and to provide an adequate return to its shareholders.

56. *See* Kapstein, *supra* note 37, at 330.

57. DALE, *supra* note 37, at 173. Under consolidated supervision, responsibility for regulating a bank's foreign subsidiaries is shared between host and parent regulators, with the parent supervisor considering all of the assets and liabilities of the bank, wherever located, in order to determine the bank's overall solvency. *See id.* at 176. *See generally* Council Directive 83/350 of 13 June 1983 on the Supervision of Credit Institutions on a Consolidated Basis, 1983 O.J. (L 193) 18 (representing the European Community's adoption of consolidated supervision principles).

58. DALE, *supra* note 37, at 173. The "primary motivation" for drafting the Revised

Another weakness of the Concordat was its lack of specific supervisory standards for international bank regulators to employ.[59] This lack of specific standards created confusion among banking regulators. For instance, in 1979 the FRB proposed that U.S. offices of foreign banks report on the structure and condition of their parent banks to the FRB, but regulators in other nations thought this requirement would violate provisions of the Concordat.[60] On another occasion, the FRB was faced with a three-way international disagreement as to the Concordat's meaning. Swiss regulators believed that host regulators had primary responsibility for regulating *branches* and *subsidiaries* of foreign banks. In contrast, regulators in Great Britain believed that host regulators were responsible for supervising only foreign bank *subsidiaries*. Bank regulators in the Netherlands, in yet another interpretation, believed that the *parent* regulator was responsible for the supervision of subsidiaries.[61] In short, lack of specific standards allowed individual nations to interpret the Concordat as they wished.

Other misconceptions resulted from the Concordat. The most important and potentially dangerous was the mistaken belief that lender of last resort responsibility accompanied supervisory responsibility.[62] The Committee never intended the Concordat to deal with lender of last resort responsibility.[63]

The Concordat also failed to address complex relationships between the parent bank and its foreign affiliates. Parent banks frequently issued letters of comfort to these affiliates, but the significance of these letters and other similar financial arrangements under the Concordat was left uncertain.[64]

The financial collapse during the summer of 1982 of the Luxembourg subsidiary of the Banco Ambrosiano, an Italian bank,

---

Concordat, adopted in 1983, was to "incorporate understandings on applying the principle of consolidated supervision." Cooke, *supra* note 39, at 152-53.

59. DALE, *supra* note 37, at 173.

60. *Id.* The Federal Reserve eventually received power to enforce such a reporting requirement under the FBSEA. *See infra* text accompanying notes 261-277.

61. *Id.* at 173-74.

62. *Id.* at 174. Lender of last resort responsibility refers to the obligation of a central bank or regulator to provide as much liquidity as necessary to a bank in order to meet its obligations to depositors and creditors.

63. *Id.*; Cooke, *supra* note 39, at 153-54. The Basle Concordat is silent on this point.

64. *See* Dale, *supra* note 51, at 58. A letter of comfort is a commitment by the parent bank to meet the financial obligations of an affiliate or subsidiary if called upon by a third party.

tested the principles of the Concordat. The Banco Ambrosiano subsidiary in Luxembourg had made $1.4 billion worth of imprudent loans to Latin American companies.[65] As a result, the subsidiary owed nearly $450 million to its creditors.[66] Unable to pay its creditors, the bank and its Luxembourg subsidiary collapsed in July 1982.[67]

Neither the Luxembourg nor the Italian regulators claimed supervisory or lender of last resort responsibility for the bank.[68] The Italian regulators argued that since they lacked the legal authority to regulate the Luxembourg subsidiary, they bore little or no responsibility for its failure.[69] Italian regulators pointed to their previous attempts to examine the offices of Banco Ambrosiano in South America, which had been rebuffed by local regulators, as proof of their inability to regulate the foreign subsidiaries of Banco Ambrosiano and indicated that they would not take responsibility for the failure of a bank they were unable to supervise properly.[70] In contrast, Luxembourg regulators believed that a subsidiary operating under the same name as its parent bank (as was the case with the Luxembourg subsidiary of Banco Ambrosiano) should have been supported either by the parent bank or indirectly by the central bank of the parent bank.[71] Given that the parent bank of Banco Ambrosiano was headquartered in Italy, Luxembourg regulators believed that the parent bank or the Italian central bank should have supported the Luxembourg subsidiary bank.[72] This explains why Luxembourg reg-

65. Hess, *supra* note 33, at 189.

66. *Id.* at 190.

67. *Id.* at 189-90.

68. DALE, *supra* note 37, at 175. *See generally* MAXIMILIAN J.B. HALL, FINANCIAL DEREGULATION: A COMPARATIVE STUDY OF AUSTRALIA AND THE UNITED KINGDOM 202 n.32 (1987) (describing the Banco Ambrosiano collapse and its resolution).

69. DALE, *supra* note 37, at 175; Hess, *supra* note 33, at 192.

70. Hess, *supra* note 33, at 192-93.

71. *See* DALE, *supra* note 37, at 175; *see also* Dale, *supra* note 51, at 57. The turmoil resulting from Banco Ambrosiano's failure ended when two settlement agreements were signed: the first between the liquidators of Banco Ambrosiano and the creditors of the Luxembourg holding company (and its foreign subsidiaries); and the second between the creditors of Banco Ambrosiano and the creditors of the Vatican bank. Hess, *supra* note 33, at 194-95.

In the aftermath of the Banco Ambrosiano affair, the Italian Parliament passed a law that required disclosure of the shareholder structure of banks and also passed enabling legislation for the 1983 Council Directive on Supervision. Hess, *supra* note 33, at 199. *See infra* text accompanying notes 228-260 for discussion of European Community directives concerning international bank regulation.

72. Hess, *supra* note 33, at 191.

ulators ignored Italian requests to tighten their supervision of the Luxembourg subsidiary of Banco Ambrosiano.

C. *The Revised Concordat of 1983*

The Basle Committee responded to the collapse of the Luxembourg subsidiary of Banco Ambrosiano by issuing in May 1983 a reformulation of the Concordat, known as the Revised Concordat.[73] Even though W. Peter Cooke, chairperson of the Basle Committee, believed that the failure of Banco Ambrosiano was a unique event,[74] the Basle Committee made substantive changes to their international regulatory agreement.

The Revised Concordat was not an entirely new agreement, but built upon the 1975 Concordat.[75] Like its predecessor, it was a non-binding agreement that embodied "recommended guidelines of best practices."[76] Under the Revised Concordat, nations still retained authority to license banks with few restrictions—even banks they were unable to regulate effectively.[77] Furthermore, there was no incentive for compliance with the Revised Concordant, except for the political pressure or moral authority that bank regulators could exercise on their recalcitrant colleagues.[78] However, with the Revised Concordat the Basle Committee did attempt to close the supervisory gaps that existed under the Concordat and to address directly the adequacy of supervision of foreign financial institutions.

1. "Dual Key" Supervision

As with the 1975 Concordat, a primary objective of the Revised Concordat was to ensure that no foreign banking establishment would escape supervision and that each establishment would be supervised adequately.[79] The Revised Concordat introduced a "dual key" approach whereby both home and host supervisory authorities assessed the quality of each other's supervision of an

---

73. Revised Concordat, *supra* note 43, at 901; *see also* Dale, *supra* note 45, at 12.

74. *See* Hall, *supra* note 68, at 166.

75. *See* Hall, *supra* note 68, at 166; Cooke, *supra* note 39, at 152; *see also* Revised Concordat, *supra* note 43, at 901.

76. Revised Concordat, *supra* note 43, at 901.

77. *See* Mendelsohn, *supra* note 48, at 2 (criticizing Basle Committee for repeating its failure to address lender of last resort responsibility in the Revised Concordat).

78. *See id.* (noting that the Revised Concordat remained "no more than an informal agreement").

79. Revised Concordat, *supra* note 43, at 903.

international bank.[80] A bank regulator in a host jurisdiction had to be satisfied that the parent bank was being supervised adequately in the parent jurisdiction, and the parent jurisdiction had to be satisfied that all foreign operations were being supervised adequately by local regulators.[81] If the host regulator considered the supervision of the parent bank by the parent regulator insufficient, the host regulator had the right to discourage or prohibit the foreign bank from operating within the host jurisdiction, or it could set conditions for the bank's continued operation there.[82] Likewise, the parent regulator could attempt to extend the jurisdictional reach of its supervision if it did not believe that the host regulator was providing adequate supervision of the operations of the foreign bank; alternatively, it could discourage the parent bank from operating in the host nation.[83] Using this "dual key" approach, the Committee intended to prevent a "race to the bottom"—the tendency for jurisdictions to relax financial regulation and supervision in order to attract more foreign investment.[84]

In the case of the failure of the Luxembourg subsidiary of Banco Ambrosiano, no regulator took responsibility for the supervision of the Luxembourg-based bank.[85] Applying the terms of the Revised Concordat to the situation that existed there, Luxembourg would have had primary responsibility to supervise the subsidiary, but if the parent regulator (Italy) had not been satisfied with that supervision, it could have tried to step in and regulate the bank.[86] The "dual key" system, as envisioned by the drafters of the Revised Concordat, should have encouraged nations to make their bank supervision practices equivalent to those present in the most stringently regulated financial centers. This kind of convergence will occur, however, only if bank regulators are prepared to lock out weakly regulated

80. Dale, *supra* note 45, at 12.

81. *Id.*; *see* REVISED CONCORDAT, *supra* note 43, at 903-04. The "dual key" approach is highly dependent on effective communication and active cooperation among host and parent regulators. *See id.* at 901-02.

82. REVISED CONCORDAT, *supra* note 43, at 903-04; DALE, *supra* note 37, at 175. This provision was a concession to U.S. regulatory authorities, whose previous attempts to monitor the status of foreign parent banks with U.S. offices were met with strong resistance from foreign supervisory authorities. Dale, *supra* note 51, at 57.

83. REVISED CONCORDAT, *supra* note 43, at 903; *see* Hess, *supra* note 33, at 200.

84. Dale, *supra* note 45, at 12.

85. DALE, *supra* note 37, at 175; *see supra* text accompanying notes 68-72.

86. *See* REVISED CONCORDAT, *supra* note 43, at 903. The Revised Concordat calls for a concerned parent regulator to extend its supervision in such a manner "to the degree that it is practicable." *Id.*

banks and to prevent their own adequately regulated banks from expanding to inadequately regulated jurisdictions.[87] Regulators must have the fortitude both to prevent foreign banks from operating in their jurisdictions and to prevent domestic banks from expanding abroad; the first scenario would result in the loss of foreign investment, the second in forgone international business opportunities.

The Revised Concordat allocated supervisory responsibility between host and parent regulators based on the nature of the regulatory objective (*e.g.*, liquidity, solvency) to be met and the type of banking establishment to be regulated.[88] The Revised Concordat describes three types of foreign banking establishments: branches, subsidiaries, and joint ventures or consortia. A branch does not have a separate legal status from the parent bank.[89] A subsidiary is a legally independent entity that is wholly-owned or majority-owned by the parent bank.[90] Joint ventures or consortia are legally independent institutions owned by two or more foreign banks.[91]

a. Solvency

The responsibility for the supervision of the solvency of a foreign bank depended on the type of bank establishment being supervised. The parent supervisor was responsible for the regulation of the solvency of a branch because the branch legally was still a part of the parent bank.[92] Parent and host supervisors had joint responsibility for the supervision of the solvency of a subsidiary:[93] the host supervisor because the subsidiary legally was an independent institution; the parent supervisor due to the principle of consolidated supervision[94] and because of the effect of the subsidiary's activities on the overall financial status of the parent bank.[95] The supervision of the solvency of joint ventures

87. DALE, *supra* note 37, at 176.

88. *See generally* HALL, *supra* note 68, at 166-68 (providing a succinct summary of the Revised Concordat).

89. REVISED CONCORDAT, *supra* note 43, at 902.

90. *Id.*

91. *Id.* The Revised Concordat defines joint ventures as "legally independent institutions incorporated in the country where their principal operations are conducted and controlled by two or more parent institutions, most of which are usually foreign and not all of which are necessarily banks." *Id.*

92. *Id.* at 905.

93. *Id.* at 906.

94. *Id.* *See supra* text accompanying notes 57-58.

95. *Id.* This provision differs from the original 1975 Concordat, where supervision

was primarily the responsibility of the regulator in the country of incorporation of the joint venture. Depending on the corporate structure of the joint venture, however, the supervisors of the shareholder (parent) banks of the joint venture also may have been involved; in such a case, solvency supervision was a joint parent-host responsibility.[96]

b. Liquidity

Under the Revised Concordat, liquidity refers to the ability of a foreign bank to meet its obligations as they fall due; it does not refer to lender of last resort responsibilities.[97] Host supervisors were primarily responsible for supervision of the liquidity of branches and subsidiaries.[98] Parent regulators also could be concerned with liquidity, as branches may call upon the resources of the parent bank and the parent bank may issue comfort letters or other standby instruments to its subsidiaries.[99] The supervision of the liquidity of joint ventures was primarily the responsibility of the supervisors of the country where the joint venture was incorporated.[100]

c. Foreign exchange operations

The Revised Concordat also allocated supervisory responsibility for the foreign exchange operations of foreign banking establishments. Parent and host regulators jointly supervised the foreign exchange exposure of foreign banking establishments.[101]

2. Consolidated Supervision

The Revised Concordat adopted the principle of consolidated supervision, by which the parent regulator monitors the parent bank's risk exposure and capital adequacy based on all the operations of the bank, wherever conducted.[102] Drafters of the Revised Concordat acknowledged that adoption of this concept

---

of a subsidiary's solvency was primarily the responsibility of the host regulator. BASLE CONCORDAT, *supra* note 32, at 31-32.

96. REVISED CONCORDAT, *supra* note 43, at 906.

97. *Id.*

98. *Id.* at 907.

99. *Id.*

100. *Id.*

101. *Id.* at 908. In the U.S. regulatory scheme, foreign exchange is not separately regulated, but rather is part of the overall supervisory process. Hultman, *supra* note 26, at 78.

102. REVISED CONCORDAT, *supra* note 43, at 905; *see* DALE, *supra* note 37, at 176; *see also supra* text accompanying notes 57-58.

could extend the traditional limits of a parent regulator's supervisory responsibility.[103]

That consolidated supervision would be difficult to implement seemed evident from the drafters' treatment of the supervision of international bank holding companies. The Revised Concordat designated the host regulator (rather than the parent regulator) as the primary supervisor of subsidiary banks belonging to a bank holding company, but failed to designate a primary regulator of the bank holding company.[104] This would prove to be a very significant gap and was a factor in the BCCI crisis.[105] As banks expand into new and different lines of business, they tend to develop complex holding company structures. Banco Ambrosiano's attenuated and far-flung corporate structure allowed it to escape effective regulation.[106] BCCI likewise took advantage of a fragmented corporate structure in order to avoid complete regulation.[107] Under the terms set forth in the Revised Concordat, a holding company with independent banks operating in different countries could avoid meaningful regulation because no one regulator had responsibility for the parent's overall health. Likewise, effective supervision of a holding company with both bank and non-bank subsidiaries also required the cooperation of different regulators.[108]

3. Weaknesses of Revised Concordat

Overall, the Revised Concordat differed significantly from the 1975 Concordat. Unlike the 1975 version, it adopted consolidated supervision, an important technique for monitoring the overall risk exposure and capital adequacy of a bank; introduced the "dual key" approach; and explicitly stated that it was not meant to address lender of last resort responsibility.

The Revised Concordat, like its predecessor, also contained

---

103. REVISED CONCORDAT, *supra* note 43, at 905.

104. *See id.* at 904.

105. *See* Dale, *supra* note 45, at 12 (pointing out that BCCI's structure was such that it could avoid stringent consolidated supervision under the Revised Concordat).

106. *See supra* text accompanying notes 65-72. Banco Ambrosiano consisted of a parent bank in Italy and several foreign subsidiaries, including banks located in Peru, Panama, and Luxembourg. *See* Hess, *supra* note 33, at 189-90. The Luxembourg subsidiary, Banco Ambrosiano Holding, itself had a Bahamian subsidiary, Banco Ambrosiano Overseas Ltd. *See id.* at 190.

107. *See* David Lascelles, *First Step Towards Tougher Regulation*, FIN. TIMES, Sept. 2, 1991, at 13. *See infra* text accompanying notes 149-165 (discussing the results of the complex corporate structure of BCCI and its affiliates).

108. *See* REVISED CONCORDAT, *supra* note 43, at 904.

some weaknesses. One major problem was the explicit refusal to address the issue of lender of last resort responsibility.[109] Theoretically, if banking regulators cooperate to *prevent* bank failures, they should also cooperate in upholding the international banking system when a failure is imminent. The Revised Concordat, however, lacked any statement on what should happen if this supervisory system failed.[110]

The Basle Committee did not address lender of last resort responsibility because some members of the Committee were not central banks and thus lacked any lending power with which to support failing banks.[111] More fundamentally, the issue was avoided because the central banks of the industrialized nations had previously stated, albeit vaguely, that they would support the liquidity of the international markets in times of crisis.[112] If a major bank failed or another major financial disruption occurred, the central banks of the major industrialized nations would provide enough funds to prevent a liquidity crisis. In drafting the Revised Concordat the central bankers sought to leave this prior commitment vague in order to encourage private sector discipline.[113] The central bankers had to create a delicate balance between creating confidence in financial markets and not encouraging reckless behavior by financial institutions.

The Revised Concordat purposely blurred host and parent regulatory responsibilities in order to avoid the pointing of fingers that occurred among regulators after the 1982 failure of Banco Ambrosiano.[114] In doing so, however, it also appeared to create problems of overlapping authority and responsibility in cases where one regulator was designated the primary regulator, but another regulator also had a strong interest in maintaining effective supervision over a foreign bank.[115] This blurring of responsibility created uncertainty for regulators over their super-

109. *Id.* at 901 (stating that Revised Concordat does not address lender of last resort responsibility); Mendelsohn, *supra* note 48, at 2.

110. David W. Wise, *International Prudential Regulation of Commercial Banks*, BANK ADMIN., June 1985, at 58, 62. "Just as laws should provide for their own enforcement, supervision should provide for the eventuality that such supervision can fail." *Id.*

111. Mendelsohn, *supra* note 48, at 2.

112. *See, e.g.*, *id.* (noting statement of support of Euromarkets still applies).

113. *Id.*

114. Wise, *supra* note 110, at 62. *See supra* text accompanying notes 68-72.

115. *E.g.*, REVISED CONCORDAT, *supra* note 43, at 906 (stating that the countries in which joint ventures are incorporated (host countries) have primary responsibility for supervising the joint venture, but that the parent regulators of banks that are shareholders in the joint venture cannot ignore supervision of the joint venture).

visory responsibilities.[116] In theory, the parent regulator ultimately should have responsibility for the safety and soundness of its banks—in all of their forms and establishments, foreign and domestic. The principle of consolidated supervision allows a parent regulator, in the course of enforcing its own regulations, to approve or disapprove of its banks' foreign operation.[117] This power would prevent crises in the foreign establishments of its domestic banks, while assuring the health of the domestic banks as well. Despite significant improvements over the original Concordat, the Revised Concordat left gaps in the coordination of international bank regulations—gaps that BCCI would later exploit.

IV. Bank of Credit and Commerce International

A. *The Closing of BCCI*

1. International Closings

In a coordinated action on July 5, 1991, regulators in eight nations closed all the BCCI branches located within their jurisdictions.[118] At the time BCCI had total assets of approximately $20 billion and was operating in sixty-nine countries, with the largest concentration of its deposits in the United Kingdom.[119] Due to the absence of any international law governing the closure of an international bank, local regulators acted under separate national laws.[120] By July 6, 1991, BCCI offices in eighteen countries either were closed or had had their operations

116. Wise, *supra* note 110, at 62.

117. *See id.*

118. Max Hall, *The BCCI Affair*, Banking World, Sept. 1991, at 8. The eight nations were the Cayman Islands, France, Germany, Luxembourg, Spain, Switzerland, the United Kingdom, and the United States. *Id.* Indeed, on that day, action to shut down BCCI's activities was taken in more than sixty nations. *Id.*

119. Federal Reserve System, *Statement by J. Virgil Mattingly, Jr., General Counsel, and William Taylor, Staff Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, and E. Gerald Corrigan, President, Federal Reserve Bank of New York, Before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, September 13, 1991*, 77 Fed. Res. Bull. 902, 905 (1991) [hereinafter *Mattingly Statement*]. BCCI was no longer accepting retail deposits in its U.S. offices because of actions taken previously by U.S. bank regulators. *Id.* at 907. *See infra* text accompanying note 131-132.

120. *Cf.* Claire Makin, *Learning From BCCI*, Institutional Investor, Nov. 1991, at 93, 94-95 (discussing various local investigations into BCCI and the lack of overall international accountability). In a 1989 interview, former BCCI chief executive Swaleh Naqvi acknowledged that "[b]ecause we do not have a dominant presence in any single country, the full impact of what we are doing is not visible." *Id.* at 94.

restricted.[121] The closure of BCCI branches continued for several weeks, and by July 29, 1991 forty-four jurisdictions had closed BCCI offices located within their borders.[122]

The immediate reason for the closure of BCCI was the Bank of England's receipt of a June 1991 report prepared by Price Waterhouse that detailed massive fraud committed by BCCI's senior managers.[123] Through the mid-1980s the treasury operations of BCCI suffered huge losses. Senior managers siphoned off deposits to cover these losses.[124] If the depositors withdrew their money, then other deposits were diverted to cover the losses. This practice resulted in an endless series of fraudulent transactions.[125] The report revealed that senior managers, board members, and representatives of major shareholders participated in the fraud by making fictitious loans; failing to record deposits; and dealing in their own shares in order to manufacture profits.[126] BCCI also used client names to trade on its own account.[127] BCCI managers hid the losses caused by bad trades, unpaid loans, and fraudulent practices by shuttling assets between subsidiaries.[128] In 1988 alone BCCI subsidiaries paid each other $152 million in fee income.[129]

Regulators in both the United States and England had been concerned about the safety and soundness of BCCI for years before the bank finally was closed. BCCI pleaded guilty in 1988

---

121. *Mattingly Statement*, *supra* note 119, at 903.

122. *Id.*

123. Hall, *supra* note 118, at 8. The Bank of England had commissioned the report under section 41 of the 1987 Banking Act, which permits the investigation of banks on behalf of depositors. Banking Act, 1987, ch. 22, § 41, 4 HALSBURY'S STATUTES OF ENGLAND AND WALES 527, 574-76 (4th ed. 1987).

124. David Lascelles, *A Never-ending Spiral of Fraud*, FIN. TIMES, Oct. 22, 1991, at 32. There are estimates that BCCI raised over $600 million in unrecorded deposits. *See All Things to All Men*, THE ECONOMIST, July 27, 1991, at 67, 68.

125. Lascelles, *supra* note 124, at 32.

126. Hall, *supra* note 118, at 8. For example, BCCI reported loans of $445 million to Ghaith Pharaon, a Saudi business executive, and $796 million to the Gokal family in Pakistan; both borrowers were shareholders of First American Bankshares, which was secretly owned by BCCI. These loans were not secured with any assets, nor were they in fact made to the named individuals. *See* Jonathan Friedland, *Rest in Pieces*, FAR E. ECON. REV., Sept. 26, 1991, at 64, 66. *See generally* JAMES R. ADAMS & DOUGLAS FRANZ, A FULL SERVICE BANK: HOW BCCI STOLE BILLIONS AROUND THE WORLD (1992).

127. *All Things to All Men*, *supra* note 124, at 67.

128. *The Many Façades of BCCI*, THE ECONOMIST, July 13, 1991, at 81. In addition, Price Waterhouse discovered a secret "bank within a bank," controlled by top BCCI officials, which hid losses and plugged holes in the balance sheets by raising deposits without recording them. *Id.*

129. *Id.*

to charges of money laundering in Tampa, Florida.[130] On June 12, 1989, the FRB issued a cease and desist order requiring BCCI to strengthen its U.S. operations and to comply with currency reporting regulations.[131] The FRB issued a second cease and desist order against BCCI on March 4, 1991, ordering it to strengthen the funding of its U.S. agency offices.[132] In February 1990, Price Waterhouse, BCCI's auditor, refused to sign off on the BCCI financial statements for 1989 and subsequently reported to the BCCI board and the Bank of England its concerns of fraud at BCCI.[133] In April 1990, the Bank of England permitted the government of Abu Dhabi to increase its investment in BCCI—in effect to bail out the bank.[134] Six months later, in October 1990, Price Waterhouse delivered to the BCCI board a follow-up to its April report, detailing the bank's massive loan problems.[135]

2. The BCCI Scandal in the United States

After receiving evidence from Price Waterhouse of BCCI's massive wrongdoing, the Bank of England, in a coördinated strike with regulators in the United States and other nations, closed BCCI in July 1991.[136] Also in July, the FRB took enforcement action against BCCI and BCCI officials for their involvement in the allegedly illegal acquisitions of the Independence Bank of Encino, California, the National Bank of Georgia, CenTrust Savings Bank, and Credit and Commerce American Holdings (CCAH), the parent company of First American Bankshares.[137] On July 29, 1991, a New York state grand jury

130. *All Things to All Men*, *supra* note 124, at 68; *see Mattingly Statement*, *supra* note 119, at 906.

131. *Mattingly Statement*, *supra* note 119, at 907. The consent order "required BCCI to implement an extensive Bank Secrecy Act compliance program, including personnel training at each of its locations and to monitor and report 'suspicious activity.' " *BCCI Plea Deal Stirs Controversy*, MONEY LAUNDERING ALERT, Feb. 1990, at 1, 2.

132. *Mattingly Statement*, *supra* note 119, at 907. This order called for BCCI to cease all banking activities in the United States by the end of 1991. *Id.* *See* Alan Friedman, *Fed Takes Action on BCCI*, FIN. TIMES, Mar. 6, 1991, at 3.

133. *1987-1992: The Morning After*, INSTITUTIONAL INVESTOR, July 1992, at 197.

134. *Id.*; *see Mattingly Statement*, *supra* note 119, at 907.

135. Richard Dale, *Reflections on the BCCI Affair: A United Kingdom Perspective*, 26 INT'L LAW. 949, 961 (1992); *Mattingly Statement*, *supra* note 119, at 907. *See generally* Symposium, *International Bank Supervision Post BCCI*, 26 INT'L LAW. 943 (1992).

136. *1987-1992: The Morning After*, *supra* note 133, at 204; *see* Patrick Stewart & Richard Phillips, *BCCI Breakdown*, INT'L FIN. L. REV., Jan. 1992, at 14; *supra* text accompanying notes 118-129.

137. Federal Reserve System, *Statement by J. Virgil Mattingly, Jr., General Counsel, and William Taylor, Staff Director, Division of Banking Supervision and Regulation, Board of Governors*

indicted BCCI, related companies, and two founders of BCCI for bank fraud.[138] The fiduciaries administering the affairs of BCCI pleaded guilty to federal and state criminal charges on December 19, 1991, agreeing to pay a $10 million fine and to forfeit over $550 million in BCCI assets located in the United States.[139] Half of these assets will fund capital for BCCI-affiliated institutions in the United States and half of the assets will be held for a "Worldwide Victim's Fund."[140]

The secret ownership of U.S. financial institutions by BCCI and its affiliates has attracted a great deal of press attention in the United States. BCCI secretly controlled four U.S. banks: First American Bank, headquartered in Washington, D.C.; the National Bank of Georgia; CenTrust Savings Bank of Florida; and the Independence Bank of Encino, California.[141] Eight of BCCI's largest customers used $1.4 billion borrowed from BCCI to buy shares in CCAH.[142] Furthermore, on July 29, 1992 federal and state authorities brought indictments against Robert Altman, Clark Clifford, Agha Hasan Abedi, Swaleh Naqvi, and Ghaith Pharaon, alleging that they had paid bribes to officials in Third World nations to ensure favorable treatment and to cover up fraudulent practices.[143]

The indictments also accuse Altman and Clifford of illegal

---

of the Federal Reserve System, Before the Subcommittee on Terrorism, Narcotics and International Operations of the Committee on Foreign Relations, U.S. Senate, August 1, 1991, 77 FED. RES. BULL. 791, 795-96 (1991) [hereinafter *Mattingly & Taylor Statement*]; Federal Reserve System, *Statement by J. Virgil Mattingly, Jr., General Counsel, Board of Governors of the Federal Reserve System, Before the Subcommittee on Terrorism, Narcotics and International Operations of the Committee on Foreign Relations, U.S. Senate, May 14, 1992*, 78 FED. RES. BULL. 504, 505 (1992) [hereinafter *Second Mattingly Statement*].

138. *The Opening-up of BCCI: Send for Richard Hannay*, THE ECONOMIST, Aug. 3, 1991, at 21, 23.

139. Max Hall, *The BCCI Affair*, BANKING WORLD, Feb. 1992, at 10; *see also Second Mattingly Statement*, *supra* note 137, at 506 (summarizing disposition of state and federal charges). The U.S. District Court for the District of Columbia approved this agreement on January 24, 1992, as had the New York state court on December 20, 1991. *Id.*

140. Hall, *supra* note 139, at 10. Both the New York and federal prosecutions charged First American Bankshares with violations of banking law. Although both indictments contain similar allegations, the indictments are different and allege violations of different laws. *Id.*

141. *See Second Mattingly Statement*, *supra* note 137, at 505; *The Opening-up of BCCI*, *supra* note 138, at 23.

142. Lascelles, *supra* note 124, at 32.

143. Alan Friedman & George Graham, *Bank Regulators Bribed by BCCI, US Suit Alleges*, FIN. TIMES, July 30, 1992, at 1. Altman was president of First American and Clark Clifford's law partner. Clifford was chairman of First American and a former U.S. defense secretary. Abedi founded BCCI in the early 1970s; Naqvi is the former chief executive officer of BCCI; and Pharaon is a Saudi Arabian business executive. *Id.* *See generally* Rich-

activity undertaken for personal gain. The state indictments against them allege that they received bribes in the guise of legal fees and sham stock transactions for facilitating BCCI's purchase of a controlling interest in First American Bankshares.[144] The federal indictment tracks the state indictment and alleges that Clifford and Altman defrauded the FRB in their representation of First American Bankshares.[145]

Clifford and Altman pleaded innocent to the criminal charges on July 29, 1992.[146] Sheikh Kamal Adham, a principal shareholder and borrower of BCCI, has pleaded guilty to criminal charges and has agreed to cooperate with prosecutors.[147] The trial on the state charges against Altman, after numerous reschedulings, began in New York in April 1993.[148]

B. *BCCI's International Corporate Structure and Regulatory Difficulties Resulting Therefrom*

While the trials of the individuals involved in the BCCI scandal will attract most of the public's attention in the short term, the scandal will have long-term ramifications on international banking regulation. BCCI's complex corporate structure aided the bank's evasion of comprehensive regulation.[149] Like Banco Ambrosiano, BCCI used a holding company structure with the holding company headquartered in Luxembourg.[150] The holding company's two principal banking subsidiaries were Bank of Credit and Commerce International, S.A., incorporated in Luxembourg; and Bank of Credit and Commerce International (Overseas) Ltd., incorporated in the Cayman Islands.[151] BCCI created other separate subsidiaries in different jurisdictions

---

ard Donkin, *Global Trial of Bribery*, FIN. TIMES, July 30, 1992, at 6 (outlining contents of the indictments).

144. Peter Truell & Thomas Petzinger, Jr., *Clifford, Altman Are Accused of Taking Over $40 Million in Bribes From BCCI*, WALL ST. J., July 30, 1992, at A3.

145. *Id.*

146. *See* Friedman & Graham, *supra* note 143, at 1; Truell & Petzinger, *supra* note 144, at A3.

147. Truell & Petzinger, *supra* note 144, at A3.

148. Sharon Walsh, *Trial Date at Issue Again for Figures in BCCI Case*, WASH. POST, Jan. 23, 1993, at G1. *See generally* Gay Jervey & Stuart Taylor, Jr., *From Statesman to Front Man: How Clark Clifford's Career Crashed*, AM. LAW., Nov. 1992, at 49 (giving background on Clark Clifford's and Robert Altman's involvement with BCCI and First American Bankshares).

149. *See* Makin, *supra* note 120, at 94.

150. Hall, *supra* note 118, at 10. The Luxembourg holding company was BCCI Holdings (Luxembourg), S.A. *Mattingly Statement*, *supra* note 119, at 905.

151. *Mattingly Statement*, *supra* note 119, at 905.

where the bank operated.[152] This complex corporate structure allowed BCCI to take advantage of a weakness in the Revised Concordat: the failure to assign responsibility for regulation of banking holding companies, which left all responsibility in this instance to the authorities required to regulate the various holding company subsidiaries located in separate jurisdictions.[153] This corporate structure also allowed BCCI to use two separate auditors, making comprehensive regulation difficult; BCCI never had to show a consolidated financial statement to any one bank regulator.[154] Because of its corporate structure, therefore, BCCI never developed a natural "home base" and no single bank regulator ever supervised the entire bank's operation.[155]

In addition, the location of BCCI's principal banking subsidiaries in Luxembourg and the Cayman Islands contributed to the magnitude of the scandal. These countries are noted for their lax financial regulation as well as their strict bank secrecy laws—two characteristics that tend to create an environment in which fraud can occur without the knowledge of bank regulators.[156] Under Luxembourg law, the Luxembourg holding company—parent of all BCCI subsidiaries—was not even considered a bank; it thus escaped bank supervision in Luxembourg.[157] But even if Luxembourg wished to regulate the holding company, it might not have been successful. To avoid more probing regulation, BCCI held many of its questionable assets in the Cayman Islands subsidiary,

152. *Mattingly & Taylor Statement*, *supra* note 137, at 791-92; *see Mattingly Statement*, *supra* note 119, at 905-06.

153. *See* Dale, *supra* note 45, at 12. The Revised Concordat provided only that "[w]here holding companies are at the head of groups that include separately incorporated banks operating in different countries, the authorities responsible for supervising *those banks* should endeavour to co-ordinate their supervision of those banks, taking account of the overall structure of the group in question." REVISED CONCORDAT, *supra* note 43, at 904 (emphasis added). Under the Revised Concordat, host regulators had sole responsibility for regulating the liquidity of foreign subsidiaries and shared responsibility for regulating foreign subsidiaries' solvency and foreign currency operations jointly with parent bank regulators. *Id.* at 906-08.

154. Rob Norton, *Lessons from BCCI*, FORTUNE, Sept. 9, 1991, at 153, 154; *see also* Hall, *supra* note 118, at 9 (suggesting that BCCI may have directly prevented its various auditors from communicating with each other and from understanding very sensitive bank documents).

155. Lascelles, *supra* note 107 at 13; Makin, *supra* note 120, at 94.

156. *See* Richard Dale, *BCCI: Regulatory Rights and Wrongs*, FIN. REG. REP., July 1991, *available in* LEXIS, Nexis Library, FRR File; *see also* Jeff Gerth, *Scandal Reveals Holes in Rules for Foreign Banks*, N.Y. TIMES, July 7, 1991, at A13 (labelling Luxembourg a "haven for intensely private banking operations"); Steven Prokesch, *Regulation of BCCI Is Faulted*, N.Y. TIMES, Mar. 12, 1992, at D1 (noting that both countries "are widely regarded as having weak regulatory systems").

157. Dale, *supra* note 45, at 12.

beyond the jurisdiction of Luxembourg regulators.[158]

Although the entire bank was never supervised by a single regulator, the two principal BCCI subsidiaries were supposed to be supervised by the regulators in their respective jurisdictions—the Institut Monetaire Luxembourgeois (ILM) and the Cayman Islands Inspectorate of Banks.[159] This supervision was inadequate. Luxembourg regulators had admitted in the late 1980s that they lacked the ability to supervise effectively the BCCI subsidiary located within their jurisdiction and requested that BCCI reincorporate the subsidiary in another country, but Luxembourg never acted upon this request.[160] In 1988 Pierre Jaans, director of the ILM, stated that BCCI had "no clear home country supervision."[161] With only fifteen bank examiners responsible for the entire country,[162] it became clear that Luxembourg lacked the resources to supervise BCCI.

To compensate for this lack of supervisory resources, bank regulators from the Cayman Islands, France, Hong Kong, Luxembourg, Spain, Switzerland, the United Arab Emirates, and the United Kingdom coordinated their regulatory efforts in 1987 and created a "college of regulators" to supervise BCCI.[163] The regulators coordinated supervisory responsibilities among themselves.[164] This scheme was an unworkable solution and allowed regulators to shift responsibility for any BCCI transgression among themselves. No single regulator had any incentive to regulate BCCI properly, and the regulators did not cooperate among themselves in sharing information on BCCI operations.[165] This arrangement proved not to be effective and was only a slight improvement over what had previously existed.

---

158. *See* Gerth, *supra* note 156, at A13. BCCI " 'parked' its shadiest assets in the Cayman Islands. This meant that the Luxembourg authority saw little of what was going on." Lascelles, *supra* note 107, at 13.

159. Hall, *supra* note 118, at 9.

160. *Id.*; *see also* Prokesch, *supra* note 156, at D7 (stating that Luxembourg regulators had put a one year deadline for compliance on their request).

161. Gerth, *supra* note 156, at A13.

162. *Id.*

163. Hall, *supra* note 118, at 10.

164. *See id.*

165. *Id.* "The dispersal of supervisory responsibilities within the [college] and the difficulties in getting agreement on coordinated action, however, served only to delay the day of reckoning at BCCI." *Id.* The college also has been criticized for its failure to cooperate with the FRB. *See* Stewart & Phillips, *supra* note 136, at 14.

C. *Liquidation of BCCI*

After the closure of BCCI in July 1991, the Bank of England petitioned the English courts to liquidate the United Kingdom branches of BCCI, S.A. (the Luxembourg subsidiary) on grounds of fraudulent management, concealment of fraud, inadequate accounting records, and the bank's insolvency, among others.[166] Touche Ross, the appointed liquidator of BCCI, stated in its initial report in December 1991 that BCCI had assets of $1.159 billion and liabilities of $10.641 billion.[167] Subsequently, Touche Ross developed a plan whereby all of the world-wide assets of BCCI would be pooled and used to pay off creditors.[168] The confusion and delay in liquidating BCCI added to the impetus to improve international bank regulation so that the risks of future bank failures could be reduced.

D. *Impetus for a New Regulatory Agreement Governing International Banking*

The BCCI affair was "a case of systematic and deliberate criminal fraud. . . . [in which] BCCI took maximum advantage of an unsupervised cooperate [sic] structure to conceal and warehouse in bank secrecy jurisdictions billions of dollars in fraudulent transactions."[169] BCCI was able to take advantage of technological advances that allowed it to shift funds world-wide very quickly. As the banking industry becomes global, the potential for global fraud grows concurrently.

Some commentators and regulators believe that the BCCI affair was a unique case.[170] Unfortunately, similar statements were made about the earlier failures of Banco Ambrosiano and the Herstatt Bank.[171] While deliberate fraud on the scale of BCCI may be unlikely to reoccur, a large bank failure, given the current precarious economic times, is not improbable. For that reason, the British government appointed Lord Justice Bingham to lead a thorough and comprehensive investigation of the regu-

166. Hall, *supra* note 118, at 8.

167. *BCCI: The Never-ending Story*, THE BANKER, Jan. 1992, at 4. It was estimated initially that BCCI's unrecoverable losses amounted to at least $4 billion. *The Many Façades of BCCI*, *supra* note 128, at 81.

168. Stewart & Phillips, *supra* note 136, at 14. This scheme has been dubbed the "Luxembourg Plan." *Id.*

169. *Mattingly Statement*, *supra* note 119, at 905.

170. *See* Lascelles, *supra* note 107, at 13; Makin, *supra* note 120, at 94 (citing assurances made by bank supervisors that BCCI was unique).

171. *See, e.g.*, *supra* text accompanying note 74.

lation of BCCI in the United Kingdom.[172] Bingham's report was released in October 1992.[173] It severely criticized the actions of the Bank of England in the BCCI affair[174] and recommended that Parliament adopt laws that would allow the Bank of England to refuse or revoke the authorization of banks whose corporate structures hinder proper supervision.[175]

The circumstances surrounding the closure of BCCI call into question the "adequacy of international supervisory arrangements" of international banks.[176] National banking laws must adhere to an international supervisory standard so that banks are unable to take advantage of the gaps in supervision created by lax jurisdictions. In other words, if all jurisdictions met a common minimum standard of bank supervision, there would be no lax jurisdiction in which banks could operate.

The Basle Committee began discussions of the ramifications of the BCCI closure almost immediately after the fact.[177] In light of the closure of BCCI, the committee members generally agreed that there was a need to strengthen the supervision provisions of the Revised Concordat.[178] To this end, in July 1992 the Basle Committee on Banking Supervision issued "Minimum Standards for the supervision of International Banking Groups and Their Cross-Border Establishments."[179]

V. THE BASLE COMMITTEE RESPONSE TO BCCI: THE NEW MINIMUM STANDARDS

A. *Explanation*

In the new standards, the Basle Committee agreed to tighten international bank supervision.[180] Generally, the Committee

172. *See The Opening-up of BCCI, supra* note 138, at 22-23.

173. HOUSE OF COMMONS, INQUIRY INTO THE SUPERVISION OF THE BANK OF CREDIT AND COMMERCE INTERNATIONAL (1992) (on file with *The George Washington Journal of International Law and Economics*).

174. *Id.* para. 2.483, at 149; *see also id.* paras. 2.1-.484, at 29-150 (discussing Bank's long term supervision of BCCI).

175. *Id.* paras. 3.13-.16, at 183-84.

176. Hall, *supra* note 118, at 8.

177. The new Minimum Standards were issued in June 1992, less then a year after BCCI was completely closed. *See* MINIMUM STANDARDS, *supra* note 3, at 7. The drafters somewhat cryptically noted that they began their work on the standards "[f]ollowing recent developments." *Id.* at 1.

178. *See id.* at 1.

179. *Id.*

180. *See* Steven Prokesch, *Regulators Agree on Rules to Prevent More B.C.C.I.'s*, N.Y. TIMES, July 7, 1992, at D1.

reformulated the principles reflected in the Concordat and the Revised Concordat into Minimum Standards for bank supervision.[181] The main features of the new Minimum Standards are that: (1) all international banks and banking groups should be supervised by a "home-country" regulator; (2) an international bank should obtain the permission of both the host and home regulators before opening a branch or other banking establishment in a foreign nation; (3) banking regulators should have the right to gather information from international banks; (4) if the minimum standards are not met, a host regulator may impose restrictive measures against the international bank; and (5) information exchanges between regulators in different nations should continue to be encouraged.[182]

1. Paramount Concern: Consolidated Supervision

The Minimum Standards specifically state that all international banks should be subject to consolidated supervision by their home regulators.[183] Consolidated supervision requires that the home-country regulator receive information that can be confirmed as reliable on the global operations of the particular international bank.[184] This information is then assessed as to the light it sheds on the safety and soundness of the international bank.[185] Under the Minimum Standards, home-country bank regulators can prevent the creation of corporate affiliations that undermine the application of consolidated supervision or that hinder effective regulation,[186] and they can prevent the opening of banking establishments in a foreign jurisdiction if, for example, they are not satisfied with that host country's supervision of foreign banks.[187]

The host-country regulator likewise has the responsibility to ensure that the home-country regulator has the ability to meet these minimum standards.[188] According to the Minimum Stan-

181. MINIMUM STANDARDS, *supra* note 3, at 1. The 1990 Supplement to the Revised Concordat concerning "Information flows between banking supervisory authorities" was not made part of the Minimum Standards. *Id.* at 2.

182. *International Panel on Banking Revises Minimum Standards*, WALL ST. J., July 7, 1992, at C25. The Minimum Standards use the terms "home-country" and "host-country" in lieu of "parent" and "host."

183. MINIMUM STANDARDS, *supra* note 3, at 3.

184. *See id.*

185. *Id.*

186. *Id.* at 3-4.

187. *See id.*

188. *Id.* at 3.

dards, an international bank must receive permission from both its home-country and host-country regulators before opening a cross-border banking establishment.[189] In determining whether to approve a foreign operation, the host-country regulator can consider the bank's strength of capital, organization, and operating procedures for risk management.[190] The approval of any new banking establishment should be contingent upon a multilateral agreement among regulators that each may gather the information necessary for effective home-country supervision. That is, regulators should reach a mutual understanding that they can gather information from establishments within each other's jurisdiction.[191]

The Minimum Standards make the same allocation of supervisory responsibilities between home-country and host-country regulators as was set forth in the Revised Concordat, except in cases where the regulators have decided that that allocation is inappropriate.[192] If a regulator determines that this allocation is not appropriate in the regulation of a particular bank, then it must reach an explicit agreement with its counterpart on a more appropriate allocation of supervisory responsibility.[193] In other words, under the Minimum Standards there can be no evasion of responsibility. In the absence of an agreement to the contrary, the Revised Concordat allocates supervisory responsibilities.

The host-country regulator has responsibility for determining whether the international bank will in fact be subject to consolidated supervision in the home-country as required by the Minimum Standards.[194] The host regulator should consider whether the bank is incorporated in a nation with which the host regulator has a mutual understanding for the exchange of information; whether the home-country regulator has given its consent for the new banking establishment; and whether the home-country regulator has the capability to perform consolidated supervision.[195] If the Minimum Standards are not met, the host-country regulator

189. *Id.* at 4.

190. *Id.* at 4. The home-country regulator, of course, should consider the same factors. *Id.*

191. *Id.* at 5-6.

192. *See id.* The allocations referred to are found at REVISED CONCORDAT, *supra* note 43, at 905-08. *See supra* text accompanying notes 92-101.

193. MINIMUM STANDARDS, *supra* note 3, at 5.

194. *See id.* at 6.

195. *Id.*

should prevent the opening of the new banking establishment.[196]

Alternatively, in its sole discretion, the host-country regulator may choose to allow the establishment of a branch subject to any regulatory restrictions it may deem necessary and appropriate.[197] The host regulator, however, will then have responsibility for regulating the establishment on a " 'stand alone' consolidated basis."[198] The discretion of a host-country regulator to allow the operation of a bank which does not meet minimum standards of supervision is a potentially broad exception to the Minimum Standards.

In its statement accompanying the issuance of the Minimum Standards, the Basle Committee stated, "The minimum standards are designed to provide greater assurances that in the future no international bank can operate without being subject to effective, consolidated supervision."[199] The Minimum Standards themselves make clear that consolidated supervision is a vital regulatory principle and that no further debate on its importance is required. E. Gerald Corrigan, chairperson of the Basle Committee, reiterated this point when he stated that a goal of the minimum standards was to ensure that all international banks were subject to consolidated supervision.[200]

Under the new standards, the home-country regulator is clearly the primary regulator of the foreign banking establishments of a bank incorporated in the home country.[201] According to the new standards, a single bank regulator must exercise primary regulatory authority over an international bank.[202] This prevents any sort of collegial regulatory arrangement, similar to the one that attempted to supervise BCCI for several years.[203]

---

196. *Id.* This course of action is not necessary if the home-country regulators are willing and able to "initiate the effort to take measures to meet these standards." *See id.*

197. *Id.* at 6-7.

198. *Id.* at 7.

199. Maggie Fox, *Watchdog Writes Standards to Stop BCCI-type Frauds*, REUTER BUS. REP., July 6, 1992, *available in* LEXIS, Nexis Library, WIRES File.

200. *Basle Committee on Banking Supervision Issues New Standards to Prevent Fraud*, Daily Rep. Exec. (BNA) No. 130, at A-1 (July 7, 1992).

201. Erik Ipsen, *Central Bankers Unveil New Anti-Fraud Rules*, INT'L HERALD TRIB., July 7, 1992, at 9; *see* MINIMUM STANDARDS, *supra* note 3, at 3.

202. *Learning from BCCI*, FIN. TIMES, July 7, 1992, at 18. Specifically, the Minimum Standards state that "[a]ll . . . international banks should be supervised by a home-country authority that capably performs consolidated supervision." MINIMUM STANDARDS, *supra* note 3, at 3.

203. *See supra* text accompanying notes 163-165.

2. Requirement of Dual Approval for Foreign Banking Establishments

The most important change provided in the new standards is formalization of the principle that an international bank must receive the permission of both home *and* host regulators before it can open a foreign banking establishment.[204] This double approval for the establishment of a new foreign branch will prevent the fingerpointing that has occurred in the past after a bank failure.[205] In approving the foreign banking establishment, the host regulator should be satisfied that the home regulator will supervise the foreign bank on a consolidated basis.[206] If not satisfied, the host regulator can prevent the foreign bank from opening the branch.[207]

B. *Analysis: Implementation and Effect of Minimum Standards Uncertain*

Problems exist with the implementation of the new Minimum Standards. Some are purely pragmatic. For instance, both home-country and host-country regulators may have difficulty obtaining information concerning a non-financial company that owns a bank. Industrial companies generally are not subject to the same degree of regulation as banks and therefore publicly disclose less information about their financial affairs.

A second basic problem could be lack of adequate resources. For example, if the new standards had been in place in 1991, the BCCI fraud would have been more difficult to conceal because a single regulator (Luxembourg) would have been in charge.[208] With its limited regulatory resources,[209] however, Luxembourg most likely would not have been able to detect the fraud.

In addition to these ministerial difficulties that might thwart

---

204. *See* MINIMUM STANDARDS, *supra* note 3, at 4; *see also* Ipsen, *supra* note 201, at 9.

205. *See Basle Committee on Banking Supervision Issues New Standards to Prevent Fraud, supra* note 200, at A-1. *See supra* text accompanying notes 68-72 and 159-165.

206. *See* MINIMUM STANDARDS, *supra* note 3, at 4; *Learning from BCCI, supra* note 202, at 18.

207. *See* MINIMUM STANDARDS, *supra* note 3, at 6 (stating that the host-country regulator should prevent creation of a foreign bank establishment when it is dissatisfied with the home-country's supervision).

208. *See* MINIMUM STANDARDS, *supra* note 3, at 3 ("All international banking groups . . . should be supervised by a home-country authority that capably performs consolidated supervision."). Luxembourg would have been BCCI's "home-country authority" because BCCI's parent holding company was incorporated there. *See supra* text accompanying note 150.

209. *See supra* text accompanying notes 160-162.

implementation of the Minimum Standards, the standards themselves contain fundamental flaws.

1. Gaps in New Standards

Despite the improvement they represent, the Minimum Standards contain a gap that banks could exploit to avoid regulation. A host regulator can still choose to allow a foreign banking establishment to operate in its jurisdiction even if the establishment's home regulator does not comply with the Minimum Standards.[210] The host-country regulator need only impose the restrictions it deems "necessary and appropriate" on this establishment.[211]

Further, the standards focus on the establishment of new branches but do not explicitly apply to existing bank branches.[212] The standards may prevent the entry of an unsuitable new establishment into international banking, but the next failure-prone bank may be operating already. Without an explicit statement in the new standards, retroactive application of the standards will vary by nation.[213]

The new Minimum Standards generally encourage the flow of information among bank regulators.[214] The standards are purposely vague, however, in order to allow regulators the flexibility to interpret them on a case-by-case basis.[215] They are designed to encourage cooperation between home-country and host-country regulators, and their operation may serve as an informal early warning system that would identify problem banks more rap-

---

210. MINIMUM STANDARDS, *supra* note 3, at 6-7; *see also* Rod McNeil, *Basel Group's Bank Supervision Plan to Step Up International Coordination*, THOMSON'S INT'L BANKING REG., July 13, 1992, at 1, 2 (summarizing this provision).

211. MINIMUM STANDARDS, *supra* note 3, at 7. The standards nevertheless require the host-country regulator to supervise the establishment adequately. *See id.*

212. Three of the Minimum Standards' four principles apply solely to the creation of a new banking establishment. *See id.* at 3-7. The first principle (requiring adequate home-country consolidated supervision) is phrased as "a condition for the creation *and maintenance* of cross-border banking establishments" and arguably may apply to existing establishments. *Id.* at 3. *See also Basle Committee on Banking Supervision Issues New Standards to Prevent Fraud*, *supra* note 200, at A-1 (quoting Mr. Corrigan of the Basle Committee as saying that Minimum Standards "would 'by implication at least' be able to be applied to existing branches").

213. *Learning from BCCI*, *supra* note 202, at 18. This is expected to be a long and cumbersome process. *Id.*

214. *See, e.g.*, MINIMUM STANDARDS, *supra* note 3, at 2 (encouraging cooperative efforts), 5-6 (conditioning establishment of cross-border banks on bilateral information exchange agreements).

215. *Cf.* MINIMUM STANDARDS, *supra* note 3, at 3 ("The following four minimum standards are to be applied by individual supervisory authorities in their own assessment of their relations with supervisory authorities in other countries.").

idly.[216] The success of the standards will depend on how accurately regulators evaluate the adequacy of supervisory standards of other countries.

2. Problems of Voluntary Compliance

Like the Concordat and the Revised Concordat that preceded them, the Minimum Standards are not a treaty and do not have the force of law. The Basle Committee, therefore, must rely on regulators' moral authority and informal pressure to enforce them. Furthermore, national regulators will implement the standards in isolation from one another, thus allowing discrepancies in enforcement among nations to develop. For instance, penalties for violation of banking laws or regulations based on the standards will rest with the individual country regulators.

Further complicating the efficacy of voluntary compliance is the fact that implementation of the new standards may require changes in the domestic laws of some nations. For example, it is questionable whether current U.S. law would allow a foreign regulator to obtain information from a banking establishment in the United States that is involved in an ongoing criminal or grand jury investigation.[217] While the standards encourage the flow of information among regulators, some nations' bank secrecy laws may prevent this free exchange of information. If the Minimum Standards had the force of law, they would override such contrary local law.[218]

In addition to problems of voluntary compliance, there are entire segments of the banking community that the Minimum Standards do not affect. The Basle Committee's membership is limited to regulators from the industrialized nations. The standards, therefore, at first apply only to those nations.[219] In 1974 the G-10 nations whose regulators make up the Committee con-

216. *See* Neil Bennett, *Bankers Tighten Rules in Fight Against Fraud*, THE TIMES (London), July 7, 1992, at 21.

217. Prokesch, *supra* note 180, at D6.

218. The Basle Committee itself admits that the Minimum Standards have some limitations. The chairperson of the Basle Committee has stated that the new standards will not prevent the occurrence of all fraud. *Basle Committee on Banking Supervision Issues New Standards to Prevent Fraud*, *supra* note 200, at A-1.

219. *See supra* note 1. Other nations are free to adopt the Committee's standards, as they did with the Committee's Basle Accord on International Convergence of Capital Measurement and Capital Standards, which was adopted in July 1988. Peter Cooke, *Preface* to PRICE WATERHOUSE, BANK CAPITAL ADEQUACY AND CAPITAL CONVERGENCE 1 (1991).

trolled ninety percent of the assets of the world's banks.[220] In 1991 the G-10 nations controlled only eighty percent of the world's banking assets.[221] A significant portion of the world's bank assets are therefore not governed by the Minimum Standards.

3. Perceived Discrimination

Some critics argue that the Basle Committee designed the new standards to prevent the development of large banks in the Third World, saying that banks in less developed nations will have the most difficulty meeting the new standards.[222] It is foreseeable that regulators from wealthier countries could use the Minimum Standards as a weapon against poorer nations that have weak financial regulatory systems. They could restrict the establishment of branches of their home-country banks in these poorer nations, rather than using the Minimum Standards as constructive tools to improve financial regulation worldwide. While the members of the Basle Committee may have a general concern about Third World banks operating in industrialized nations after their experience with BCCI,[223] they did not intend to limit the expansion of Third World banks.[224] By issuing these standards, the Committee intended to respond to the failure of a $20 billion international bank, not to limit the growth of Third World banks generally.

4. Lack of Any New Substantive Standards

Some analysts believe that the new standards are merely symbolic and will have no appreciable effect on international banking

220. Makin, *supra* note 120, at 97.

221. *Id.*

222. McNeil, *supra* note 210, at 2. The United Nations Center on Transnational Corporations also issued a report in light of the closure of BCCI. UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, NEW ISSUES FOR TRANSNATIONAL COOPERATION IN TRANSNATIONAL BANKING (1992) [hereinafter U.N. REPORT] (on file with *The George Washington Journal of International Law and Economics*). *See also* Steve Lohr, *U.N. Study Assails the Way B.C.C.I. Was Shut by Western Central Banks*, N.Y. TIMES, Feb. 5, 1992, at D7. The report noted the massive losses caused by the bank's closure and pointed out that the economic damage fell hardest on countries such as Nigeria and Bangladesh, where BCCI was an important institution. U.N. REPORT, *supra*, at 13-14; Lohr, *supra*, at D7.

223. Pakistani business executives founded BCCI in 1972. *Mattingly Statement*, *supra* note 119, at 905.

224. *Cf. BIS Panel Lines Up Plans to Prevent New BCCI's*, INSTITUTIONAL INVESTOR BANK LETTER, June 29, 1992, at 1, 9 (stating that the intent of Basle Committee is to head off any future BCCI-type failures).

practice.[225] The standards themselves offer little new substance. One international banking scholar has commented that the Minimum Standards simply reiterate what was agreed upon in the Revised Concordat.[226] The main effect of the new standards, if any, may be an increase in the amount of information flowing between banks and regulators and among regulators in different countries.

VI. Other Regulatory Responses to BCCI

Other legislative bodies are also responding to the failure of BCCI. The U.S. Congress, in response to both the BCCI and the Banca Nazionale del Lavoro scandals, passed the Foreign Bank Supervision Enhancement Act of 1991.[227] As part of its 1992 program, the European Community (EC) has adopted a directive on consolidated supervision of financial institutions.[228]

A. *European Community Response*

With the implementation of the 1992 EC program, European nations are placing more emphasis on supervisory standards and bank regulation, the goal being the eventual mutual convergence of banking regulation in the EC.[229] To meet this goal, the EC has passed several directives, the most important of which is the Second Banking Directive.[230] Under the Second Banking Directive, a bank licensed in a Member State will be able to open a branch

225. *E.g.*, *International Banking Authorities Set Post-BCCI Standards*, Japan Economic Newswire, July 7, 1992 (quoting Alicia Ogawa of S.G. Warburg Securities (Japan), Inc.), *available in* LEXIS, Nexis Library, OMNI File.

226. *E.g.*, Maggie Fox, *Promises and Problems in New Basel Rules*, AM. BANKER, July 8, 1992, at 6 (quoting Richard Dale). For instance, the Revised Concordat also discussed the principle of consolidated supervision. REVISED CONCORDAT, *supra* note 43, at 905.

227. FBSEA, *supra* note 6.

228. Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52.

229. *See* ROB DIXON, BANKING IN EUROPE: THE SINGLE MARKET 55-56 (1991).

230. Second Council Directive 89/646 of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780, 1989 O.J. (L 386) 1 [hereinafter Second Banking Directive]. The others are Council Directive 91/308 of 10 June 1991 on Prevention of the Use of the Financial System for Purposes of Money Laundering, 1991 O.J. (L 166) 77; Council Directive 89/647 of 18 December 1989 on a Solvency Ratio for Credit Institutions, 1989 O.J. (L 386) 14; Council Directive 89/299 of 17 April 1989 on the Own Funds of Credit Institution, 1989 O.J. (L 124) 16; and Council Directive 83/350 of 13 June 1983 on the Supervision of Credit Institutions on a Consolidated Basis, 1983 O.J. (L 193) 18, *superseded by* Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52.

without restriction in any other member state.[231] Any activity that a Member State authorizes a bank to perform in that Member State can also be performed by the bank in any other Member State.[232] A host Member State may not require additional licensing or authorization for a bank that already is authorized or licensed in another Member State.[233] In effect, the Second Banking Directive provides for the granting of a single license to a bank of a Member State which will be recognized throughout the EC.[234] The stability of the European banking system under this "single passport" scheme thus depends upon adequate supervision of banks in their respective parent jurisdictions.[235]

In order to ensure adequate supervision in all member nations, on April 6, 1992 the EC Council of Ministers adopted a new Directive on Consolidated Supervision[236] that supplanted the previous 1983 Directive.[237] The new directive has four aims: (1)

---

231. Second Banking Directive, *supra* note 230, art. 18, Annex at 9-10, 13. Under this directive, foreign bank establishments may be entitled to engage in the following activities in host-countries:

1. Acceptance of deposits and other repayable funds from the public.
2. Lending.
3. Financial leasing.
4. Money transmission services.
5. Issuing and administering means of payment (e.g. credit cards, travellers' cheques and bankers' drafts).
6. Guarantees and commitments.
7. Trading for own account or for account of customers in:
   (a) money market instruments (cheques, bills, CDs, etc.);
   (b) foreign exchange;
   (c) financial futures and options;
   (d) exchange and interest rate instruments;
   (e) transferable securities.
8. Participation in share issues and the provision of services related to such issues.
9. Advice to undertakings on capital structure, industrial strategy and related questions, and advice and services relating to mergers and the purchase of undertakings.
10. Money broking [sic].
11. Portofolio [sic] management and advice.
12. Safekeeping and administration of securities.
13. Credit reference services.
14. Safe custody services.

Id. Annex, at 13.

232. *Id.* art. 18, para. 1, at 9.

233. *Id.* art. 6, para. 1, at 4.

234. *See id.*

235. Hall, *supra* note 118, at 10.

236. Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52. Member States were required to promulgate enabling legislation for this directive by January 1, 1993. *Id.* art. 9, para. 1, at 58.

237. Council Directive 83/350 of 13 June 1983 on the Supervision of Credit Institu-

to extend consolidated supervision to more types of banking structures; (2) to require non-bank companies of a mixed activity holding company to provide necessary information to regulators who are responsible for the supervision of banks; (3) to specify areas covered by consolidated supervision; and (4) to specify consolidation methods.[238]

In a significant change, the directive applies to an entire bank holding company, not merely the bank itself,[239] and applies to banking groups whether or not the parent company is a credit institution.[240] By contrast, the 1983 Directive applied only to banking groups of which the parent company was a credit institution.[241] Thus, while the 1983 Directive did not apply to BCCI because its parent holding company was not a bank, the new directive applies to BCCI-type corporate structures—non-bank holding companies with banking subsidiaries.[242] Under the new directive, bank regulators must apply EC banking standards (capital requirements, credit limits to customers, solvency ratios) to consolidated banking groups.[243]

The new Directive on Consolidated Supervision also allocates regulatory responsibility among bank supervisors, in a manner similar to that of the Minimum Standards. The primary regulator of any EC bank is the regulator in the Member State in which the parent credit institution is authorized or licensed.[244] Where the bank is held by a financial holding company, however, the Member State that licensed or authorized the banking subsidiary has primary regulatory responsibility.[245] Where a financial holding company has banking establishments in two or more Member States, three allocations of regulatory responsibility are possible: (1) the Member State in which the holding company is licensed or authorized has primary responsibility if it also has licensed or

---

tions on a Consolidated Basis, 1983 O.J. (L 193) 18. For replacement language, see Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52, 53. *See BCCI Lesson Spurs EC Ministers to Adopt Consolidated Supervision Plan*, 58 Banking Rep. (BNA), at 663 (Apr. 13, 1992).

238. *See* Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52, 53.

239. *See id.* arts. 2-3, at 54-55.

240. *See id.*

241. *See* Council Directive 83/350 of 13 June 1983 on the Supervision of Credit Institutions on a Consolidated Basis, arts. 2-3, 1983 O.J. (L 193) 18, 18-19.

242. *See* Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52.

243. *See id.* art. 3, para. 5, at 54.

244. *Id.* art. 4, para. 1, at 55.

245. *Id.* art. 4, para. 2, at 55.

authorized a banking establishment of that company; (2) if not, all of the Member states "concerned" (including the one that licensed the holding company) must reach agreement as to who has primary responsibility; or (3) if the concerned Member States cannot reach agreement, as a default, primary authority must rest with the Member State that has authorized the banking establishment with the "greatest balance sheet total."[246]

The new directive does apply, in a limited fashion, to "mixed-activity" companies—those that provide both banking and non-banking services (*e.g.*, insurance).[247] Under the new directive, Member States must insure that mixed-activity companies supply bank regulators with "any information which would be relevant for the purposes of supervising the credit institution subsidiaries" as well as guarantee that appropriate inspectors are able to carry out on-the-spot verification inspections of mixed-activity companies.[248] Furthermore, Member States generally shall facilitate the exchange of information between regulators[249] and shall allow regulators to verify the information provided.[250]

Finally, the directive authorizes the EC Commission to petition the Council to enter into agreements with non-member states concerning consolidated supervision of foreign banks.[251] Thus, the EC as a whole could negotiate with the United States to develop a regulatory plan for a bank and, at least, would be able to negotiate an information-exchange agreement.

It is interesting to note that the Minimum Standards may conflict with the European Community's Second Banking Directive, which expressly prohibits discrimination against banks of Member States.[252] The Minimum Standards allow a host regulator to prevent the operation of a foreign banking establishment if the host regulator is not satisfied with the supervision provided by the home regulator of the foreign bank.[253] While the Minimum Standards encourage host regulators to discriminate more finely among home regulators, the Second Directive prohibits this type of discrimination.[254] One solution may be for bank regulators to

246. *Id.*
247. *Id.* art. 2, at 54.
248. *Id.* art. 6, at 56.
249. *See id.* art. 7, paras. 2-4, at 56-57.
250. *See, e.g., id.* art. 6, para. 2, at 56.
251. *Id.* art. 8, paras. 1-2, at 57.
252. Second Banking Directive, *supra* note 230, art. 14, para. 2, at 7-8.
253. MINIMUM STANDARDS, *supra* note 3, at 6-7.
254. Second Banking Directive, *supra* note 230, art. 14, para. 2, at 7-8.

treat the European Community as one jurisdiction.

The forced closure of BCCI also generated discussion regarding possible changes in other EC laws. Sir Leon Brittan, formerly the EC's Financial Services Commissioner and currently the EC's Trade Commissioner, has considered amending the draft Deposit Guarantee Directive to include a requirement that a nation that registers a bank is also responsible for the protection of all depositors of that bank even if the deposits are located in a foreign nation.[255] Another of Sir Brittan's proposals would outlaw certain banking structures that are specifically designed to avoid effective consolidated supervision.[256]

Eventually, the European Central Bank, proposed in the Treaty of Maastricht,[257] may oversee the regulation of European banks to a certain extent.[258] The European Central Bank may have some supervisory responsibilities over the foreign operations of European banks, but national regulators will retain significant regulatory power.[259] With the ultimate approval of the Treaty of Maastricht in doubt, however, the future of European bank regulation and of the allocation of supervisory responsibility is not clear.[260]

B. *U.S. Response*

The U.S. Congress, like the EC, passed legislation in response

255. Max Hall, *The BCCI Affair*, BANKING WORLD, Oct. 1991, at 11, 12-13.

256. *See id.* at 13.

257. TREATY ON EUROPEAN UNION [TREATY OF MAASTRICHT], Feb. 7, 1992 art. G(7) (amending the Treaty Establishing the European Economic Community). The future of the Treaty is in question following a plebiscite that rejected the Maastricht Treaty in Denmark. *See Why the Danes Wouldn't*, THE ECONOMIST, June 6, 1992, at 52. Plebiscites in France and Ireland have been in favor of the Treaty. *See A Vote Too Far*, THE ECONOMIST, Sept. 26, 1992, at 48 (France); *Maastricht at a Glance*, THE ECONOMIST, Oct. 17, 1992, at 60 (Ireland). The Treaty faces a great deal of opposition in Britain. *Germany Ratifies Europe Unity Pacts*, CHI. TRIB., Dec. 19, 1992, at 19. *See generally An Idea That is Sinking Fast*, THE ECONOMIST, Sept. 26, 1992, at 47 (summarizing hindrances to the ratification of the Treaty).

258. TREATY OF MAASTRICHT, *supra* note 257, ch. 2, art. 105, paras. 5-6 (stating that the European System of Central Banks shall "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions" and that the European Central Bank may be given "specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions").

259. *See id.*

260. *Spain Ratifies Maastricht Treaty*, Common Mkt. Rep. (CCH) No. 721, at 10 (Dec. 10, 1992). As of March 29, 1993, ten member countries of the EC had ratified the Treaty of Maastricht. *Balladur and Mitterrand Agree on Importance of Europe*, EUR. REP., Mar. 31, 1993, *available in* LEXIS, Nexis Library, CURRNT File.

to the failure of BCCI. The FRB studied and proposed tougher regulatory laws based upon its experience dealing with BCCI.[261] In December 1991, Congress passed the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA)[262] as part of the Federal Deposit Insurance Corporation Improvement Act of 1991.[263] Prior to passage of the FBSEA, individual state banking regulators supervised most foreign banks in the United States.[264] Under the FBSEA, the FRB now must approve the opening of all foreign banking establishments—branches, agencies, and representative offices.[265] Thus, the FBSEA creates a federal overlay of regulation of foreign banks. The FBSEA is designed to keep poorly managed, poorly capitalized or inadequately supervised banking institutions from operating in the United States.[266]

In order to obtain FRB approval, a foreign bank wishing to open an establishment in the United States must show that it is subject to "comprehensive supervision or regulation on a consolidated basis" by its home regulator.[267] If it wishes to establish a branch or agency in the United States, the foreign bank also must make adequate assurances that it will provide the FRB whatever information the FRB deems necessary for its supervision of the foreign bank.[268] The FRB thus will be concerned about other nations' bank secrecy laws that may prevent it from obtaining sufficient information on the parent bank.[269] This new approval

261. *Mattingly Statement*, *supra* note 119; *see also* Federal Reserve System, *Statement by E. Gerald Corrigan, President, Federal Reserve Bank of New York, Before the Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives, September 13, 1991*, 77 FED. RES. BULL. 918, 919 (1991) (advocating passage of tougher legislation).

262. FBSEA, *supra* note 6. *See generally* Ann E. Misback, *The Foreign Bank Supervision Enhancement Act of 1991*, 79 FED. RES. BULL. 1 (1993).

263. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified in scattered sections of 12 U.S.C.). On January 28, 1993, the Federal Reserve Board issued final rules revising Regulation Y and Regulation K in response to the FBSEA. 58 Fed. Reg. 6348 (1993) (to be codified at 12 C.F.R. §§ 211, 225, 263, 265). Earlier, on January 6, 1993, the Federal Reserve Board issued regulations in response to changes in the Bank Holding Company Act resulting from the FBSEA. 58 Fed. Reg. 471 (1993) (to be codified at 12 C.F.R. § 225).

264. Gerth, *supra* note 156, at A13. *See also supra* text accompanying note 16.

265. FBSEA, *supra* note 6, codified at 12 U.S.C. §§ 3105(d)(1), 3107(a)(1) (Supp. III 1992). FRB approval for representative offices is a significant change from prior law. *See* H.R. REP. No. 330, 102d Cong., 1st Sess. 128 (1991), *reprinted in* 1991 U.S.C.C.A.N. 1901, 1941.

266. *Mattingly Statement*, *supra* note 119, at 917. This is an attempt to prevent establishments that might engage in BCCI-type illegal activities from entering the U.S. market. *See id.*

267. FBSEA, *supra* note 6, codified at 12 U.S.C. §§ 3105(d)(2)(A) (Supp. III 1992).

268. *Id.* § 3105(d)(3)(C).

269. *See BIS Panel Lines Up Plans to Prevent New BCCI's*, *supra* note 224, at 9.

process is likely to be slow and require the exchange of large amounts of information.[270]

In addition to expanding the FRB's power to approve foreign banking establishments, the FBSEA also grants it the authority to terminate foreign bank operations in the United States. The FRB may terminate a foreign bank's authority to operate if the bank is not subject to comprehensive supervision on a consolidated basis; if the FRB has "reasonable cause to believe" that the foreign bank has violated a law; or if the bank has engaged in unsound or unsafe banking practices.[271]

Under the FBSEA, the FRB has the authority to examine a foreign bank even if it is licensed by a state,[272] and it must make at least one examination of each branch or agency every year.[273]

The FBSEA as originally enacted requires foreign banks to create at least one separate U.S. subsidiary if the bank accepts deposits in amounts less than $100,000.[274] A separate subsidiary allows for easier compensation to depositors in case of a bank failure; this structure facilitates the enforcement of court orders (such as discovery or attachment orders) by avoiding complicated extraterritoriality issues that would be present if a foreign branch were involved. On the other hand, the subsidiary structure limits

---

270. *See id.*

271. FBSEA, *supra* note 6, codified at 12 U.S.C. § 3105(e)(1) (Supp. III 1992). This authority applies only to U.S. branches and agencies. Representative offices may be closed by the FRB based upon the criteria discussed *supra* at text accompanying notes 265, 267. *Id.* § 3107(b).

272. *Compare* 12 U.S.C. § 3105(b)(1) (1988) (requiring FRB to defer to state authorities in examining foreign banks) *with* 12 U.S.C. § 3105(e)(1)(A) (Supp. III 1992) (containing no such language with relation to FRB examinations). *See* H.R. REP. NO. 330, *supra* note 265, at 127, *reprinted in* 1991 U.S.C.C.A.N. at 1940 (noting the removal of this language); *see also* Thomas E. Crocker, *Foreign Banks in the US: A Political Power Struggle*, INT'L FIN. L. REV., Jan. 1992, at 24, 25 (stating that this language marks a shift in the dual monitoring system of foreign banks in the United States).

273. FBSEA, *supra* note 6, codified at 12 U.S.C. § 3105(c)(1)(C) (Supp. III 1992). The FRB is given discretion as to whether and when it examines representative offices. *See id.* § 3107(c).

274. *Id.* § 3104(c)(1) (Supp. III 1992). There is a grandfather clause that exempts from this provision any foreign branch that was an "insured branch" on December 19, 1991. *Id.* § 3104(c)(2). *See generally* Barbara C. Matthews, *Foreign Bank Supervision Enhancement Act; Implications for Foreign and Domestic Banks*, 58 Banking Rep. (BNA) No. 23, at 1001, 1005-10 (June 8, 1992) (discussing subsidiary and insurance expansion requirements in the FBSEA).

In drafting the law, Congress obviously meant banks which accept retail deposits, but the statute does not qualify the type of deposits. A technical amendment was passed in October 1992 to correct this ambiguity. Housing and Community Development Act of 1992 Pub. L. No. 102-550, § 1604(a)(11), 106 Stat. 3672, 4083 (to be codified at 12 U.S.C. § 3104).

the amount of lending legally permissible by the foreign bank subsidiary. Because a subsidiary is capitalized separately from the parent bank, the subsidiary, unlike a branch, cannot rely on the assets and capital of the parent to support its lending.[275]

The FBSEA makes significant changes in the regulation of foreign banks in the United States. The FRB is now the clear primary regulator of foreign banks in the United States. Under this statute, the dual system of banking regulation is no longer applicable to foreign banks. A state banking license is no longer sufficient to operate in the United States; a foreign bank must also obtain the prior approval of the FRB in order to open any U.S. establishment. The FBSEA also erodes the unconditional national treatment approach previously adopted by Congress in the International Banking Act of 1978.[276] While U.S.-chartered banks can operate with either state or federal approval,[277] a foreign bank must obtain FRB approval before it can operate an establishment in the United States. Foreign banks thus are subject to an additional layer of federal supervision that domestic banks can avoid. The new act is designed to prevent another exploitation of uncoordinated supervision, similar to the fraud perpetrated by BCCI's managers.

C. *Other Proposals for Changes in International Bank Regulation*

1. British Parliamentary Recommendations

The Treasury and Civil Service Committee of the House of Commons of the British Parliament issued a report on March 4, 1992, before the new Minimum Standards were released, entitled "Banking Supervision and BCCI: International and National Regulation."[278] The Committee in its report made several recommendations for changes in banking law. The Committee suggested that bank auditors should have a legal duty to report suspicious activity to regulators.[279] The Committee also suggested that the Bank for International Settlements (BIS) should supervise the standards employed by the domestic regulators of

275. *See* Wolfram & Whitener, *supra* note 25, at 24.

276. Crocker, *supra* note 272, at 24, 25. *See supra* text accompanying notes 28-31.

277. *See supra* note 31.

278. HOUSE OF COMMONS TREASURY AND CIVIL SERVICE COMMITTEE, BANKING SUPERVISION AND BCCI: INTERNATIONAL AND NATIONAL REGULATION, FOURTH REPORT, H.C. Doc. No. 177, House of Commons Sess. 1991-92 (1992) [hereinafter COMMONS COMMITTEE REPORT].

279. *Id.* paras. 20-21, at xxx.

international banks.[280] The Committee felt that the BIS, well versed in international bank regulation, could expand its role in that area relatively easily and that other international regulatory bodies (such as the International Monetary Fund (IMF) and General Agreement on Tariffs and Trade (GATT)) were less suited for this role.[281] The report also recommended that the Bank of England study whether foreign banks should be required to incorporate in Great Britain if they wished to operate there.[282]

While the Committee did not recommend the creation of a new international regulatory agency, it did conclude that a college of regulators, like the one used to oversee BCCI in the late 1980s, was not effective and could not replace a lead regulator who could be held accountable and thus would be likely to regulate the bank more stringently.[283] The report also recommended that the Revised Concordat become a legally enforceable document[284] and that a revision of the Revised Concordat be drafted to ensure that every international bank has a lead regulator.[285]

In assessing the performance of the parties in handling the BCCI affair, the Parliament report had relatively few complaints about Price Waterhouse, BCCI's auditors,[286] but criticized bank regulators in both Great Britain and Luxembourg. The regulators in Britain and Luxembourg had known of irregularities at BCCI since the 1970s, yet took no action. British regulators refused to take over the supervision of BCCI when Luxembourg admitted it lacked the necessary capabilities.[287] According to the report, the British and Luxembourg regulators should have forced a change in the corporate structure of BCCI in order to ensure that BCCI had a capable lead regulator.[288] The regulators made these efforts shortly before the bank's closure, but they clearly waited too long to act.[289]

2. British Regulators' Recommendations

British regulators responded to criticism of their regulation of

280. *Id.* para. 19, at xxx; *see supra* note 1 (addressing the BIS).
281. COMMONS COMMITTEE REPORT, *supra* note 278, para 19, at xxx.
282. *Id.* para. 89, at xxviii; *see id.* para. 23, at xxxi.
283. *Id.* para. 49, at xx.
284. *Id.* para. 44, at xviii-xix. The Committee did note the difficulty of implementing such a change and the decrease in regulatory flexibility that would result therefrom. *Id.*
285. *Id.* para. 49, at xx.
286. *See id.* paras. 22-26, at xii-xiii.
287. *See id.* paras. 7-8, 37-40, at viii, xvii-xviii.
288. *Id.* para. 13, at xxix; *see id.* para. 12, at x.
289. *See id.* paras. 26-33, at xiii-xvi.

BCCI in a report issued by the Bank of England on July 8, 1992.[290] The Bank of England requested legislative changes that would grant it additional authority to respond to future financial disruptions such as the BCCI affair. First, it requested the power to refuse or revoke the authorization of a bank if the bank's corporate structure prevented effective supervision.[291] The Bank also wanted to ensure that all foreign banks were subject to effective home supervision on a consolidated basis.[292] The Bank noted the benefits of prohibiting a bank from operating in the United Kingdom if its home regulator did not follow the new Minimum Standards, but also acknowledged the difficulties inherent in assessing compliance with the standards.[293] The Bank requested the power to withdraw the authorization of a bank operating a branch in a jurisdiction whose supervision was lax.[294] In addition, the Bank called for close cooperation among international regulators[295] and for reconsideration of codifying a requirement that bank auditors inform regulators of fraud.[296] Auditors in the United Kingdom currently have the authority, but not the duty, to inform regulators of fraud.[297]

3. Group of Thirty's Recommendations

Before the closure of BCCI, the Group of Thirty, a private research and advisory group based in Washington, D.C., prepared a report suggesting changes in international bank regulation.[298] In the report the Group stated the goals of bank regulation: maintaining competitiveness among financial institutions; ensuring the safety and soundness of the financial system; ensuring the safety of deposits; protecting against systemic risk that prudential controls may be ineffective to prevent; ensuring

290. BANK OF ENGLAND, TREASURY AND CIVIL SERVICE COMMITTEE, BANKING SUPERVISION AND BCCI: INTERNATIONAL AND NATIONAL REGULATION; FOURTH REPORT; BANK OF ENGLAND RESPONSE (1992) [hereinafter BANK OF ENGLAND RESPONSE] (on file with *The George Washington Journal of International Law and Economics*).

291. *Id.* paras. 10-13.

292. *See id.* para. 14.

293. *See id.* paras. 16-20.

294. *See id.* para. 13.

295. *Id.* para. 20.

296. *See id.* paras. 34-36.

297. *See* Banking Act, 1987, ch. 22, § 47, 4 HALSBURY'S STATUTES OF ENGLAND AND WALES 527, 581 (4th ed., 1987) (stating only that it is not a breach of an auditor's duty of confidentiality to the bank to report such fraud to the Bank of England).

298. SYDNEY J. KEY & HAL S. SCOTT, INTERNATIONAL TRADE IN BANKING SERVICES: A CONCEPTUAL FRAMEWORK (Group of Thirty Occasional Papers No. 35, 1991) (on file with *The George Washington Journal of International Law and Economics*).

adequate consumer protection; and maintaining effective monetary policy.[299] The report laid out a framework of international bank regulation that takes cognizance of both the regulatory objectives being sought and the mode of providing banking services being used (a branch, a subsidiary or merely selling across borders).[300]

The report principally addressed the allocation of supervisory responsibility between host and home regulators[301] and suggested that host laws should apply to the local subsidiaries of foreign banks.[302] When a bank offers services across borders without operating an establishment in a foreign jurisdiction, however, the law of the *home* country should govern.[303] The Group recommended that a set of harmonized rules govern the operation of the branches of foreign banks.[304] Finally, the Group of Thirty recommended granting to an international institution such as the Organization for Economic Cooperation and Development (OECD), GATT or BIS the power to formulate rules governing international banking; to monitor the implementation of those rules; and to resolve disputes.[305]

4. Other Recommendations

a. Increased regulator liability

Regardless of the changes and recommendations made by the Basle Committee and commentators, domestic bank regulators will continue to play a significant role in the supervision of international banks. Domestic regulators, however, need an incentive to enforce the Minimum Standards as written and not to ignore or circumvent them in order to increase their nation's share of the international banking market. For this reason, Sir Leon Brittan has suggested that the home country, through its deposit insurance program, should be responsible for the losses of a foreign branch of a bank incorporated in the home country.[306] If

299. *Id.* at 8-15.

300. *Id.* at 4-6; *see also Home Thoughts from Abroad*, THE ECONOMIST, Aug. 17, 1991, at 74.

301. See KEY & SCOTT, *supra* note 298, at 15-33.

302. *Id.* at 29-33. The paper also stresses the use of "harmonized rules"—those rules that apply in both the host- and home-countries—in relation to foreign subsidiaries. *Id.* at 29-33.

303. *Id.* at 16-19. Harmonization is less necessary here. *See id.*

304. *Id.* at 19-29. The report notes that enforcement and deposit insurance still would have to be provided by the home country. *Id.*

305. *Id.* at 37-43.

306. Leon Brittan, *Lesson of BCCI for the Regulators*, FIN. TIMES, July 29, 1991, at 11.

adopted, this proposal would give regulators a strong economic incentive to supervise effectively the global operations of a bank headquartered within their jurisdiction.[307] Bank regulators so far have rejected this notion.[308]

b. Supranational Regulation

Some commentators argue that a new supranational regulatory body, having the power to enforce its own standards and mete out sanctions, is needed to supervise international banks.[309] The Basle Committee and BIS are mentioned as institutions that could fill this role.[310] Both entities would require additional full-time personnel who could deal with these issues on a regular basis and resolve technical questions.[311] On the other hand, the Basle Committee and BIS may not be effective in this area, since their membership is comprised solely of industrialized nations. Banks headquartered in Third World nations that are not members would escape this more stringent comprehensive supervision.[312]

Other analysts see no need for a new international bank regulator. Some European Community officials argue that a single world-wide regulator would not be practical in handling a major international bank failure[313] and that a new international bureaucracy would be slow to respond to a problem. Furthermore, the effectiveness of a new international agency might suffer from a lack of broad support among national regulators.[314]

---

307. *See, e.g.*, Makin, *supra* note 120, at 96 (quoting disgruntled British banker forced to make good on losses of sterling deposits in the aftermath of the BCCI scandal).

308. *See, e.g.*, *id.*

309. *E.g.*, Connie M. Friesen, *The Regulation and Supervision of International Lending: Part II*, 20 INT'L LAW. 153, 215 (1986). Friesen acknowledges the obstacles that current principles of international law and national sovereignty present to this idea. *Id.* *See also supra* text accompanying note 305 (regarding Group of Thirty's suggestion of having an international body set and implement standards).

310. *See, e.g.*, Friesen, *supra* note 309.

311. *See* Gary N. Kleiman, *Much Criticized Basel Banking Group Comes Under Siege from Member Countries*, THOMSON'S INT'L BANKING REG., Feb. 3, 1992 (discussing need for expanded Basle Committee permanent staff), *available in* LEXIS, Banks Library, ALLBNK File.

312. While GATT or the IMF may be more appropriate entities, they lack expertise in bank regulation.

313. Paolo Clarotti, *EC's Financial Regulations Should Stand the Test of Worldwide BCCI Scandal*, THOMSON'S INT'L BANKING REG., Jan. 20, 1992, *available in* LEXIS, Banks Library, ALLBNK File. Clarotti works in the Directorate General For Financial Institutions at the EC Commission in Brussels.

314. *See* Makin, *supra* note 120, at 96, 97 (raising issue of proprietary attitudes toward regulatory jurisdiction as well as issue of cost). Both the Group of Thirty and L. William

There also would be pragmatic difficulties with such an approach. Decisions in the Basle Committee are reached by consensus. Such an institution, operating slowly and conservatively, would not be effective as an international bank regulator; formulating a quick response to a crisis would be difficult (if not impossible) where unanimity was required. The college of regulators that supervised BCCI for several years illustrates the weaknesses of regulation by consensus.[315] Furthermore, banking laws and the safety and soundness of a nation's financial institutions are closely tied to national security and sovereignty. Nations would be very reluctant to relinquish this supervisory power to an international agency.[316] The new Minimum Standards issued by the Basle Committee do not create a new international regulatory body and do not hint at the creation of one in the near future.

c. A compromise on supranational regulation

Improved cooperation and the exchange of information among national regulators would create a more potent regulatory regime. In the absence of one international bank regulator, domestic regulators who are more familiar with the global health of their local institutions would be in a better position to regulate those institutions. Furthermore, not being able to shift responsibility for a bank failure to an international supervisor would give them greater incentive to regulate effectively.

Through its laws on financial institutions, particularly the new Directive on Consolidated Supervision,[317] the European Community is developing this type of regime. Domestic regulators still have primary responsibility for the safety and soundness of institutions incorporated in their country, but are required to exchange information with regulators in other Member States.[318] No EC bank regulator has been created yet.

The size of the BCCI failure highlights the potential danger of

---

Seidman, former head of the FDIC, support this new agency. *Id.* at 97. *See supra* text accompanying note 305.

315. *See supra* text accompanying notes 163-165.

316. Denmark's plebiscite rejecting the Treaty of Maastricht and the intense debate in France that preceded the referendum that very narrowly approved the treaty on September 20, 1992, *see supra* note 257, illustrate the reluctance of an electorate to relinquish a portion of national sovereignty to an international body (in this case European Community institutions).

317. Council Directive 92/30 of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110) 52.

318. *See id.* art. 4, paras. 1-2, at 55; *see also id.* arts. 6-7, at 56-57. *See generally supra* text accompanying notes 236-251.

an international bank failure and the need for changes in international bank regulation.[319] A system that allows a $20 billion bank to grow while committing massive fraud is clearly in need of change. Although the coordinated closure of BCCI in this case prevented a massive disruption of the financial system, the absence of clear lender of last resort responsibility and a lack of coordination among regulators in the future could threaten the integrity of payments and settlements systems throughout the world.[320] For example, without a coordinated closure of BCCI, the U.S. settlements system could have been threatened because BCCI held assets and deposits in U.S. dollars.[321]

The international bank regulatory system must address the issue of offshore financial centers with lax regulation and strict bank secrecy laws. BCCI took advantage of the lax regulatory environment in the Cayman Islands and Luxembourg in order to perpetrate fraud. The Basle Committee's Minimum Standards, issued in July 1992, undoubtedly are not the final resolution of this issue.[322]

VII. Recommendations and Conclusion

The closure of BCCI revealed that while the banking industry has expanded and developed, world-wide bank regulation has not. These new realities demand that international bank regulation be updated. The Basle Committee has attempted to meet the new realities by promulgating the Minimum Standards, but in the final analysis the new standards do not make any dramatic changes in bank regulation and contain flaws.

First, the Minimum Standards assert as a fundamental principle that the parent (or home) regulator should have primary responsibility for the supervision of the foreign operations of an international bank. The new standards directly state that a bank should have a single regulator for all of its global operations. At

319. For example, BCCI had no lender of last resort. Assuring that each international bank in the world had a lender of last resort could bring greater security to the banking system.

320. Dale, *supra* note 156.

321. *Id.* Without a relatively organized closing of BCCI, banks would be unable to settle transactions with other banks because BCCI could not make its payments. If the resulting shortfall of funds was significant, the lender of last resort would have to provide sufficient liquidity to allow transactions to settle.

322. Indeed, a meeting of over 100 bank regulators to discuss the standards was held in October 1992 in France. Michael Rowe, *Proposed Oversight Standards Are Welcomed Worldwide*, THOMSON'S INT'L BANKING REG., Oct. 19, 1992, *available in* LEXIS, Banks Library, ALLBNK File.

the same time, however, the standards carve out a generous exception undercutting this general single regulator principle: a host supervisor may allow a local branch or subsidiary of a foreign bank to operate in its jurisdiction even though the home regulator is not providing adequate supervision of the foreign bank.[323] While the host supervisor *should* impose restrictive measures on the establishment in this situation, the language of the standards does not make this imposition an absolute requirement.[324] Furthermore, under the new standards the supervision of subsidiaries is left as a *joint* responsibility between the host and home regulators. This division of responsibility leaves open the opportunity for miscommunication and inadequate supervision.[325]

Second, it is acknowledged that a lead regulator should supervise a bank on a consolidated basis. In the case of BCCI there was no clear lead regulator, and no regulator supervised the overall bank on a consolidated basis. As a result, BCCI senior managers were able to conceal their fraudulent transactions for several years. On this point the Minimum Standards are adequate.[326]

Third, in order for the new standards to be effective, all jurisdictions need to enforce them. Yet only a small minority of the world's banking regulators have pledged to abide by them. To enforce the new regulatory system created by the Minimum Standards, members of the Basle Committee must have the fortitude to lock out banks with offices in jurisdictions that do not abide by the new Minimum Standards and prevent their own banks from opening offices in those lax jurisdictions.

International bank regulators need to avoid a "race to the bottom," that is, the weakening of their own financial regulatory system in order to attract additional foreign capital. In a multijurisdictional regulatory regime, a tendency for competitive deregulation exists.[327] Conscientious regulators are faced with a dilemma. If they impose too much regulation relative to other nations, they become less competitive and the amount of foreign investment decreases. On the other hand, if the regulation in a local jurisdiction is lax and banks in that jurisdiction have signifi-

323. MINIMUM STANDARDS, *supra* note 3, at 6-7.
324. *See id.* at 7.
325. *See id.* at 2-3.
326. *See id.* at 3-4.
327. DALE, *supra* note 37, at 172.

cant financial dealings with other banks, then systemic risk increases and is shared by all nations, not only by the nations with lax bank regulation.[328] As long as regulatory disparities exist, so will competitive inequalities.[329]

In order to discourage this tendency to "race to the bottom," therefore, any new regulatory regime must attack the causes that lead to a lax regulatory environment: national autonomy, neutrality, and parent responsibility.[330] To counter the influence of national autonomy, regulators should harmonize banking regulations, which they are attempting to do through the new Minimum Standards. The Basle Committee has articulated the type and degree of supervision that is minimally acceptable. To reverse neutrality, regulators should make each foreign bank subject to the parent bank's domestic regulations, although this may create competitive disadvantages within a single jurisdiction.[331] The foreign bank may be limited in its activities not because of the host regulator's rules but rather because some regulation of its parent bank restricts the bank's activities in the host country. In order to remove parental responsibility, the home regulator or central bank should not have lender of last resort responsibility for the foreign subsidiaries of an international bank.[332] Making a home regulator of a bank the lender of last resort for that bank tends to encourage host nations to be more lax in regulation of foreign banks.[333] Lender of last resort responsibility in the international context has the tendency to generate moral hazard and cause foreign banks to behave imprudently.[334] A regulatory system with the preceding characteristics may discourage lax international bank supervision.

As a result of the failure of BCCI, regulators are reaching a consensus that international banks require more specific rules in

---

328. Kapstein, *supra* note 37, at 327; *see also* James W. Dean, *Conservative versus Liberal Regulation of International Banking*, 23 J. WORLD TRADE 5, 7 (1989) (setting forth and explaining consumer-based reasons for this dilemma).

329. Usually this dilemma is resolved at a time when regulators are attempting to respond to a large bank failure (and to prevent future failures), when solutions are not apt to be thoughtful. Since 1974, cooperation among international banking regulators and the harmonization of bank regulation has resulted only from successive financial disruptions, not from a coordinated plan of changes agreed upon by regulators.

330. DALE, *supra* note 37, at 182.

331. *Id.* at 183. This is known as the "equity principle." *Id.*

332. *Cf. id.* at 183 (suggesting the abolition of "the principle of parental responsibility by preventing risk transfers from foreign banking establishments to their parent institutions").

333. *See id.* at 181.

334. Hess, *supra* note 33, at 184.

order to operate safely and soundly. Broad principles, such as those stated in the Concordat and the Revised Concordat, are no longer sufficient in the complex world of global banking. The Basle Committee has taken a step towards more stringent regulation by turning these principles into minimum standards. The new standards reinforce the principle of consolidated supervision and state that the home regulator of an international bank should be its primary regulator.[335] Still, further efforts by the Basle Committee and international bank regulators are necessary to achieve "global arrangements with the proper balance between binding rules and discretionary powers."[336] International banking regulators need to agree on the meaning of common terms and concepts in international bank regulation and then harmonize domestic bank regulation even more than the new Minimum Standards have done.

The EC directives on bank regulation[337] show promise in their attempt to create the proper balance between harmonization of banking law and local autonomy in implementing and interpreting the law. The directives set substantive standards that each member nation must follow, while leaving domestic bank regulators significant power to regulate banks. Furthermore, these directives encourage regulators to exchange information with their foreign colleagues and to examine banks outside their jurisdiction if necessary. The requirement of one regulator supervising the entire bank, even when it operates in several countries, necessitates the exchange of information about the bank. Simply determining which regulator will take the lead role in supervising a bank with operations in several countries requires cooperation among national regulators.

In addition to exchanging information and engaging in day-to-day supervision, regulators need to create an early warning system for potential financial disruptions. The increased cooperation among regulators contemplated by the Basle Committee may help meet this goal. The aid of auditors who witness questionable banking practices would also improve early detection of problem banks. Canadian law, for instance, allows auditors to communicate their concerns directly to bank regulators and may

335. MINIMUM STANDARDS, *supra* note 3, at 3-4.

336. Leigh Bruce, *BCCI: A Case for Global Banking Rules*, INT'L HERALD TRIB., July 26, 1991 (quoting Richard Dale).

337. *See supra* note 230.

be a useful model for bank regulation in other nations.[338]

Finally, while no system of international bank regulation can guarantee the prevention of deliberate fraud, international banking as it currently stands is weakly regulated. The Basle Committee's Minimum Standards are a step towards more stringent regulation of international banks, but their effectiveness depends on both the passage of national laws that accurately reflect the standards' substantive provisions and the cooperation of domestic regulators in enforcing these provisions. The effectiveness of the new standards remains to be seen.

The harmonization of international bank regulation has moved into a new stage of development, as national regulators attempt to allocate supervisory responsibility among themselves and perhaps to international entities. This evolution of bank regulation is by no means complete. As banking becomes more global, international bank regulation must develop and keep pace with both the geographic expansion and the growing operational complexity of international banks.

---

338. Bank Act, R.S.C., ch. B-1, § 242(1)-(4) (1985) (Can.) (requiring private auditors to provide regulators with a copy of all reports they make to bank officials regarding "any transactions or conditions affecting the well-being of the bank that . . . are not satisfactory and require rectification"). *Id.* at § 242(3).