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Statement of the Shadow Financial Regulatory Committee
on the
Bank of Credit and Commerce International
September 16, 1991

The central question raised by the collapse of the Bank of Credit and Commerce International (BCCI) is why it took so long for its problems to be detected and acted upon by bank regulators. A second question is how regulation and supervision of foreign banks should be changed.

BCCI allegedly committed fraud on a global scale. Fraud is notoriously difficult for regulators to detect. But it is especially difficult to discover when fraudulent transactions cross national borders and can be concealed through the use of secrecy havens. BCCI, like Banco Ambrosiano nearly a decade earlier, was cleverly structured to impede careful supervision. Indeed, its headquarters were established in countries with weak supervisory authorities, strong secrecy laws, and neither lenders of last resort nor deposit insurers who would have financial reasons to be concerned about the solvency of banks that are chartered in their jurisdiction.

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Apparently banks and regulatory authorities in many countries were deeply concerned about BCCI several years before its collapse. Indeed, an international "regulatory college" was established several years ago to monitor BCCI. But in the absence of strong supervisory control over the parent, this improvised mode of cooperation among national regulators proved ineffective. Prior to the bank's seizure, sophisticated participants in financial markets acted to protect themselves from BCCI's weakening condition. This information was not shared by the regulators with thousands of less sophisticated depositors, many of whom sustained ruinous losses.

Institutions such as BCCI seriously challenge the U.S. tradition of permitting relatively free entry to foreign banks. When a foreign bank's global operations are not subject to effective supervision in its home country, the bank should be permitted to enter only through a subsidiary which can be monitored by the U.S. supervisory authorities. Even though BCCI succeeded surreptitiously in obtaining a charter for a U.S. subsidiary, so far available evidence indicates little damage to American depositors. Other modes of entry -- such as branches, state-chartered agencies, or representative offices -- facilitate evasion of scrutiny by U.S. regulatory authorities and may increase the ease with which a rogue bank can engage in money laundering and other nefarious activities.

The BCCI collapse contains important implications for the coordination of international regulation and supervision. Clearly the Bank for International Settlement Concordat, negotiated among the banking authorities of twelve leading nations, needs to be strengthened with regard to the sharing of information. It should also be extended to all other important banking centers. Depository institutions should not be allowed to buccaneer under flags of convenience.

In addition, this scandal should cause the European Community to reconsider its allocation of responsibility between parent and host country supervisory authorities. The Second Banking Directive assigns responsibility for supervising the solvency of a bank to the chartering country, but places responsibility for providing deposit insurance with the host country. This division of responsibilities

undermines incentives for effective supervision. The parent authority is likely to be more attentive in monitoring the solvency of an institution if it shares the risk of loss with the institution's creditors.

It is the Committee's policy that members abstain from participation on policy statements in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, John D. Hawke, Jr. abstained from voting on this statement.

