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Article on

AN ANALYTICAL STUDY ON SUPERVISION STRUCTURE OF INTERNATIONAL BANKING

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ABSTRACT

The Basel Committee on Banking Supervision (BCBS) publishes Basel Norms for international banking regulations. These standards aim to harmonise banking legislation throughout the world while also enhancing the international banking system. The BCBS is made up of 27 representatives from all around the world, including India. Basel I, II, and III are the three guidelines that the Basel Committee has released to achieve its goal. The Bank for International Settlements (BIS) is an international organization that assists central banks and other financial authorities around the world in gaining a better understanding of the global economy, encouraging international cooperation, and assisting them in achieving global monetary and financial stability. The BIS facilitates monetary and financial stability by acting as a forum for discussion and a platform for cooperation among policymakers through the Basel Process. The Core Principles for Effective Banking Supervision are the de-facto minimal benchmark for sound banking system prudential regulation and supervision. Countries use them as a benchmark for assessing the quality of their supervisory systems and identifying future work to attain a baseline level of sound supervisory procedures. The first part deals with application and consistency of core principles, second part deals with the need of adequate international standards to provide stability for low and lower middle-income countries, third part elucidates about the Bank of International Settlement initiative in strengthening the cross-border financial regulation in the global financial regulatory system and the last part deals with the Conclusion and suggestions.

Keywords: Basel, Banking, Core Principles, cross border, regulation

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INTRODUCTION

Banking has internationalised in the last two decades in such a way that domestic oversight no longer offers an appropriate basis for the regulation of banking operations. The shortcomings in international banking supervision have been exposed in recent circumstances – including many failures in Europe and the US bank and dramatic and unrestricted increases in private credit to developing countries.[1] These holes have not yet been filled by international collaboration between banking supervisors, which began to expand a decade ago. Therefore, as part of the wider search for international financial regulation, the search for stronger global banking regulation begins. Different institutions deal with different facets of the supervision of international banking. While no agency governs international banking directly, certain institutions have considerable effect on this legislation.[2] The International Finance Institute, the International Development Bank, the Cooke Committee and other monitoring bodies, and the European Economic Community Contact Group are these organisations. In addition, banks, such as "the International Monetary Fund (IMF), the World Bank, the Paris Club" and private banking consultation boards, who are not specifically monitored by the banks, participate in international lending operations. Since the mid-1960s, there have been major shifts to the International banking and financial scene. However, the improvements that have occurred since 1984 were remarkable in terms of their speed and width. [3] The mission of the "Bank of International Settlement" is to assist central banks, through international cooperation, in the promotion of financial and monetary stability, and to serve as a Central Bank banking bench.

Two distinct sets are concerned about international banking analysis; one concerns the issues relating to industrial organisations and the pattern of the expansion of foreign branches and subsidiaries of banks with headquarters in the United States, the United Kingdom, Japan and several other industrialised countries and the nature of their advantages in relation to these subsidiaries and branches; The second collection, international finance, includes the involvement of banks both from their headquarters and from their global branches and subsidiaries in transnational and trans-departmental financial flows.[4] There are few

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[1]READ "FOLLOWING THE MONEY: U.S. FINANCE IN THE WORLD ECONOMY" AT NAP.EDU, , https://www.nap.edu/read/2134/chapter/3 (last visited Mar 4, 2021).
[2] Emily Jones & Peter Knaack, *Global Financial Regulation: Shortcomings and Reform Options*, 10 GLOB. POLICY 193–206 (2019).
[3] James V Hackney & Kim Leslie Shafer, *The Regulation of International Banking: An Assessment of International Institutions* 23.
[4] Robert Z. Aliber, *International Banking: A Survey*, 16 J. MONEY CREDIT BANK. 661–678 (1984).

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international institutions, despite the attention paid to international banking, rather international banks are a subset of domestic banks with a significant number of overseas branches and subsidiaries. The "Core Principles for Effective Banking Supervision", ("core principles") are "the de-facto minimum standard for the prudential regulation and supervision of Banks and banking processes." The Committee revised and updated the core principles in March 2011 mandated by "the Core Principles Group2". During the 2020 Saudi Arabia Presidency, the G20 called improving cross-border payments a priority. ***"Smooth Cross-border payments will offer broad advantages for citizens and economies around the world, faster, cheaper, more open and equitable, promoting economic growth, international trade and global development and financial integration.[5]"*** The economic consequences of the Covid-19 pandemic would inevitably impact the short-term payment environment, but it is necessary to retain the impetus for identifying and implementing systemic changes in the post pandemic global economy's cross-border payment structures.

I. APPLICATION AND CONSISTENCY OF "CORE PRINCIPLES"

The "Core Principles for Effective Banking Supervision", ("core principles") are the "de-facto minimum standard for the prudential regulation and supervision of Banks and banking processes"[6]. The Committee revised and updated the core principles in March 2011 mandated by "the Core Principles Group2"[7]. The mandate of the committee was to conduct an analysis, taking into consideration significant developments since October 2006 on global financial markets and regulatory environment, including lessons 3 post crises to promote sound surveillance systems. The aim was to ensure that the core principles were continuously relevant ***"to foster effective banking supervision in all countries over time and in evolving environments".[8]***

A. Structure of "Core Principles"

A separate assessment framework was added to the preceding iterations of the core principles and laid out the standards to measure compliance with "the core principles". This revision incorporates the assessment framework in a single document reflecting the critical

[5] Katia D'Hulster, *Cross Border Banking Supervision: Incentive Conflicts in Supervisory Information Sharing between Home and Host supervisors* 39.
[6] BASEL COMMITTEE ON BANKING SUPERVISION & BANK FOR INTERNATIONAL SETTLEMENTS, CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (2012), http://www.bis.org/publ/bcbs230.pdf (last visited May 9, 2021).
[7] *Id.*
[8] *Id.*

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interdependence and common use of core principles and evaluation criteria. The principles have been reorganized in such a manner: "**Principles 1-13"** cover supervisory rights, duties and roles, and **"Principles 14-29"** cover the "*supervisory expectations of banks and emphasise the importance of good corporate governance, risk control and the adherence to supervision requirements".* This reorganisation shows the disparity between what supervisors do and what the banks expect.[9]

B. <u>Evaluation of "Core Principles"</u>

The core principles set the level of sound monitoring practises that supervisors should use as a reference point to evaluate the effectiveness of their monitoring systems. The "IMF" and the "World Bank" both evaluate the efficiency of banking supervisory regimes and practises in countries under the Financial Sector Assessment Program (FSAP). The revision of the core principles retained the prior tradition of using as part of the evaluation methodology both critical requirements and additional criteria. Important standards for sound supervisory procedures lay down minimum conditions that are universally applicable to all countries.

However, the assessment of a country against the basic parameters must recognise that the monitoring activities must be in keeping with the risk level and structural value of the supervising banks. In other words, the evaluation should take into account the context in which monitoring activities are implemented. Both standards for evaluation are supported by the "concept of proportionality" even though they are not always strictly related.[10]

C. <u>Consistency as well as Implementation of "Core Principles"</u>

The Bank sector is an integral part of the financial system. In undertaking this analysis of its "core principles", the Committee has aimed to ensure that the corresponding requirements for "securities and insurance"[11] (which themselves have been subject to recent reviews) along with anti-money laundering and transparency are maintained where appropriate. However, there will certainly be differences, since "key risk areas" and monitoring targets vary from sector to sector. Supervisors should consider the role of the banking industry in promoting and encouraging real economy productivity practises in the implementation of the core principles.[12]

[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*

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II. THE NEED OF ADEQUATE INTERNATIONAL STANDARDS TO PROVIDE STABILITY FOR "LOW AND LOWER MIDDLE-INCOME COUNTRIES" (LMICs)

BASEL-I

BCBS introduced the Basel capital accord, often known as Basel 1, as a capital measurement system in 1988. It was essentially solely concerned with credit risk.

It established capital requirements for banks as well as the risk weighting framework. The capital requirement was established at 8% of risk-weighted assets as a minimum (RWA). RWA refers to assets having varying risk profiles. When contrasted to personal loans, which have no collateral, an asset secured by collateral has fewer risks. In 1999, India implemented the Basel I guidelines.

BASEL-II

The Basel II guidelines, which were believed to be the refined and reformed versions of the Basel I Agreement, were issued by BCBS in June of 2004. The rules were built around three pillars, as the committee refers to them as - Capital Adequacy Requirements: Banks should have minimum capital adequacy requirement of 8% of risk assets at all times. - Supervisory Review: Banks were required to create and employ stronger risk management strategies in order to monitor and manage all three categories of risks that a bank encounters, namely credit, market, and operational risks. - Market Discipline: This necessitates more stringent disclosure obligations.[13] Banks must report their CAR, risk exposure, and other information to the central bank. The Basel II regulations have yet to be completely applied in India and overseas.

BASEL-III

Basel III standards were published in 2010. In reaction to the financial crisis of 2008, certain recommendations were implemented. The system needed to be strengthened further since banks in developed economies were undercapitalized, over-leveraged, and reliant on short-term borrowing. In addition, Basel II's size and quality of capital were judged insufficient to control any additional risk. The Basel III standards aim to make most banking operations, such as trading book activities, more capital-intensive. The rules focus on four key banking parameters:

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[13] History of the Basel Committee, (2014), https://www.bis.org/bcbs/history.htm (last visited May 8, 2021).

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capital, leverage, financing, and liquidity, with the goal of promoting a more robust banking sector.

A. Issues with the Implementation of "Basel II and Basel II"I in LMICs

Overall, the evidence available indicates that while there are strong grounds for enhancing banking supervision in "LMICs", it is far from clear that the "Basel criteria" are the best solution. LMICs have specific difficulties in implementation of Basel II and III.[14]

1. **Financial gaps in infrastructure**-Also the simplified parts of Basel II and III have been presumed to have a degree of financial growth and the existence of infrastructure that lacks in many LMICs. The standardized approach to credit risk under Basel II, for instance, depends on credit rating agencies but many LMICs do not have national rating agencies and global rating agencies only penetrate larger companies.
2. **Poor match against threats to financial stability**-In "Basel II and III", financial threats that may not be important in simplified financial systems of LMICs, like counterparty risk for exposures to derivatives or liquidity mismatches resulting from "wholesale funding", are addressed. By contrast, the main macroeconomic threatening to financial stability in LMICs such as fluctuations in international capital flows and significant changes in international commodity prices cannot be adequately addressed.
3. **Resource constraints on human and finances-** The "Basel II and III" implementation entails significant transition costs both for banks and regulators. Costs are based on the complexity of the Basel Rules rather than on regulatory "stringency–capital requirements in most LMICs are greater than Basel III"[15]. The introduction of new global norms exacerbates regulatory resources constraints which in many LMICs are already essential.
4. **Increased asymmetry of information. -** In many LMICs, remunerative gaps and brain drain into the private sector provide regulatory authorities with problems already. Asymmetries of information can be compounded by implementing the more complex aspects of Basel II and III, increasing the complexity of regulatory arbitrage.
5. **The regulatory agenda has been distorted-** Basel II and III implementation can remove limited resources from the regulatory agency's other priorities. Basel II/III implementation

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[14]HANDBOOK OF FINANCE AND DEVELOPMENT, (2018), https://www.elgaronline.com/view/edcoll/9781785360503/9781785360503.xml (last visited May 8, 2021).
[15] Mind the Gap, *supra* note 10.

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does not explicitly fix the underlying regulatory framework vulnerabilities. International norms, as structured, are a complex, not inherently powerful regulatory regime.

6. **Credit composition deterioration**- Banks implementing Basel II and III should be encouraged to shift their portfolio from sectors of the economy that are critical to inclusive economic growth. For example, higher risks from lending to SMEs do not properly reflect the potential benefit of diversification away from certain big enterprises and may deter financial inclusion.

B. Solution to the proper implementation of "Basel II and Basel III" in LMICs

1. **Consider the threats of Basel II/III execution as they are overly ambitious-** Prioritize main financial difficulties and evaluate to what degree the implementation of Basel can intensify credit rating agency dependence, information asymmetry between regulators and banks, and economic sectors exclusion, including small- and medium-sized enterprises.
2. **A selection of "Basel components" may be implemented-** The Basel Consultative Group is responsible for facilitate communication between "members and Non- Members"[16], but only a few of "LMICs" are consistently under-represented. Therefore, the design of international norms does not take into account LMICs. Following the global financial crisis, the G-20 called for standard making organisations to examine the consequences of "international financial norms" for developing countries and further open decision-making mechanisms. The "***Financial Stability Board"*** developed an internal workstream on the impact on emerging markets and developing economies of the reform of regulatory systems. Six regional consultative groups have already been formed but discussions with regulators have the feeling that these bodies have less insight into the creation of international standards, functioning and is instead a forum for regulators to resolve issues related to implementation.[17]
3. **Implementation of "proportional rules"-** Regulators can refrain from copying "Basel II and III" prudential requirements. They should use their in-depth knowledge of the domestic financial system to draw up guidelines more suited to local conditions than the "Basel template". "In the Philippines, for instance, regulators have adjusted risk weights of SMEs to minimise bank incentives to move away from lending to such enterprises".[18]
4. **Adjust the banking regulatory perimeter**- Regulators can change the perimeter of the regulations of banking to allow only large internationally active banks, and simple (though

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[16] Cassidy, *supra* note 20.
[17] *Id.*
[18] *Id.*

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not generally less stringent) guidelines apply to small domestic banks, to regulations consistent with international norms. This technique is common in countries which belong to the Basel Committee countries. Regulators should draw on the abundance of knowledge within their peers to change international norms. Although regulators in many developed countries seek advice first from international institutions, they should also strive to make peer-to-peer learning systems strong.[19]

III. BANK OF INTERNATIONAL SETTLEMENT (BIS) INITIATIVE IN STRENGTHENING "THE CROSS-BORDER FINANCIAL REGULATION IN THE GLOBAL FINANCIAL REGULATORY SYSTEM"

During the 2020 Saudi Arabia Presidency, the G20 called improving cross-border payments a priority. Cross-border payments will offer broad advantages for citizens and economies around the world, faster, cheaper, more open and equitable, promoting economic growth, international trade and global development and financial integration. The economic consequences of the Covid-19 pandemic would inevitably impact the short-term payment environment, but it is necessary to retain the impetus for identifying and implementing systemic changes in the post pandemic global economy's cross-border payment structures.

By far, "cross-border payments" are more complicated than "domestic payments". They have more as well as multiple players, time areas, jurisdictions and regulations. The long-term frictions in them are on the agenda for several years, as they need a strong collaboration and are a multidimensional challenge. It has given a significant global impetus because it is a focus of the G20.

A route map for building blocks to strengthen cross-border payments was established and built in by the Bank Of International Settlement (BIS) using the following procedure.[20]

STAGE-1 "ASSESSMENT"- In cooperation with related international organisations and standard-setting bodies, the Financial Stability Board (FSB) has taken into account the existing practices of the Findings in April 2020. In December 2019, The Committee on Payments and Market Infrastructure (CPMI) set up a task force to focus on cross-border payments and contributed to the Stage 1 assessment report by means of members. Market participants have

[19] Carvalho et al., *supra* note 6.
[20] Enhancing cross-border payments: building blocks of a global roadmap, 11 (2020).

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verified during industry outreach the difficulties and frictions found and accepted the assessment that cross-border wholesale/retail payments (incl. remittances) gets affected with the same forms of friction, although the magnitude of the effect which differ. Addressing those frictions will improve international payments for all end users worldwide.

STAGE-2 "BUILDING BLOCKS"- 'The Committee of Payments and Market Infrastructures'[21] (CPMI) has worked to establish the "building blocks" of the response to enhance the existing "global cross border payment arrangements"[22]. These building blocks identify ways in which further analysis will help to move towards a better cross-border payment system and remove unwanted obstacles. A holistic approach was adopted by the task force which included payments related to retail and wholesale. The study conducted a qualitative review for each building block, examining: "*(i) the anticipated effect on the Seven frictions; ii) the interdependencies with the other building blocks; iii) the difficulty and potential timing of its delivery; and (iv) the potential threats to smooth functioning of payment processes, monetary stability and financial stability arising from the building block*."[23]

STAGE-3 "ROADMAP"- On the basis of its previous phases, the FSB will coordinate the development of a road map with the CPMI as well as with other international organisations and standard-setting bodies. The FSB would report on the realistic measures and time periods necessary to do so to the G20 in particular. "A combined report to the G20 FMCBG meeting in October 2020" will be presented for the three-stage process.

CONCLUSION AND SUGGESTIONS

The crisis due to Covid-19 has shown how much online and in real time we can now live and work in. Buying trillions of monies, providing trillions of loans to banks, increasing internet shopping by 50% in the United Kingdom and doubling online supermarket buying has become a key issue for central banks. Technology has progressed at disruptive speed, we have found.

There is a need to function in the five main fields. This requires a dedication to a common view of the public and the private sector. They have greater coordination of the global frameworks for policy, monitoring and supervision. These involve a number of necessary changes to current payment processes, such as improving service hours, increasing connectivity and more effectively leveraging liquidity. It aims to ensure that various payment processes can

[21] *Id.*
[22] D'Hulster, *supra* note 5.
[23] *Id.*

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communicate easily with each other. This study also indicates that more disruptive innovations, such as digital central bank currencies and global "stablecoins," can be incorporated, supported by some reserved assets. The low middle-income countries looked for alternatives in order to have a smooth baking system rather than being dependent on Basel norms. A strong supervision is needed to adhere with the Core Principles.

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