INSTITUTE *of*
INTERNATIONAL FINANCE

June 2020

Supervisory coordination during the COVID-19 pandemic: observations from the global banking industry

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Box 1 – Paper in brief

- *During the COVID-19 pandemic, supervisory coordination is a necessary condition to ensure that the efforts at global prudential policy coordination deliver the desired effects at the level of individual firms and the customers they serve in different markets.*
- *Supervisory mechanisms and relationships have been operating throughout the pandemic. Nevertheless, it is possible for fragmentation pressures to emerge during stress situations such as this, which is a global shock with an uncertain medium- and long-term impact.*
- *Modern global supervisory frameworks are designed to mitigate tensions in the inherently complex relationship between home and host authorities.*
- *There may be opportunities to continue enhancing supervisory cooperation to boost efficiency, coordination and certainty for internationally active banks and their supervisors and, ultimately, to support the global economy through the pandemic and the recovery phase.*

Context and Overview

The COVID-19 pandemic presents a tremendous challenge to policymakers around the world. Policymakers have been responding with large-scale, creative, and broad-based measures in the face of this unprecedented health crisis. These include targeted regulatory and supervisory measures to provide the necessary conditions for banks and other financial firms to continue serving their clients by addressing the liquidity, credit, investment and risk management needs of retail and corporate customers.[1]

The IIF has welcomed coordinated policy action through the global standard setting bodies. Since the start of the pandemic, the IIF has called on the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), as well as their respective member authorities, to coordinate the policy response

[1] For a summary of the measures taken by the global standard setting bodies, G20 members and other leading financial jurisdictions visit https://www.iif.com/COVID-19 and navigate to the 'COVID-19 Regulatory Measures' file, which is updated daily.

where possible. There has been very welcome evidence of international dialogue and efforts at policy coordination through the global standard setting bodies.[2]

Supervisory coordination is a necessary condition to ensure that the efforts at global prudential policy coordination deliver the desired effects at the level of individual firms and the customers they serve in different markets. In the case of banks that operate across borders, it is essential that supervisors from home and host authorities[3] *"share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations"*.[4]

Nevertheless, it is possible for fragmentation pressures to emerge during crisis situations such as the COVID-19 pandemic, which is global in nature with an uncertain medium- and long-term impact. Authorities are naturally focused on the stability of home markets and other local jurisdictional prudential priorities and may have incentives to take unilateral action to maximize the strength of the group entities under their supervision, even if this could potentially reduce the resilience of the group as a whole or inhibit the group's ability to draw on its capital and liquidity buffers to serve the real economy. This can lead to a so-called "prisoner's dilemma" situation, where all authorities are collectively worse off by acting unilaterally rather than cooperatively.[5] A careful balance therefore needs to be struck between fungibility and excessive pre-positioning of resources, a point that was noted in the 2019 work on market fragmentation undertaken by the FSB and IOSCO under a mandate from the G20.[6] That work acknowledged the importance of global cooperation and coordination as important mechanisms to mitigate fragmentation.

Modern global supervisory frameworks are designed to mitigate tensions in the inherently complex relationship between home and host authorities. Mechanisms – such as supervisory colleges (see Box 2) – exist to aid communication and coordination among banking supervisors globally in normal times and in stressed conditions. In response to the unprecedented global shock due to COVID-19, supervisory mechanisms should now be fully mobilized to boost efficiency, coordination and certainty for internationally active banks and their supervisors and, ultimately, to support the real economy through this stress period. This short note discusses the importance of enhanced supervisory coordination through the pandemic and the recovery phase.

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[2] See for example, FSB 2020. "*COVID-19 pandemic: Financial stability implications and policy measures taken*" (April 15), BCBS 2020. "*Basel Committee coordinates policy and supervisory response to Covid-19*" (March 20) and IOSCO 2020. "*Securities regulators coordinate responses to COVID-19 through IOSCO*" (March 25). And the FSB engagement with the private sector, FSB 2020. *"Financial policymakers discuss responses to COVID-19 with the private sector"* (May 26).

[3] The home country supervisor is the authority responsible for the oversight of the group on a consolidated basis. A host supervisor is principally responsible for the regulation of the entity or entities of a foreign banking group (e.g. subsidiary or branch) that is/are located in the host supervisor's jurisdiction.

[4] This is a summary of Core Principle 13 from the BCBS 2012 "*Core Principles for Effective Banking Supervision*" (September).

[5] The loss of flexibility to move resources within a group can give rise to 'misallocation risk' with material negative implications for group resilience. See IIF 2019. "*The Value of Cross-Border Banking and the Cost of Fragmentation*" (November 13) and Ervin 2018. "*Understanding 'ring-fencing' and how it could make banking riskier*" (February 7).

[6] FSB 2019. "*FSB Report on Market Fragmentation*" (June). Further discussed in Box 2, below.

Opportunities for enhanced supervisory coordination during the COVID-19 pandemic

In general, international supervisory communication and cooperation have increased in recent years, particularly with the advent of modern supervisory colleges (described in more detail in Box 2). The establishment and operation of colleges has led to the development of strong relationships, protocols and legal arrangements among a banking group's home and host supervisory authorities. Colleges may also have contributed to an increased amount of multilateral and bilateral communication and coordination among a group's principal supervisory authorities. Sharing information and increasing understanding of different authorities' prudential and supervisory approaches is likely to have contributed to increased trust among authorities.

While these relationships and mechanisms have been operating through the COVID-19 pandemic, there may still be opportunities for additional and enhanced coordination among supervisory authorities. An enhanced degree of coordination is beneficial from the perspective of increasing the effectiveness of policy measures aimed at addressing crisis-related challenges and alleviating operational pressures at supervised firms, which otherwise could divert resources away from responding to the crisis.

Below is a summary of observations and some recommendations for home and host supervisors, as well as the BCBS, to continue enhancing coordination in real time. These are intended to help achieve the following:

- *Improve information flows*
- *Reduce impediments to the fungibility of group resources*
- *Provide greater supervisory certainty for banks*
- *Facilitate the transition "back to normal" for individual banking groups*
- *Continue to enhance supervisory best practices.*

❖ **Some global banks observe that there could be greater information sharing between home and host authorities at this time, and home authorities could facilitate greater efficiency in terms of information requests.**

Firms have seen a significant increase in supervisory communications and *ad hoc* information requests from their supervisors during the pandemic. While it is logical and understandable that supervisors will need higher frequency information during a crisis period, firms sometimes receive the same or very similar requests from different supervisory authorities. This applies both to the home and host supervisors that participate in a bank's core supervisory college and host supervisors outside of the core college. In addition, firms note that certain requests are very granular and sometimes come without clear reporting guidance. This creates challenges for firms as they try to comply with requests quickly, including under what are currently often remote and non-traditional working conditions.

Notwithstanding the right of host supervisors to request information from a firm directly,[7] it would reduce the operational pressures on individual banks in the present situation if home supervisory authorities took further steps to centralize and streamline information and data requests to the extent possible under current information sharing arrangements. For example, home regulators could issue non-objection statements to firms for sharing relevant group-level information with host regulators. Looking further beyond, supervisory authorities could seek to further harmonize data confidentiality standards, leveraging established experience in international reporting standards and protocols to allow a freer flow of information between authorities.[8]

- **As the situation continues to evolve in all countries, home authorities can ensure that key topics continue to be discussed among a banking group's principal supervisory authorities. Dialogue and coordination are crucial for issues such as intra-group transfers and the usability of capital and liquidity buffers.**

The BCBS has been coordinating from a policy perspective since March 2020, including issuing a press release confirming that the Basel III capital and liquidity buffers are designed to be used in periods of stress,[9] and announcing other measures to alleviate the impact of COVID-19 on the global banking system.[10] Home/host supervisory coordination is a precondition to ensuring that individual banks can use their buffers effectively across the entire group without encountering supervisory barriers to capital or liquidity reallocation decisions that can render buffers *de facto* unusable. It is therefore important for authorities to work together on these topics as, in most cases, neither the home nor host authority has sole responsibility for oversight and assessment of these issues.[11] Home authorities can take the lead in convening discussions among supervisory authorities of key topics such as the supervisory assessment of a banking group's resource allocation.

- **Supervisory coordination should be maintained through the different phases of the pandemic to ensure that global banks have supervisory certainty throughout.**

Supervisory discussions, including (virtual) college meeting agendas,[12] should continue to adapt dynamically over time so that the relevant risks are being discussed through different phases of the pandemic and the associated economic cycle. Specific and timely feedback to banking groups about discussions among their supervisors, to the extent that this would be possible, would help firms to stay informed about and understand any concerns across their

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[7] For example, as mentioned in the BCBS 2014 "*Principles for Effective Supervisory Colleges*" (June). Principle 6: Interaction with the institution.

[8] Although information sharing is a BCBS principle for effective supervisory colleges, there are known issues around "real or perceived" legal constraints that can hamper information sharing in supervisory colleges. See BCBS 2017. "*Progress Report on the Implementation of Principles for Effective Supervisory Colleges*" (December). Quote taken from page 7.

[9] BCBS 2020. "*Basel Committee coordinates policy and supervisory response to Covid-19*" (March 20).

[10] All of the BCBS measures are catalogued in the IIF's table of COVID-19 Regulatory Measures, see footnote 1.

[11] BCBS 1983. "*Principles for the Supervision of Banks' Foreign Establishments*" (May) (also known as the Basel Concordat) and still in force today discusses the allocation of responsibilities between the home authority and host authorities for the supervision of solvency, liquidity and foreign exchange operations and positions. The precise allocation of responsibilities depends on the type of entity (e.g. branch or subsidiary) and the aspect in question (for example, there are different considerations between solvency and liquidity).

[12] Where possible, colleges can and do make use of technology to convene virtual meetings and calls as necessary, including with the bank's senior management and relevant experts.

supervisory authorities, and would help firms to assess emerging challenges quickly (e.g. from sector-wide risks).

- **A coordinated supervisory response will be important throughout the crisis period, including in the recovery phase.**

Equally as important as a clear and coordinated policy and supervisory response at the beginning of a severe stress period is a coordinated approach through the stress and, ultimately, the transition "back to normal". For example, understanding how quickly firms need to replenish capital and liquidity buffers will affect the ability of firms to fully respond now to countercyclical or extraordinary policy measures. Supervisory coordination will be essential so that home and host authorities take a synchronized approach with firms, particularly on decisions and actions that are of a group-wide nature. On this matter, members of the Basel Committee have recently issued a helpful statement that *"supervisors will provide banks sufficient time to restore buffers taking account of economic and market conditions and individual bank circumstances"* in line with the objectives of capital and liquidity buffers in the Basel III framework.[13]

- **In addition to the above recommendations to individual supervisory authorities, the Basel Committee could further support its member authorities and deliver its policy objectives by gathering information and promoting best practices in this area.**

While supervisory cooperation is firm-specific by nature, the BCBS can continue to play an active role to promote best practices in cross-border supervisory coordination through the crisis. Through their engagement with member authorities, the BCBS can promote good cross-border supervisory practices and discourage any fragmentary actions they might observe. Similar to the recent Basel Committee statement about restoring buffers, the BCBS could also consider further ways to facilitate consistent and clear supervisory communications to banks on matters relating to the Basel framework, for example on the usability of regulatory buffers across entities in a global banking group.[14]

At a future date, the BCBS could evaluate the degree of home/host coordination and any prevailing obstacles observed during this stress period with a view to improving overall supervisory coordination in stress and business as usual conditions. Topics to consider in such a review could include the arrangements for sharing confidential information between

[13] Basel Committee 2020. *"Basel Committee meets; discusses impact of Covid-19; reiterates guidance on buffers"* (June 17).

[14] While the Basel Framework is intended to apply *"on a consolidated basis to internationally active banks"*, the Basel Framework text recognizes that *"to supplement consolidated supervision, it is essential to ensure that capital recognised in capital adequacy measures is adequately distributed amongst legal entities of a banking group. Accordingly, supervisors should test that individual banks are adequately capitalised on a stand-alone basis."* Extract from section 10.4 of the Scope and Definitions section of the consolidated Basel Framework. As an example of clarificatory public communications from the BCBS, see BCBS 2019. "*Newsletter on buffer usability*" (October 31).

supervisory authorities, consistency in supervisory reporting requirements and the home/host supervisory assessment of banking group resource allocation.

Box 2 – Background on cross-border bank supervisory colleges

Supervisory colleges are working groups of regulatory supervisors formed to enhance global cooperation. Large cross-border banks have so-called 'supervisory colleges' to support the supervision of their global activities and encourage cooperation and coordination among the group's supervisory authorities in different jurisdictions. Colleges are permanent fora for coordination, cooperation and information exchange. Other formal groupings exist to increase cooperation between regulatory authorities of global firms, including narrower colleges of the supervisors in a group's major operating jurisdictions.[a] The concepts in this paper apply generally to all multilateral supervisory structures and discussions.

According to the BCBS, the overarching objective of a supervisory college is to assist its members in developing a better understanding of the risk profile and vulnerabilities of a cross-border bank, and to provide a framework for addressing key topics that are relevant to the supervision of the banking group.[b] An important aspect of college interaction is the formal, physical college meeting that usually take place at least once per year for each large cross-border bank. However, the college structure is meant to encourage a much broader and ongoing communication and information flow between supervisors. For example, the BCBS *Principles for Effective Supervisory Colleges* instruct that college objectives *"should be achieved on an ongoing basis and not just during the meetings of the colleges. Supervisory colleges are conceived as a set of ongoing relationships among supervisors, covering any contact among them (e.g. teleconferences, videoconferences, letters, e-mails and via secure websites)."*[c] This distinction is particularly important during the current pandemic, when ongoing communication is crucial and physical meetings currently either challenging or impossible.

With the focus of the G20, FSB and IOSCO over the past two years on the issue of market fragmentation, reducing and resisting regulatory and supervisory fragmentation between markets is an ongoing global priority for the public sector and financial industry.[d] Global cooperation and coordination have been acknowledged as important mechanisms to mitigate fragmentation. The FSB has recognized that *"greater cross-border communication and information sharing among authorities, including via existing fora such as supervisory colleges and crisis management groups (CMGs), and the alignment of data collection"* have the potential to address market fragmentation.[e]

Box 2 endnotes:

[a] See BCBS 2017. "Progress Report on the Implementation of Principles for Effective Supervisory Colleges" (December). Annex 3 explains the concepts of core colleges, expanded/extended colleges, regional colleges, etc.

[b] BCBS 2014. "Principles for Effective Supervisory Colleges" (June). See Principle 1 on College Objectives.

[c] Ibid.

[d] FSB 2019. "FSB Report on Market Fragmentation" (June) and "Updates on the Work on Market Fragmentation" (November). IOSCO 2019. "Market Fragmentation & Cross-border Regulation" (June). IIF 2019. "IIF Report on Market Fragmentation and Need for Regulatory Cooperation" (January) and "The Value of Cross-Border Banking and the Cost of Fragmentation" (November).

[e] FSB 2019. "FSB Report on Market Fragmentation" (June).