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PUTTING THE SUPER BACK IN THE SUPERVISION OF INTERNATIONAL BANKING, POST-BCCI

DANIEL M. LAIFER

INTRODUCTION

Historically, banks that were chartered in a given country conducted most of their business in that domestic market. In the past decade, however, financial institutions both in the United States and in other nations have rapidly expanded their overseas offices.¹ Indeed, banking transactions have become increasingly global, setting the stage for even greater transnational financial activity in the 1990s.² This cross-border presence of banks, though, has disturbing potential to increase the risk of bank failure and reduce the soundness of international banking.³

Regulation of this now highly mobile, innovative, and risky financial environment requires supervisory finesse. While banking has become international, supervision has not. Recent international bank scandals, particularly the ignoble closure of the worldwide operations of the Bank of Credit and Commerce International ("BCCI"),⁴ illustrate the disastrous effects of deficient supervision of the international banking system. While BCCI and the U.S. Department of Justice have reached a monetary settlement, further investigations into what some observers believe to be the biggest financial fraud in history will undoubtedly continue for

1. The long period of prosperity in the 1960s and early 1970s led to substantial increases in global operations of industrial and commercial companies. This, in turn, caused an increase in international banking activity, since banks tend to follow their customers. See Quinn, *Cross-Border Regulation of Banking*, in *Legal Issues of Cross-Border Banking* 109, 110 (1989) [hereinafter *Cross-Border Banking*]. By the end of 1990, over 200 foreign banks, with aggregate assets of \$800 billion, were present in the United States. Moreover, branches and agencies of foreign banks operating in the U.S. had assets of about \$626 billion, or 18% of the total bank assets in the nation. See *Operations of Foreign Banks in the U.S.: Hearings Before the House Banking, Finance and Urban Affairs Comm.*, 102d Cong., 1st Sess. *1 (June 11, 1991), available in LEXIS, Nexis library, Fednews file [hereinafter *Foreign Banks Hearings*] (statement of Rep. Gonzalez, chairman); see also J. Baker, *International Bank Regulation* 7-12 (1978) (discussing the growth of foreign banks in the U.S. in the late 1970s).

2. From 1982 to 1989, the commercial and industrial loans made by foreign-owned U.S. banks increased from \$83 billion to \$178.9 billion. The amount of deposits grew from \$148.6 billion in 1982 to \$370.4 billion in 1989. The assets of foreign-owned U.S. banks increased from \$285.4 billion in 1982 to \$695.6 billion in 1989. See *Foreign Banks in the United States*, *Am. Banker*, Feb. 27, 1990, at 18A [hereinafter *Foreign Banks*].

3. The collapse of a single bank will have global consequences, not only in the banking industry, but also in financial markets. For example, English lawyers have estimated that the closure of BCCI jeopardized \$8.7 billion in international trade because it complicated payments for export contracts handled by the bank. See *BCCI Failure Said to Jeopardize \$8.7 Billion in International Trade*, *Daily Rep. for Executives (BNA)* No. 147, at A-9 (July 26, 1991); see also Baker, *supra* note 1, at 15-17 (discussing various economic implications of bank failures).

4. See *infra* notes 82-90 and accompanying text.

several years.⁵

This Note explores the underlying and central function of consolidated supervision in international banking.⁶ Part I discusses international coordination of bank supervision and provides a brief overview of the current regulatory framework for supervising foreign banks operating in the United States. Part II examines gaps in this regulatory framework, with the BCCI scandal providing a particularly compelling example of the supervisory difficulties inherent in regulating a modern global banking entity. Part III suggests areas where reform is needed and analyzes several legislative proposals from both Europe and the United States. Finally, this Note concludes that problems in international banking arise from the confusing and overlapping roles of national bank regulators, and from a lack of any real ability to enforce bank compliance with regulations—in other words, a lack of consolidated supervision.

I. CURRENT REGULATORY FRAMEWORK

The multinational nature of modern banking institutions raises questions about the ultimate supervisory authority over a bank's international activities. Banking activities that occur outside banks' national borders extend beyond the direct control of their national regulators.⁷ For example, is the United States Government or the British Government responsible for supervising the London branch of an American-chartered bank? Similarly, which government should supervise the subsidiary of a British bank located in New York? Answering these questions requires reaching some consensus on the role of comprehensive supervision and international cooperation in multinational bank regulation.

A. *International Supervision of Banking Regulations*

Increased concern with international cooperation in banking supervision, both in Europe and in the United States, began in 1974 when banks from various countries experienced serious crises, including failure.⁸ Af-

5. See Johnston, *BCCI Agrees to Plead Guilty and Will Forfeit \$550 Million*, N.Y. Times, Dec. 20, 1991, at A1, col. 1.

6. For definition and discussion of consolidated supervision, see *infra* notes 20-25 and accompanying text.

7. Nations exert control over the banking industry by creating a central bank and other similar agencies. See *infra* note 9.

8. See Giusti, *Banking Crises of the Early 1970s Demonstrated a Need for Coordinated Supervision of International Finance*, Am. Banker, Dec. 16, 1983, at 26. In the U.S., the Franklin National Bank failed; it was the most notable of the bank failures caused by the high inflation and interest rates of the early 1970s. See Kotsopoulos, *Franklin National Bank*, in *A Case History of Bank Failures: 1971-1975*, at 322 (1981). Franklin National Bank, once the 20th largest bank in the U.S., closed on October 8, 1974, and was then the largest bank failure in U.S. history. See Rose, *What Really Went Wrong at Franklin National*, Fortune, Oct. 1974, at 118.

The failure of a small domestic German bank, Herstatt Bank, caused strong ripple effects on confidence in banks in other financial centers. See *Cross-Border Banking*, *supra* note 1, at 113. These crises convinced banking regulators that different national banking

ter these crises, each nation's central bank⁹ sought to create better coordination of the surveillance activities exercised by national authorities.¹⁰ To achieve this improved coordination, the central bank governors of the Group of Ten major industrialized countries ("G-10"),¹¹ together with Switzerland and Luxembourg, met in Basle, Switzerland, in 1975. They established the Committee on Banking Regulations and Supervisory Practices, commonly referred to as the Basle Committee.¹²

The Basle Committee established closer cooperation among the supervisory banking authorities—a development that eventually led to the drafting of the first principles for international banking supervision.¹³ In 1975 these principles were embodied in an agreement that became known as "the Basle Concordat."¹⁴ Although the Concordat does not have the force of law, it sets out the responsibilities for the supervision of banks engaged in international business, and has become the cornerstone of cooperation between national regulators in the supervision of these banks.¹⁵

The central principle of the Basle Concordat of 1975 was that the supervision of foreign banks should be the joint responsibility of the home and host authority.¹⁶ The Basle Committee agreed that, rather than create a separate monitoring system operated by an international body, common principles would be developed and implemented by the various

systems were truly interconnected, and pointed out an urgent need for cooperation among banking regulators representing different nations. *See id.*

9. *See* F. Mishkin, *The Economics of Money, Banking, and Financial Markets* 321 (1992). The central bank is the government agency that oversees the banking system and is responsible for the conduct of monetary policy. *See id.*

10. *See* U.S. Gen. Acct. Off., *International Banking—International Coordination of Bank Supervision: The Record to Date 14-15* (Feb. 1986) [hereinafter *International Coordination*].

11. These are the ten major industrialized countries—Belgium, Canada, France, Germany, Holland, Italy, Japan, Sweden, the United Kingdom, and the United States—that established the International Monetary Fund's General Agreement to Borrow in October 1962. *See* A. Mullineux, *International Money and Banking: The Creation of a New Order* 66 n.4 (1987).

12. *See* *International Coordination*, *supra* note 10, at 14. The Committee is "the primary means through which bank supervisory officials from the major industrialized countries can exchange ideas and reach agreements in supervising the foreign establishments and other international activities of financial institutions." *Id.*

13. *See* Giusti, *supra* note 8, at 26.

14. *See* *International Coordination*, *supra* note 10, at 17; *Committee on Banking Regulations and Supervisory Practices: The 'Basle Concordat'*, in *Legal Issues of Cross-Border Banking*, *supra* note 1, at 133-40 [hereinafter *Basle Text*] (reprints the 1983 Basle Concordat).

15. *See* *Cross-Border Banking*, *supra* note 1, at 113. The Concordat does not constitute a formal agreement, and it has no force in law. Hence, the use of the word 'concordat,' which in public law refers to "[a] compact, covenant, or convention between two or more independent governments." *Black's Law Dictionary* 290 (6th ed. 1990).

16. *See* Mendelsohn, *New Basel Concordat: Main Deficiency is Intact*, *Am. Banker*, June 16, 1983, at 2. A bank's headquarters are located in its "home country" and are supervised by a home or parent authority. An overseas office of the bank is located in the "host country" and may be directly subject to the regulatory standard of the host country's supervising authority. *See* *International Coordination*, *supra* note 10, at 19.

nations.¹⁷

In 1983, in response to several gaps in the 1975 Concordat, and in reaction to yet another banking scandal,¹⁸ the original Concordat was revised and a new Concordat approved.¹⁹ The 1983 Concordat introduced two regulatory precepts that together constitute the foundation for the principle of consolidated supervision.²⁰ First, the adequacy of supervisory standards within national jurisdictions was ensured by adopting a "dual key" approach in which home and host authorities assess the quality of one another's supervision.²¹ If a host country believes that a parent's supervision of foreign banks in its territory is inadequate, the host country should prohibit or discourage the continued operation of these offices.²² Second, the home authority was required to take primary responsibility for supervising the operations of banks incorporated in its country on a worldwide basis, including foreign subsidiaries.²³

The 1983 Basle Concordat states that "banking supervisory authorities cannot be fully satisfied about the soundness of individual banks unless they can examine the totality of each bank's business worldwide through the technique of consolidation."²⁴ The Concordat further explains that "[t]he principle of consolidated supervision is that parent banks and parent supervisory authorities monitor the risk exposure . . . of the banks or banking groups for which they are responsible, as well as the adequacy of their capital, on the basis of the totality of their business wherever conducted."²⁵ In short, the idea is that overall supervision and enforcement of bank regulations should be strengthened by having home authorities supervise activities on the basis of a bank's global operations.

The intention of the Basle Committee was to prevent banks from gravitating toward the least-regulated jurisdictions and thereby perpetuating the resulting competition in regulatory laxity between financial centers

17. See Giusti, *supra* note 8, at 26. The hope was that the Concordat would enable national officials to work with and understand the different practices of supervisory agencies, eventually finding practical ways of aligning legislation in the G-10. See *id.*

18. In 1982, an Italian bank, Banco Ambrosiano, further demonstrated the need for consolidated supervision. The Bank of Italy had assumed responsibility for rescuing Ambrosiano's Italian operations, but declined to take any responsibility for the failure of the group's operations outside Italy, especially those in Luxembourg and South America. See Mendelsohn, *supra* note 16, at 2. Luxembourg, however, disclaimed responsibility for Banco Ambrosiano's Luxembourg subsidiary. See Dale, *Someone Must Be In Charge*, *Fin. Times*, July 22, 1991, at 12, col. 3.

19. See Giusti, *supra* note 8, at 26.

20. See *Basle Text*, *supra* note 14, at 135.

21. See Dale, *supra* note 18, at 12, col. 3.

22. See *id.* In addition, if the parent authority believes that the host authority's supervision is inadequate, it should "either extend its supervision, to the degree that is practicable, or it should be prepared to discourage the parent bank from continuing to operate the establishment in question." *Id.*

23. See *id.*

24. *Basle Text*, *supra* note 14, at 133.

25. *Id.* at 136.

competing for foreign banking business.²⁶ In order to ensure that the supervisory standards are aligned with those of the most stringently regulated centers, however, national authorities must also be prepared to lock out foreign banks that originate in permissive jurisdictions.²⁷

For several reasons, however, the 1983 Basle Concordat did not prove to be a magic solution to the problem of international bank regulation. First, in a provision that has proven controversial, the Concordat allowed for an exception to the consolidation principle. It stated that "[w]here holding companies are at the head of groups that include separately incorporated banks operating in different countries," there is no requirement for home supervision of the institution as a whole.²⁸ This provision has left a void in home-country responsibility for those banks that fall under the exception. Second, while over eighty nations agreed to adhere to the principles of the 1983 Concordat, not until very recently did any of the signatories in fact begin to implement its proposals.²⁹ Indeed, the European Community ("EC") has just called for consolidated action both in supervising institutions³⁰ and in harmonizing the contents of published accounts of banks³¹ as part of its goal of a single market by the end of 1992. This kind of delay has potentially allowed even more banks to operate without proper supervision.

B. *Supervisory Structure in the United States*

The regulatory structure in the United States governing domestic

26. See Dale, *supra* note 18, at 12, col. 3. Therefore, "each national supervisory authority must satisfy itself that banks' foreign operations are being conducted in jurisdictions with sound supervisory practices and that foreign banks to which it is host are subject to adequate supervision in their home jurisdiction." *Id.*

27. See *id.*; see also *Basle Text*, *supra* note 14, at 135 (host authority "should be prepared to discourage the parent bank from continuing to operate the establishment in question"). For example, in the U.S., Manhattan District Attorney Robert Morgenthau, during his investigation of BCCI, has called for legislation that would "'say to foreign banks that you can't do business in the U.S. unless you are regulated by a strong central bank and there are no bank secrecy laws in your country.'" *Fed Hits BCCI With \$200 Million Penalty as N.Y. Grand Jury Hands Down Indictments*, 57 *Banking Rep.* (BNA) No. 6, at 210 (Aug. 5, 1991).

28. *Basle Text*, *supra* note 14, at 136. BCCI was structured as a holding company as a way to minimize regulatory constraints. It is precisely those banks, however, that are seeking to avoid regulatory attention that need to be supervised most closely. See *infra* notes 82-88 and accompanying text.

29. See *Cross-Border Banking*, *supra* note 1, at 114 n.9. For example, the G-10 Governors have agreed that the Basle Committee's proposals on capital adequacy should be implemented by 1992. See *id.*

30. See Council Directive 83/350 of 13 June 1983 on the Supervision of Credit Institutions on a Consolidated Basis, 1983 O.J. (L 193) 18. The aim of this directive is to establish the "principle that supervision of a credit institution operating in several Member states is provided by the competent authorities of the Member state in which the head office of the credit institution is situated." 1992-Planning for Financial Services and the Insurance Sector 46 (1989) [hereinafter 1992-Financial Services].

31. See Council Directive 86/635 of 8 December 1986, 1986 O.J. (L 372). "The directive prescribes the same layout, nomenclature and terminology for balance sheets of all credit institutions in the Community." 1992-Financial Services, *supra* note 30, at 48.

banks evolved haphazardly as a series of reactions to and "fixes" of financial crises.³² The regulatory structure for foreign banks operating in the United States has evolved in a similar way, with foreign banks often trying to circumvent regulations aimed at amending problems in the domestic or foreign banking system that would effectively render American banks uncompetitive.³³ Currently the regulation and supervision of foreign banks operating in the United States are the shared responsibility of three federal agencies: the Federal Reserve Board ("Fed"),³⁴ the Office of the Comptroller of the Currency ("OCC"),³⁵ and the Federal Deposit

32. For example, problems related to the Civil War led to the enactment of the Act of June 3, 1864, ch. 106, 13 Stat. 99 (codified as amended at 12 U.S.C. § 1865 (1988)) [hereinafter National Bank Act of 1864]. See Note, *Too Many Consonants and Not Enough Consonance: The Development of the S&L Regulatory Framework*, in Annual Survey of Financial Institutions and Regulation, The S&L Crisis: Death and Transfiguration, 59 Fordham L. Rev. S263, S265-66 (1991) [hereinafter *Too Many Consonants*]. Recurring bank crises from 1873 to 1907 led to the Federal Reserve Act, ch. 6, 38 Stat. 251 (1913) (codified as amended at 12 U.S.C. §§ 221-226 (1988) and other various sections). See *id.* The Great Depression led to the Banking Act of 1933, ch. 89, 48 Stat. 162, (codified at 12 U.S.C., distributed throughout chapters 2,3 and 6). The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified at various sections of 12 U.S.C. (1988)) was aimed at the problems in the thrift industry as was the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 202B, 96 Stat. 1469 (codified at 12 U.S.C. § 1811 (1988)). For a detailed discussion about the reactive nature of Savings and Loan legislation in this country, see generally N. Lash, *Banking Laws and Regulations: An Economic Perspective* 1-21 (1987) (discussing the history of U.S. banking legislation); *Too Many Consonants, supra*, at S263 (same).

33. See D. Khambata, *The Practice of Multinational Banking* 35 (1986) [hereinafter *Multinational Banking*]. Regulations for foreign banks in the U.S. were reactions to the enormous increase in the foreign banking presence in the U.S., see *id.* at 47, not necessarily to financial crises. Regulators were also concerned about any preferential treatment that foreign banks might be receiving. See S. Rep. No. 1073, 95th Cong., 2d Sess. 2, reprinted in 1978 U.S. Code Cong. & Admin. News 1421, 1421-22 [hereinafter *IBA Legislative History*].

34. The National Monetary Commission of 1908 proposed the creation of a central banking system to oversee the monetary and credit functions of the nation's financial system. See S. Rep. No. 243, 62d Cong., 2d Sess. 3-4 (1912). As finally enacted into law, this central banking system was also charged with related supervisory duties. See Federal Reserve Act, *supra* note 32, § 11, 38 Stat. at 261-62 (codified as amended at 12 U.S.C. § 248 (1988)).

The Federal Reserve Act of 1913 created a system of twelve federal reserve banks, each acting, in effect, as a central bank for its geographical region and overseen by the Board of Governors of the Fed located in Washington. See *id.* § 2, 38 Stat. at 251-52 (codified as amended at 12 U.S.C. § 222 (1988)). The member banks of the Fed include all national banks, as required by law, and those state-chartered banks that have chosen to apply and who have received membership in the federal system. See *id.* §§ 2, 9, 38 Stat. at 251-52, 259 (codified as amended at 12 U.S.C. §§ 222, 321 (1988)).

The Division of Banking Supervision and Regulation is primarily responsible for the coordination and oversight of the supervisory activities of the Fed and for examination procedures of the Reserve Banks. See Rules of Organization of Federal Reserve System, 51 Fed. Reg. 42,935 (1986); see also 1 M. Malloy, *The Corporate Law of Banks*, § 1.3.2, at 40-47 (1988) (discussing the general structure of the Federal Reserve System).

35. The Comptroller of the Currency is the oldest federal bank regulatory institution still in existence. Today, the Comptroller functions as the administrator of those banks chartered by him under the National Bank Act and is responsible for the administration of virtually all federal laws applicable to national banks. See Malloy, *supra* note 34,

Insurance Corporation ("FDIC").³⁶ These agencies are charged with monitoring foreign branch activity in the United States and assuring sound banking practices and management.³⁷

Supervision of foreign banks operating in the United States poses particular problems because of the dual nature of the American banking system.³⁸ Under the dual system, the licensing, regulation, and supervision of banks, both domestic and international, fall under the aegis of both state and federal governments,³⁹ and is, indeed, a source of contention.⁴⁰ The Federal Reserve Act of 1913⁴¹ and the Banking Act of 1933⁴² provided for the Federal Government to regulate foreign banks participating in the state banking system.⁴³ The Federal Government is responsible for formulating national monetary policy and therefore has

§ 1.3.1, at 28-40. "The approval of the Comptroller is required for practically any significant action to be taken by a national bank, including chartering, establishment of branches, changes in corporate control, or in the structure of the organization." *Id.* Additionally, the Comptroller has supervisory authority over the day-to-day activities of national banks. *See id.*

A national bank is defined as a bank, chartered by an official of the Federal Government, that is subject to federal law regarding its corporate structure, powers and the like, although it is still subject to state law for its day-to-day operations. *See id.* at 31-32 & n.19.

36. *See* Multinational Banking, *supra* note 33, at 44. The primary statutory mandate of the FDIC is to provide deposit insurance to all banks qualifying for insurance coverage under the Federal Deposit Insurance Act, 12 U.S.C. § 1814(b) (1988). *See* Multinational Banking, *supra* note 33, at 44; *see also* Baker, *supra* note 1, at 81-82 (the FDIC "would assure that depositors in virtually all banking institutions in the United States would be covered by insurance"). *See generally* Malloy, *supra* note 34, § 1.3.3, at 47-52 (discussing the general structure of the FDIC).

37. *See* Multinational Banking, *supra* note 33, at 46.

38. The dual banking system dates back to the beginning of banking in this country. It was not until 1819 that the Supreme Court established the right of the Federal Government to create and operate a system of banks. *See* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 325-26 (1819). When the Act of February 25, 1863, ch. 58, 12 Stat. 665 [hereinafter the National Currency Act of 1863], which was later repealed by the National Bank Act of 1864, *supra* note 32, § 62, 13 Stat. at 118, was passed to finance the Civil War, Congress provided for a co-equal system of national banks regulated by federal agencies, and state banks regulated and supervised by state banking authorities. *See* Malloy, *supra* note 34, § 1.3.1, at 28-30.

39. *See* Multinational Banking, *supra* note 33, at 36. This duality is a result of the principle that states have the right to manage and control activities within their borders, and that the Federal Government has the right to manage national fiscal and monetary policy. *See id.*

40. Consider, for instance, the circumstance of a state-chartered bank that is insured by the FDIC and is a member of the Federal Reserve System. This institution is under the authority and jurisdiction of three distinct and independent regulators: the state chartering authority, the FDIC, and the Fed. *See* Malloy, *supra* note 34, § 1.3, at 23. For a detailed discussion of the division of labor, see Lash, *supra* note 32, at 27-35.

41. *See* Federal Reserve Act, *supra* note 32, § 25, 38 Stat. at 273 (codified as amended at 12 U.S.C. §§ 601-04, 611-31 (1988)).

42. *See* Banking Act of 1933, *supra* note 32, § 21, 48 Stat. at 189 (codified as amended at 12 U.S.C. § 378 (1988)).

43. *See generally* Considine, *A State's Response to the United States Treasury Department Proposals to Modernize the Nation's Banking System*, in Annual Survey of Financial Institutions and Regulation, The S&L Crisis: Death and Transfiguration, 59 Fordham L.

distinct interests in maintaining a principal position in bank regulation.⁴⁴ Additionally, the Federal Government, through the FDIC, is the "lender of last resort,"⁴⁵ guaranteeing payment of insured deposits at failed institutions.⁴⁶

The Fed's authority and responsibility for supervising the U.S. operations of foreign banks derive primarily from the Bank Holding Company Act ("BHCA")⁴⁷ and the International Banking Act of 1978 ("IBA").⁴⁸ The BHCA regulates the acquisition of American bank holding companies by foreign banks and the IBA controls the operation of foreign banks in the United States.⁴⁹

The BHCA conferred on the Fed the power to regulate overseas affiliates of American banks, foreign branches of American banks, and all foreign banks operating in the United States with consolidated assets

Rev. S243, S244-45 (1991) (the Fed, FDIC, and OCC were given supervisory powers over federal and state banks' foreign banking activities).

44. Under the Federal Reserve Act of 1913, the Fed became the central bank of the U.S., thus making the Fed responsible for national monetary policy. *See* Federal Reserve Act, *supra* note 32, § 2, 38 Stat. at 251-52 (codified as amended at 12 U.S.C. § 222 (1988)). Because banking activities are a key ingredient to monetary policy and help the government maintain the overall stability of the economy, the Fed seeks a primary role in bank regulation. *See* Multinational Banking, *supra* note 33, at 36.

45. *See* Multinational Banking, *supra* note 33, at 36. In times of crisis, the Fed will act to maintain the stability and health of the banking system by advancing credit to solvent but temporarily illiquid financial institutions. Through this role, the Fed has the duty to impose prudential measures designed to ensure the soundness of the system and to monitor and examine banks to ensure compliance and to identify problems before they become too severe. *See generally* Mishkin, *supra* note 9, at 452-61 (discussing the progression of federal regulation measures).

46. *See* Malloy, *supra* note 34, § 1.3.3, at 48. For instance, the Fed has indicated that it will not allow the collapse of two banks associated with BCCI: First American of Washington, D.C., and Independence Bank of Encino, California. *See* Lohr, *2 Banks Tied to BCCI Get Aid From a Worried Federal Reserve*, N.Y. Times, Nov. 8, 1991, at A1, col. 5. The Independence case highlights the machinations of the dual U.S. system. Independence is a state chartered bank and its principal Federal overseer is the FDIC, yet the Fed is leading the effort to bail out the bank. *See id.*; *see also infra* notes 106-111 and accompanying text (discussing the problems of the dual U.S. banking system).

47. *See* Bank Holding Company Act, ch. 240, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841-49 (1988)) [hereinafter BHCA]. The BHCA was passed to regulate the process by which banks were using holding companies to expand and acquire additional banks and to engage in non-banking business. *See* S. Rep. No. 1095, 84th Cong., 2d Sess. 1, *reprinted in* 1956 U.S. Code Cong. & Admin. News 2482. Following the enactment of the BHCA, bank holding companies had to obtain approval by the Fed before acquiring a voting share in excess of 5% of a bank or company, and state law had to permit the investment. *See* BHCA, *supra*, § 3(a)(3), 70 Stat. at 134 (codified as amended at 12 U.S.C. § 1842(a)(3) (1988)). Bank holding companies were also prohibited from acquiring a bank outside the bank's principal state of operations unless the state permitted it. *See id.*

48. International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (codified at 12 U.S.C. §§ 3101-08 (1988)) [hereinafter IBA].

49. *See* R. Pecchioli, *The Internationalisation of Banking* 76 (1983). A bank holding company is defined as "[a] corporation that owns, controls, or otherwise has the power to vote at least 25 percent of the voting stock in one or more banks." E. Compton, *Principles of Banking* 371 (1988).

greater than one billion dollars.⁵⁰ Through the BHCA, the Fed also has residual authority to conduct special investigations of all foreign banks under state supervision.⁵¹ Additionally, the BHCA gave the OCC and the FDIC some supervisory functions over foreign banks.⁵²

The importance of the Fed's functions have increased with the growth of global banking entities. There is an overwhelming need for a primary and definitive authority to regulate the often byzantine character of international banking transactions.⁵³ Before Congress passed the IBA, foreign banks present in the United States were primarily regulated and supervised by state regulatory authorities.⁵⁴ Moreover, foreign banks were generally permitted to establish or acquire bank subsidiaries under either federal or state law, and to establish branches or agencies under state law.⁵⁵ Indeed, foreign banks generally preferred state regulation because, by avoiding many of the federal restrictions applicable to domestic banking institutions,⁵⁶ foreign banks could provide more competi-

50. See IBA, *supra* note 48, § 7(a)(1)(B)(2), 92 Stat. at 620 (codified as amended at 12 U.S.C. § 3105(a)(1)(B)(2) (1988)).

51. See *id.* § 7(c)(1), 92 Stat. at 621 (codified as amended at 12 U.S.C. § 3105(b)(1) (1988)).

52. The OCC supervises all national banks with assets of over \$10 billion, all national banks with overseas branches, and federally chartered foreign branches and agencies in the U.S. See Multinational Banking, *supra* note 33, at 45. The OCC shares with the states the supervision of non-federally insured state-chartered foreign branches. See *id.*

FDIC deposit insurance and assessments are mandatory for essentially all domestic banks, and for federal and state branches of foreign banks that receive any significant level of retail deposits of less than \$100,000. See 12 C.F.R. §§ 28.8, 346.4(a), 346.8 (1991). For a discussion of the federal and state banking systems, see *supra* notes 38-43 and accompanying text. The FDIC conducts examinations of the activities of insured banks on the basis of "safety and soundness" considerations. See Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 207, 103 Stat. 183, 206 (amending 12 U.S.C. § 1816 (1988)); Note, *A Note to Congress and the FDIC: After FIRREA, Where's the BIF?*, in Annual Survey of Financial Institutions and Regulation, The S&L Crisis: Death and Transfiguration, 59 Fordham L. Rev. S411, S413-14 (1991).

53. See *infra* notes 73-146 and accompanying text.

54. See IBA Legislative History, *supra* note 33, at 1426.

55. See Carr, Jr. & More, *Developments in the Regulation of Foreign Bank Operations in the United States*, 1988 U. Ill. L. Rev. 225, 228. A foreign bank's offices can take several forms. Most closely linked to a parent bank are its "branches." These units have no separate legal identity; they are mere extensions of the parent bank in foreign locations. Branches are defined by the IBA as "any office or any place of business of a foreign bank located in any State of the United States at which deposits are received." IBA, *supra* note 48, § 1(b)(3), 92 Stat. at 607 (codified as amended at 12 U.S.C. § 3101(3) (1988)). Closely related to branches are "agencies." An agency is "any office or any place of business of a foreign bank located in any State of the United States at which credit balances are maintained . . . checks are paid, or money is lent but at which deposits may not be accepted from citizens or residents of the United States." *Id.* § 1(b)(1), 92 Stat. at 607 (codified as amended at 12 U.S.C. § 3101(1) (1988)). Parent banks may also operate overseas through "subsidiaries." These independent institutions, in which the parent bank has a total or partial interest, are incorporated in the country in which they operate. See Multinational Banking, *supra* note 33, at 27.

56. For example, before the enactment of the IBA many foreign banks engaged in rapid multistate expansion because states, in an effort to encourage investment in their

tive services than domestic banks.⁵⁷

With most foreign banks opting for state regulation, Congress enacted the IBA in 1978. The Act responded to problems such as the lack of federal supervision over most foreign bank operations in the United States, the rapid growth of such operations, and the expansion of foreign banks' operations into the domestic retail-deposit market.⁵⁸ The IBA established a new regulatory framework to govern the American operations of foreign banks. The central premises of this framework were the policy of "national treatment" and increased federal supervisory powers over foreign banks.⁵⁹ The IBA established, for the first time, statutory federal jurisdiction over the U.S. operations of foreign banks.⁶⁰ The IBA also amended previously "domestic-only" laws and regulations, such as the BHCA, to include foreign banks.⁶¹

The enactment of the IBA gave foreign banks the option, similar to domestic banks, to establish a banking office in the U.S. by obtaining either a federal license from the OCC or a license from the appropriate state regulator.⁶² But to provide the mechanism for consolidated supervision over such a dual banking structure, Congress determined that

states, permitted the entry of foreign banks into their state, irrespective of whether the bank had facilities in other states. Domestic banks, though, are prohibited from organizing full-service banking entities in more than one state. See IBA Legislative History, *supra* note 33, at 1427.

57. See *International Banking Act of 1978: Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking*, 95th Cong., 2d Sess. 46 (1978) [hereinafter *IBA Senate Hearings*]. Before the enactment of the IBA there were many complaints that foreign banks present in the U.S. had competitive advantages over domestic institutions regardless of whether the foreign banks were federally or state-chartered. See *id.*

Specifically, unlike domestic banks, "foreign banks could cross state lines, engage in nonbanking activities, hold equity in U.S. securities firms, benefit from lower capitalization requirements, ignore federal reserve requirements and interest rate ceilings, and decline FDIC insurance and related assessments." *Multinational Banking*, *supra* note 33, at 40. Thus, not only did foreign banks have more business latitude, but they could offer their banking services at a cheaper rate because they were not burdened by Federal regulations. See *id.*

58. See *IBA Senate Hearings*, *supra* note 57, at 46. The Fed was concerned about the status of foreign banks not only because of the disparate treatment caused by varying state laws, but also because its inability to control their reserves made it very difficult to implement federal monetary policy that relies on management of reserves. See Baker, *supra* note 1, at 83-85.

59. An underlying principle of national treatment is "parity of treatment between foreign and domestic banks in like circumstances." IBA Legislative History, *supra* note 33, at 1422.

60. See IBA, *supra* note 48, §§ 7-13, 92 Stat. at 620-25 (codified as amended at 12 U.S.C. §§ 3105-08 (1988)).

61. The IBA recognized the different banking structures that foreign banks are permitted to operate by their home countries. As a result, under § 8(a) of the IBA, foreign banks are treated as bank holding companies for the purposes of the non-banking restrictions of the BHCA, but are not actually required to establish separate holding companies. See IBA, *supra* note 48, § 8(a), 92 Stat. at 622 (codified as amended at 12 U.S.C. § 3106(a) (1988)).

62. See Carr, Jr. & More, *supra* note 55, at 238.

there should be one agency responsible for overseeing all U.S. operations of foreign banks.⁶³ The Fed was given this umbrella supervisory authority.⁶⁴ The main areas of concern for the Fed relate to: (1) the entry of foreign banking institutions into the American market;⁶⁵ (2) the application of regulations to the foreign banks;⁶⁶ and (3) the extent of supervision and examination.

The Fed has exercised its supervisory authority under the IBA by establishing a regular reporting system that covers all of the American banking operations of foreign banks. The Fed also works with the other state and federal supervisors to set examination standards, and it reviews all examination reports of branches and agencies.⁶⁷ Further, the Fed has established a common examination format and has attempted to ensure that each foreign branch or agency is examined at least once every eighteen months.⁶⁸ The Fed, in its capacity as the central bank, also obtains information on the financial condition of the parent bank, meets regularly with the management of the foreign banks operating in the United States, and acts as an enforcer when necessary.⁶⁹

Nevertheless, despite the Fed's development of its own internal examination format, Congress has instructed the Fed to rely "insofar as possible" upon the examinations conducted by the OCC, the FDIC, or the appropriate state licensing authority—an instruction that actually works

63. *See id.*

64. *See IBA, supra* note 48, § 7(a), 92 Stat. at 620 (codified as amended at 12 U.S.C. § 3105(a) (1988)).

65. Because of the dual banking system, foreign banks were still able to choose between state and federal chartering. *See supra* notes 38-43 and accompanying text. The IBA, however, did close some doors by making entry of certain types of banking institutions a federal responsibility. For example, foreign banks cannot acquire domestic banks in more than one state, although they can still establish branches and agencies in more than one state. *See IBA, supra* note 48, § 4, 92 Stat. at 610 (codified as amended at 12 U.S.C. § 3102 (1988)).

The following areas are now subject to federal approval: "acquisition of national or state banks, establishment of federal or state branches and agencies, and formation of an investment company." *Multinational Banking, supra* note 33, at 48.

66. Subject to certain exemptions, foreign banking institutions must meet capitalization and federal reserve requirements and adhere to ceilings on interest rates. *See IBA, supra* note 48, § 4(g), 92 Stat. at 611 (codified as amended at 12 U.S.C. § 3102(g) (1988)). Again, with certain exemptions, foreign banking institutions must have FDIC insurance for retail deposits. *See id.* § 6, 92 Stat. at 614 (codified as amended at 12 U.S.C. § 3104 (1988)).

67. *See* 76 Fed. Res. Bull. 1032 (1990). As stated by William Taylor, Staff Director, Division of Banking Supervision and Regulation,

[t]he Federal Reserve receives and reviews all examination reports conducted by the other federal and state bank supervisors. It collects and analyzes quarterly reports of condition and reports on foreign credit exposure from all branches and agencies of foreign banks. Through these and other means, the Federal Reserve tracks the condition of all U.S. offices of a foreign bank to assess the foreign bank's performance on a nationwide basis.

Id. at 1033. The examiners also rely on internal and external auditors. *See id.* at 1034.

68. *See id.* at 1033.

69. *See id.*

to limit the Fed's power.⁷⁰ As a result, the role of the Fed in both the examination and supervision process varies from state to state.⁷¹ Its role depends on such factors as the "importance of foreign banks in a particular state, the examination resources of the states, and the experience of the states in this area."⁷² Thus, the potential for inconsistent and inexact supervision still exists even though one entity is technically responsible for oversight.

II. REGULATORY AND SUPERVISORY PROBLEMS: A LACK OF CONSOLIDATED SUPERVISION

As the banking issues discussed in the preceding section demonstrate, the growth in the overseas presence of banks has complicated the work of bank regulators and supervisors. Indeed, the problems facing banking regulators stem precisely from national regulators and supervisors not performing their functions properly, or simply not knowing what their duties are.⁷³ This confusion, in turn, contributes to and compounds the underlying problem in international banking—lack of consolidated supervision.

When an institution operates internationally in multiple jurisdictions with differing laws and regulations, review and supervision of all of the institution's components provide the only means of determining the true financial condition of the institution and the extent and lawfulness of its operations.⁷⁴ With no real possibility of a uniform international banking law, the only means of assuring uniform standards of bank supervision is through international cooperation and coordination.⁷⁵

As the BCCI scandal shows, the costs of inadequate international cooperation in this area can be enormous. BCCI was engaged in four major frauds. One was a cover-up of \$633 million of losses on treasury trad-

70. See IBA, *supra* note 48, § 7(c)(1), 92 Stat. at 621 (codified as amended at 12 U.S.C. § 3105(b)(1) (1988)).

71. See 76 Fed. Res. Bull. 1032, 1033 (1990).

72. *Id.* at 1033. For example, in some states where there is a very small foreign banking presence, there is no direct Fed participation in the examination process. See *id.* In California and Texas, the Federal Reserve Banks of San Francisco and of Dallas, respectively, share the examination workload with the state banking authority. See *id.* In New York, however, the examinations are conducted almost entirely by the state. See *id.*

73. See *infra* notes 127-41 and accompanying text.

74. See Dale, *supra* note 18, at 12, col. 3.

75. The Basle Concordat stresses the need for cooperation, stating that:

Adequate supervision of banks' foreign establishments calls not only for an appropriate allocation of responsibilities between parent and host supervisory authorities but also for contact and co-operation between them. It has been, and remains, one of the Committee's principal purposes to foster such co-operation both among its member countries and more widely. The Committee has been encouraged by the like-minded approach of other groups of supervisors and it hopes to continue to strengthen its relationships with these other groups and to develop new ones.

Basle Text, *supra* note 14, at 133.

ing.⁷⁶ The second was the illegal acquisition of several banks in the U.S., on which it spent \$346 million.⁷⁷ The third was spending \$725 million in a complex manipulation of accounts to support its largest borrower.⁷⁸ The fourth was BCCI leveraging itself by allegedly acquiring secret control of 56% of its own shares at a cost of over \$500 million.⁷⁹ Additionally, BCCI spent about \$2 billion to cover up its fraud, bringing the total bill to over \$4 billion.⁸⁰ According to William Taylor, Staff Director of the Fed's Division of Banking Regulation and Supervision, "[N]o one country had a clear view of the BCCI's worldwide activities or the responsibility to supervise the company on a consolidated basis."⁸¹ That, indeed, is the problem.

Using the BCCI scandal⁸² as an illustration of what can happen when adequate supervision is absent, the following section discusses several reasons for the existing lack of consolidated supervision—including large banking structures, deficient home-country supervision, national sovereignty concerns, bank secrecy laws and, in the U.S., the dual nature of the banking system.

A. *Barriers to Consolidated Supervision*

1. Large Banking Structures

As the BCCI debacle shows, large banking structures pose particular

76. See Lascelles, *The Biggest Bank Fraud in History*, *Fin. Times*, Nov. 9, 1991, at 1, cols. 3-4.

77. *See id.*

78. *See id.*

79. *See id.*

80. *See id.*

81. 77 Fed. Res. Bull. 569, 571 (1991).

82. In a global operation on July 5, 1991, authorities of the Bank of England, along with the U.S., Luxembourg, the Cayman Islands, Switzerland, Spain, Canada, France and Argentina closed most of the operations of BCCI because of evidence of widespread fraud, including fraudulent concealment of losses from its lending and trading operations. *See Kraus & Evans, BCCI Assets Are Seized in 8 Nations; Fraud Cited*, *Am. Banker*, July 8, 1991, at 1.

Luxembourg seized control over the assets of BCCI S.A. Luxembourg, two Cayman Island affiliates were seized by that Island's inspector of banks, and the New York State Banking Department took control of the New York City agency of BCCI. *See International Authorities Seize Control of BCCI, After Evidence of Major Fraud*, 57 *Banking Rep. (BNA)* No. 3, at 119 (July 15, 1991). A Bank of England official stated that "regulators acted after a report completed by Price Waterhouse on June 27 showed evidence of widespread fraud at BCCI." *Id.*

BCCI began closing its offices in several other countries around the world. In Japan, BCCI's Tokyo branch closed temporarily. *See Evans, More BCCI Offices Closed; U.S. Exposure Called Small*, *Am. Banker*, July 9, 1991, at 9. BCCI ceased operations in Sri Lanka, in Seoul, South Korea, and in Nicosia, Cyprus. *See id.* Germany froze the bank accounts at BCCI's two German branches; authorities in Hong Kong closed BCCI's subsidiary; and the Netherlands closed the BCCI office in Amsterdam. *See id.* BCCI's three branches in Pakistan remained open. *See id.* According to the Bank of England, the coordinating regulator, eighteen other countries were cooperating to shut BCCI's operations. *See id.*

supervisory nightmares. Founded in the early 1970s in Pakistan by a group of Arab investors, BCCI became, in every respect, a global bank.⁸³ At its height, BCCI was the seventh-largest private bank in the world, with capital of \$1.5 billion and assets worth twenty billion dollars.⁸⁴ Through a network of subsidiaries, affiliates, and branches, BCCI operated in seventy-three countries, with most of its banking offices located in Europe, Africa, the Middle East, the Caribbean, and South America.⁸⁵ The holding company for these entities, BCCI Holdings, was chartered in Luxembourg.⁸⁶ Two major subsidiaries of the BCCI Holdings, BCCI S.A. in Luxembourg and BCCI Overseas in the Cayman Islands,⁸⁷ operated agencies in the U.S. that were licensed by California, Florida, and New York.⁸⁸

The activities of BCCI and its affiliates demonstrate that those running the bank had a clear and distinct objective to exploit its complex structure in order to evade as many regulatory and supervisory authorities as possible.⁸⁹ The very nature of a large modern corporate entity raises an inherent concern of fractioned supervision. The potential for deception, coupled with an intent to deceive, is ominous. Indeed, public awareness of BCCI and its nefarious deeds is now quite high, and its initials, "BCCI," have become synonymous with financial crime and

83. See Lascelles, *BCCI, Behind Closed Doors: 'This Bank Would Bribe God'*, Fin. Times, Nov. 11, 1991, at 7, col. 3.

84. See Donkin, *Four European Central Banks Are Monitoring BCCI Dealings*, Fin. Times, Oct. 18, 1988, at 28, col. 3.

85. See *BCCI: Till Drugs Do Us Part*, Economist, Oct. 15, 1988, at 96. BCCI's businesses ranged from seemingly respectable European banks to mysterious offshore investment companies and arms trading. For a detailed discussion of these dubious activities, see Beaty & Gwynne, *Not Just a Bank; You Can Get Anything You Want Through BCCI—Guns, Planes, Even Nuclear-Weapons Technology*, Time, Sept. 2, 1991, at 56 [hereinafter *Not Just a Bank*].

86. See *BCCI: Till Drugs Do Us Part*, *supra* note 85, at 96.

87. See *id.*

88. See Schmalz, *Bank is Charged by U.S. With Money-Laundering*, N.Y. Times, Oct. 12, 1988, at D6, col. 6. Agency operations are limited by law, and, therefore, the BCCI offices in the U.S. were not allowed to accept consumer deposits, nor were they able to offer insured deposits of any kind. See IBA, *supra* note 48, § 4(d), 92 Stat. at 611 (codified as amended at 12 U.S.C. § 3102(d) (1988)). BCCI's U.S. agencies in Los Angeles and New York had a total of about \$240 million in assets. See *BCCI Assets Are Seized*, *supra* note 82, at 1.

89. See Maremont, *The Long and Winding Road to BCCI's Dead End*, Bus. Wk., July 22, 1991, at 54. The Financial Times describes the situation as follows:

At the peak, the auditors had about 300 people around the world trying to reassemble 32,000 separate transactions going back over 10 years. It was a giant hall of mirrors; money that didn't exist, money that did exist but was stolen, customers who didn't exist, customers who did exist but denied their loans, money that went round in circles, money that vanished and money that popped up out of nowhere.

Lascelles, *BCCI Behind Closed Doors: 'The Final Hours'*, Fin. Times, Nov. 16, 1991, at 4, cols. 4-5.

corruption.⁹⁰

2. Lack of Home-Country Supervision

It is vital to international banking that any foreign bank entering any nation be subject to comprehensive supervision on a consolidated basis by a home-country regulator.⁹¹ Indeed, the core of the consolidated supervision principle requires the home country to provide adequate supervision.⁹² Where this does not occur, problems will arise, as demonstrated by the failure of authorities in BCCI's home country to subject the institution to a comprehensive system of supervisory oversight.⁹³

Both the holding company for BCCI and one of its major banking subsidiaries were chartered in Luxembourg.⁹⁴ But neither of these BCCI entities actually conducted business in that country, which meant that under then-existing Luxembourg law, the regulatory authorities in Luxembourg were not required to supervise BCCI's global operations.⁹⁵ Because there was no home supervision, each separate BCCI affiliate around the world was monitored individually without a complete understanding of how the affiliate's local activities fit within the whole BCCI organization.⁹⁶ In other words, no one regulatory authority was watching "the big picture."

90. "Bank for Check-Kiting Congressional Incumbents," is an example. *See On Language*, N.Y. Times, Oct. 20, 1991, § 6 (Magazine), at 18, col. 1.

91. *See Dale*, *supra* note 18, at 12, col. 3; *see also supra* notes 20-25 and accompanying text (discussing consolidated supervision).

92. *See Basle Text*, *supra* note 14, at 135-36.

93. One key reason BCCI was able to get away with criminal activities was because "it was careful never to develop a home country base where it would be subjected to the full scrutiny of the local banking authority." Lascelles, *First Steps Towards Tougher Regulation*, *Fin. Times*, Sept. 2, 1991, at 13, col. 1. BCCI's banking operations were split between two main subsidiaries incorporated in different jurisdictions—Luxembourg and the Cayman Islands. This structure ruled out consolidated supervision. *See id.* at 13, cols. 2-3.

94. *See BCCI: Regulatory Rights and Wrongs*, *Fin. Reg. Rep.*, July, 1991, at 1-2.

95. *See First Steps Towards Tougher Regulation*, *supra* note 93, at 13. The relevant Luxembourg law was changed in 1982 and 1984 and, according to Luxembourg Prime Minister, Jacques Santer, these new laws "are capable of preventing the future establishment of banks structured similar to BCCI." *Luxembourg Will Not Adopt Stricter Banking Rules In Wake of BCCI Scandal*, 57 *Banking Rep. (BNA)* No. 5, at 197 (July 29, 1991). Indeed, Pierre Jaans, the director of the Luxembourg Monetary Institute, "explained that the Institute recently asked a bank to move its official headquarters out of Luxembourg because its international activities were much more active than its local operations," which was precisely the situation with BCCI. *See id.* at 197-98.

96. When the BCCI branch in Tampa was convicted of drug-money laundering in the U.S. in 1988, the Bank of England conducted a thorough investigation of BCCI's British branches but found nothing abnormal. *See First Steps Towards Tougher Regulation*, *supra* note 93, at 13, col. 2. This suggests that BCCI was adept at keeping its questionable activities out of the more closely supervised countries. The Bank of England was, however, the regulator that did eventually lead the closure of BCCI's global operations in the summer of 1991. *See id.*

3. National Sovereignty Issues and Differences in Supervisory Standards

Adequate supervision can also be hindered by the differences in the supervisory standards of the home and host supervisory agencies.⁹⁷ Indeed, for competitive advantage, many banks actually seek those locations promising minimum supervision.⁹⁸

Under the principle of consolidated supervision, home supervisors are encouraged and often required to broaden the scope of their supervision to include the foreign offices of domestic institutions.⁹⁹ Any attempt, however, to exert complete control over these foreign offices raises national sovereignty issues. This is especially true when the foreign office operates as a subsidiary, since subsidiaries have a legally independent standing in the host country.¹⁰⁰ Nations are also reluctant to share or delegate authority regarding banks domiciled in their borders because of the correlation between bank security and national monetary policy.¹⁰¹

4. Bank Secrecy Laws

As cross-border banking increased, international banking centers began competing for the banks' business. Some countries sought to attract business by implementing an array of bank secrecy laws,¹⁰² which lure banks by attracting a large amount of private deposits from clients who prefer to keep their money away from the interfering eyes of their governments. BCCI appears to have considered this when it set up its major subsidiaries in Luxembourg and the Cayman Islands—both offshore havens for companies wishing to maintain secrecy.¹⁰³

97. Problems will also arise due to jurisdictional issues, and due to the fact that nations have different ways of characterizing banking transactions. See F. Ryder, *Legal Problems in International Banking* 3-6 (1987).

98. See Dale, *supra* note 18, at 12, col. 7; Kuttner, *Controlling the Climate That Let BCCI Bloom*, *Bus. Wk.*, July 29, 1991, at 16; see also *supra* notes 86-88 and accompanying text (BCCI chose Luxembourg and the Cayman Islands as its headquarters).

In international banking, the U.S. and Great Britain, the traditional caretakers of global finance, are usually the regulatory hawks. See Kuttner, *supra*, at 16. Japan and Germany, in contrast, have a more national approach to banking and tend to enjoy and support the competitive strength of their own banks. See *id.*

99. In giving effect to the principle of consolidated supervision, "host authorities should ensure that parent authorities are informed immediately of any serious problems which arise in a parent bank's foreign establishment. Similarly, parent authorities should inform host authorities when problems arise in a parent bank which are likely to affect the parent bank's foreign establishment." *Basle Text, supra* note 14, at 135.

100. See *supra* note 55 for a definition of subsidiaries.

101. See *supra* note 44 and accompanying text.

102. See *BCCI Imbroglia: Predictable . . . and Predicted*, *Fin. Reg. Rep.*, July 1991, at 3-4 [hereinafter *BCCI Imbroglia*].

103. Under Luxembourg law, the regulators cannot compel a bank to reveal information about a depositor unless it can be proved in a Luxembourg court that the depositor is suspected of a criminal offense—in other words, an offense that is criminal under Luxembourg law. See *id.* For more information regarding Luxembourg's strict bank secrecy laws, see Note, *Putting Starch in European Efforts to Combat Money Laundering*, in An-

Consolidated supervision relies on all pieces of the picture being available for review. Stringent bank secrecy laws of the kind that exist in Luxembourg or the Cayman Islands create gaps for review and thus facilitate criminal activity.¹⁰⁴ The problem becomes circular: a banking center's willingness to enact secrecy laws attracts criminal activities, and then the country argues that it could not provide adequate supervision of those activities because of secrecy laws.¹⁰⁵

5. Dual Nature of the U.S. Banking System

The problems caused by the duality of the banking system are unique to the United States.¹⁰⁶ The ability of global banks to seek out the weakest national regulatory forum is analogous to the situation in the U.S., where banks are able to choose the most compliant state or federal regulatory environment.¹⁰⁷ Of course, allowing banks to select their regulator, on whatever scale, undermines the logic of regulation.¹⁰⁸

Under the IBA, Congress did not require prior federal review of a foreign bank's entry into the U.S. banking system, thus leaving the door open for state regulation.¹⁰⁹ Consequently, with state agencies having authority over certain matters and federal agencies having authority over others, cooperation is essential. When dealing with foreign institutions, however, the presence of dual supervisory and regulatory authorities is inadequate if there is no effective coordination of supervision over major foreign banks with operations in more than one state.¹¹⁰ In one indica-

Annual Survey of Financial Institutions and Regulation, *Transnational Financial Services in the 1990s*, 60 *Fordham L. Rev.* S429, S454-55 (1992).

104. See *BCCI Imbroglia*, *supra* note 102, at 3. For a detailed discussion on bank secrecy laws' effect on fraud in facilitating insider trading, see Note, *Outside Investors: A New Breed of Insider Traders?*, in *Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s*, 60 *Fordham L. Rev.* S319, S341 (1992).

105. See *BCCI: Regulatory Rights and Wrongs*, *supra* note 94, at 1-2. Considering the existence of strict bank secrecy laws in Luxembourg, it is certainly incredulous for its prime minister to then argue that "the normal controls of a state based on laws are insufficient to prevent deception." *Id.*; see also *Luxembourg Will Not Adopt Stricter Banking Rules in Wake of BCCI Scandal*, *supra* note 95, at 197 (Luxembourg Prime Minister Santer told his parliament that neither tighter banking regulations nor increased protection for creditors are needed).

106. See *supra* notes 38-43 and accompanying text (discussing U.S. banking system).

107. See Kuttner, *supra* note 98, at 16.

108. See *id.* In some instances, the motive may be purely innocent. Although state charters do not offer any outright advantages over national charters, most foreign banks prefer the accessibility and cooperation associated with the local regulators. See Kraus, *State Officials Fear Losing Foreign-Bank Jurisdiction*, *Am. Banker*, May 14, 1991, at 6.

109. See IBA, *supra* note 48, § 7, 92 Stat. at 620-21 (codified as amended at 12 U.S.C. § 3105 (1988)). The IBA sets out a Fed role only after a bank is present in the U.S. Indeed, 81% of foreign banks operating in the U.S. still choose state regulators. See Riegle and Garn *Introduce Bill to Close Loopholes for Foreign Banks*, 56 *Banking Rep. (BNA)* No. 19, at 918 (May 13, 1991) [hereinafter *Riegle and Garn*].

110. See *Foreign Banks Hearings*, *supra* note 1, at *2 (statement of Rep. Gonzalez). While discussing the scandal involving the Banco Nazionale de Lavoro ("BNL"), an Atlanta-based bank, Representative Gonzalez said "we found state examiners principally

tion of this failure of the dual banking system, BCCI was able to engage in long-term criminal activity through its agencies in the U.S.—agencies that operated under state authority.¹¹¹

B. *Ramifications of a Lack of Consolidated Supervision*

1. Ease of Money Laundering

The potential for money laundering is just one example of the problems created by a lack of consolidated supervision. The U.S. Customs Service Commissioner has alleged that more than \$32 million was laundered through the offices of BCCI.¹¹² The method by which BCCI laundered money thus presents another useful illustration of the need for consolidated supervision.¹¹³

BCCI is said to have laundered drug money in the following way. Drug money was first deposited in a non-BCCI bank in any city in the U.S. The money was then wired to an account at BCCI in Tampa that was set up for the laundering operation. From Tampa the money was transferred by wire through a non-BCCI New York bank to BCCI headquarters in Luxembourg. From there the money was wired to BCCI in London, where it was placed in a certificate of deposit. This certificate of deposit was used as a basis to generate a loan in the Bahamas to a phony corporation set up by the drug dealers. From the Bahamas the money was wired back into the undercover account in Tampa, where it was transferred by wire to the BCCI branch in Uruguay. From Uruguay, the money was transferred as cash into Colombia.¹¹⁴

As customs agents explain, the point of the maneuvering “was to keep the money shifting from country to country and account to account to make it difficult to trace.”¹¹⁵ BCCI undoubtedly created its elaborate network of transactions within its internal organization, knowing that without adequate home supervision, and because of the bank’s vast structure, it would be extremely difficult for host regulators to detect any illegal activity.¹¹⁶ Other examples of BCCI’s seemingly widespread links to criminal activities include alleged involvement with arms smuggling, for-

concerned with the basic functional qualities solely of the agency or branch in their own state. No one looked at the totality of the BNL operation in this country.” *Id.* Representative Gonzalez says this situation was predictable because the Fed “was not the primary regulator and the states had no authority to examine other states’ operations.” *Id.*

111. BCCI had set up state agencies in New York, California and Florida. BNL, similarly, was established as a state-chartered institution. *See* 76 Fed. Res. Bull. 1032 (1990).

112. *See* Schmalz, *supra* note 88, at D6, col. 4.

113. *See id.* BCCI pleaded guilty to money laundering charges in Federal Court in Tampa, Florida in 1988. *See id.*

114. *See How Laundering is Said to Work*, N.Y. Times, Oct. 13, 1988, at D10, col. 5.

115. Schmalz, *supra* note 88, at D6, col. 4. For a discussion on current reforms concerning money laundering, see Note, *Putting Starch in European Efforts to Combat Money Laundering*, in Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s, 60 Fordham L. Rev. S439-54 (1992).

116. *See BCCI Imbroglia*, *supra* note 102, at 3-4.

mer Panamanian leader Manuel Noriega,¹¹⁷ and terrorist Abu Nidal.¹¹⁸

2. Hidden Ownership Interests

The host country's influence over the condition of foreign banks is limited because a foreign bank can hide its activities through its parent office. Foreign banks may be directly affected by the condition of their parent banks, but the host supervisor has no direct regulatory authority over these parent banks.¹¹⁹ Thus, in efforts to ensure the soundness of a foreign bank organization, the host country must collect information about the bank on a consolidated basis, with parent and affiliate treated as a single unit.¹²⁰

Host-country supervisors, therefore, must know who owns and controls the foreign banks within their borders in order to determine if their own banking laws are being followed. In the U.S., for example, Section 3 of the BHCA provides that the Fed must approve the acquisition or establishment of a bank subsidiary by a foreign bank.¹²¹ The Fed has stated that "in general foreign banks seeking to establish banks . . . in the U.S. should meet the same general standards of strength, experience and reputation as required for domestic organizers of banks and bank holding companies."¹²² The Fed, of course, must know the identity of any potential foreign purchasers of American institutions before it can determine the foreign company's soundness. Allegedly, however, BCCI was secretly able to purchase First American Bankshares, Inc., a Washington D.C. bank holding company, because the Fed was unable to examine the potential buyers on a consolidated basis.¹²³ BCCI evidently made secret

117. BCCI has been accused of helping the former leader of Panama, Manuel Noriega move and hide laundered money. See Lascelles & Hill, *The BCCI Shutdown; Citibank in HK Hit By Rumours*, Fin. Times, Aug. 9, 1991, at 8, col. 5. The Panamanian Government filed suit against BCCI in the U.S. District Court for the Southern District of Florida. See *Judge Issues Restraining Order on BCCI, Allows Exceptions for Bank Regulators*, 57 Banking Rep. (BNA) No. 9, at 339 (Aug. 26, 1991) (discussing several outstanding court cases against BCCI).

118. BCCI's connections ran far into the depths of underground and clandestine activities. Intelligence agencies in several countries have been accused of using BCCI for funneling money to various causes, because of its ties to the Middle East and Third World nations. See *Not Just a Bank*, *supra* note 85, at 56.

119. Host nations seek information from parent banks based on the principle of consolidated supervision. Problems, however, do arise. See *supra* notes 97-101 and accompanying text.

120. See Hultman, *U.S. International Bank Supervision and the Revised Basle Concordat*, Mag. of Bank Admin., Feb. 1985, at 76.

121. See BHCA, *supra* note 47, § 3(c), 70 Stat. at 134 (codified as amended at 12 U.S.C. § 1842(c) (1988)).

122. Federal Reserve Board Statement of Policy on Supervision and Regulation of Foreign Bank Holding Companies, [1978-79] Fed. Banking L. Rep. (CCH) ¶ 97,725.

123. See 77 Fed. Res. Bull. 572, 578 (1991). The Fed has charged that BCCI illegally acquired 60% of First American Bankshares, Inc., the Washington area's largest bank holding company, with \$10.6 billion in assets. See Atkinson, *Fed Said to Probe BCCI Ties with Foreign Banks in U.S.*, Am. Banker, Aug. 20, 1991, at 6.

The Fed has imposed a \$200 million fine on BCCI Holdings and several BCCI-related

nominee loans to "front men", Credit and Commerce American Holdings ("CCAH"), who presented themselves to the Fed for approval.¹²⁴ The documents evidencing the arrangements between CCAH shareholders and BCCI were maintained outside the U.S., thus impeding a thorough investigation.¹²⁵ Indeed, BCCI allegedly gained control of at least two other U.S. banks without receiving the necessary approval under the BHCA.¹²⁶

3. Confusion of Roles

Consolidated supervision diminishes the possibility of a confusion of roles among banking regulators. Both the home and host regulators should be aware of their proper duties and perform them. When supervision is not consolidated, the cooperation necessary for the supervision of modern international banking institutions is absent as well. Thus, cooperation is essential in defining the appropriate roles of home and host regulators.

Host supervisors are affected by the growth of international banking as a result of their significant interest in the domestic business of foreign bank offices. These offices can, and usually do, have a strong effect on the

banks, companies, and individuals for BCCI's alleged use of secret arrangements to gain illegal ownership interests in several U.S. financial institutions. *See id.* The Fed announced its action the same day a Manhattan grand jury handed down a multi-count indictment against BCCI, several BCCI entities, and two of the bank's founders, charging the defendants with defrauding depositors, falsifying bank records, and with larcenies totalling over \$30 million. *See House Banking Approves BCCI Subpoena Authority; Riegle Wants Investigation*, *Banking Daily (BNA)*, at A-9 (July 31, 1991).

In compliance with the \$550 million settlement between BCCI and the U.S. Department of Justice, the Federal Reserve has agreed to forego the \$200 million fine and BCCI has agreed to plead guilty to charges of secretly acquiring control of First American, Independence, and the National Bank of Georgia. BCCI will also pay a \$10 million fine resulting from the charges filed by the Manhattan District Attorney. *See BCCI Agrees to Plead Guilty and Will Forfeit \$550 Million*, *supra* note 5, at D2, col. 1.

124. *See* 77 Fed. Res. Bull. 572, 577 (1991). On April 19, 1982, after months of investigation, the Fed approved the Middle Eastern investors' acquisition of First American provided they remain passive investors. The Fed received financial statements, statements identifying the source of funds to be used to make the acquisition, and letters from the potential shareholders' banks confirming their financial statements. The Fed also conducted background checks on the proposed shareholders. CCAH expressly told the Fed that BCCI would not be involved in the acquisition of First American other than as an investment advisor. On the basis of these assurances, the Fed approved CCAH's acquisition of First American. *See id.* at 574-75.

125. *See id.* In proposing the FBSEA, Senator Riegle suggested that the lack of sufficient information resulted in the Fed's approval of CCAH's purchase of First American, because the Fed never knew precisely who the owners of CCAH were. *See Federal Reserve Seeks Control Over U.S. Activities of Non-U.S. Banks*, *Fin. Reg. Rep.*, May 1991, at 119.

126. They are Independence Bank, located in Encino, California, and the National Bank of Georgia. *See* 77 Fed. Res. Bull. 572, 577-78 (1991). In March 1991, the Fed issued a cease and desist order, consented to by BCCI without admitting or denying any wrongdoing, that requires BCCI to divest itself of any shares of Independence Bank that it controls. BCCI was also required to divest itself of shares in the National Bank of Georgia. *See id.*

domestic banking industry, especially if they accept retail deposits.¹²⁷ When confusion arises as to the proper role of both the home and host regulators, problems are not far behind.¹²⁸ As a general rule, however, home regulators are believed to provide better control for services across borders, while host regulators are better positioned to control services that occur within the host's border.¹²⁹

Confusion also arises in the enforcement of regulations. When national regulators lack clear roles, even after authorities know there is a problem with a particular bank, there may be no effective enforcement framework in place.¹³⁰ For example, even after international regulators had evidence that BCCI was a crime-ridden institution, it still took several years to either shut BCCI down or revamp its structure.¹³¹ Finally, in 1987, trouble with BCCI became too apparent to avoid and regulators placed BCCI's worldwide operations under the supervision of a "college of supervisors" from the countries where it had its main businesses.¹³² This approach was clearly ineffective in averting the eventual shutdown of BCCI, however, because the "college" was only able to move "at the pace of its slowest member," and some members refrained from acting in order to avoid a scandal in their own countries.¹³³

Moreover, as far back as 1978, some banking experts wrote about the defects in BCCI's structure while others were presaging the collapse to

127. See *Foreign Banks*, *supra* note 2, at 20A.

128. Regulators want to promote competition, ensure the safety of banks and the banking system, and look after consumers' interest. The choice is whether to apply the home country's or the host country's rules, or to combine them resulting in harmonized rules acceptable to both. See *Home Thoughts From Abroad*, *Economist*, Aug. 17, 1991, at 74.

129. Home regulators are more capable of reviewing the totality of the operation because, at least theoretically, the home office should know what is happening with its affiliates around the globe. See *generally* International Coordination, *supra* note 10, at 17 ("solvency supervision was predominantly a parent authority responsibility. For subsidiaries and joint ventures, primary responsibility rests with host authorities.").

130. Regulators in the U.S. and Luxembourg are at odds over who controls BCCI's stake in First American. According to reports, Luxembourg is now in control of at least 25% of the stock of First American Bankshares. The Fed had planned to sell BCCI's illegal holdings in First American, and requested instructions from the Luxembourg authorities, whom the Fed believes are in control of BCCI's stake in First American. The director of the Luxembourg Monetary Institute, Pierre Jaans, however, claims this is a U.S. legal problem and not under the responsibility of the Luxembourg authorities. See Atkinson, *Luxembourg Is Left Holding 25% Stake in First American*, *Am. Banker*, July 10, 1991 at 2; Kraus, *Regulators at Odds Over BCCI Stake in D.C. Bank*, *Am. Banker*, July 12, 1991, at 1.

For a detailed discussion of the legal and jurisdictional problems facing international regulators, see F. Ryder, *Legal Problems of International Banking* 45-62 (1987).

131. A BCCI agency was convicted of money laundering charges in Florida in 1988. See Schmalz, *supra* note 88, at D6, col. 4.

132. See *Maremont*, *supra* note 89, at 54. In 1987, regulators from Luxembourg, Britain, France, Spain, Switzerland and the Cayman Islands formed a special "college" just to exchange information. See *id.* at 55. The college, however, did not include many countries in which BCCI had big operations, including the U.S. See *id.*

133. See Donkin & Lascelles, *The Scandal That Remains a Mystery*, *Fin. Times*, July 13, 1991, at 6, col. 5.

come.¹³⁴ Indeed, all of the factors relevant to the collapse of BCCI in 1991 were evident in the late 1980s, including, among other things, the absence of a lender of last resort, the criminal attraction to bank secrecy havens, and the labyrinthian holding company structure.¹³⁵ Yet several years passed before any definitive action commenced.¹³⁶

Finally, another potential confusion in the international regulatory scheme is the role of a lender of last resort.¹³⁷ BCCI has been called the world's largest bank without a lender of last resort.¹³⁸ The home authority traditionally performs this role.¹³⁹ In this instance, because BCCI is largely a dollar-based bank, "its sudden failure would have threatened the integrity of the U.S. payments/settlement system, possibly forcing the U.S. authorities to provide emergency support."¹⁴⁰ Without a clear definition of roles, a host country's central bank might be called upon to cover losses created by a foreign institution.¹⁴¹

134. See *BCCI Imbroglia*, *supra* note 102, at 3. In a reprint of an article from 1988, one commentator had asked who, under the principle of consolidated supervision, is supposed to be supervising BCCI, and who, if anybody, would rescue BCCI if it were to experience a confidence-induced liquidity crisis. See *id.* Even more disturbing is a recent disclosure that, in 1978, a senior American bank examiner warned U.S. banking regulators that BCCI was engaged in the same practices for which it was closed thirteen years later. See Lohr, *U.S. Memo Saw BCCI Trouble in '78*, N.Y. Times, Feb. 20, 1992, at D1, col. 6.

135. See *id.*

136. During the current investigation, evidence leaked out that the Bank of England and other regulators knew of financial malpractice, if not fraud, at BCCI for several years. See *The BCCI Affair: Blaming the Bank of England*, Economist, July 20, 1991, at 88. The Bank of England contends, in part, that it did not act earlier because it was only one of many national regulators and had limited power to act on its own. See *id.* at 92.

137. See Pecchioli, *supra* note 49, at 108; see also *supra* notes 45-46 and accompanying text (defining lender of last resort as the agency that will provide reserves to prevent a bank failure or, if a bank has failed, it will guarantee payment to depositors).

138. See *Four European Central Banks are Monitoring BCCI Dealings*, *supra* note 84, at 28, col. 3.

139. See generally Pecchioli, *supra* note 49, at 108-09 (explaining the market need for a lender of last resort).

140. *BCCI: Regulatory Rights and Wrongs*, *supra* note 94, at 1-2. What is certain is that in today's marketplace, it is an absurdity to permit any bank, let alone a \$20 billion institution such as BCCI, to operate internationally without clear lines of access to a lender of last resort. It is also certain that Luxembourg was not prepared to fill this role. See *BCCI Imbroglia*, *supra* note 102, at 3-4.

141. See *BCCI Imbroglia*, *supra* note 102, at 4. This would be a politically unacceptable situation, for example, if the Bank of England is forced to bail out a Luxembourg-based bank. See Brittan, *Lessons of BCCI for the Regulators*, Fin. Times, July 29, 1991, at 11, col. 1; see also *infra* notes 168-71 and accompanying text (both discussing EC deposit guarantee reforms).

In the U.S., the Fed, in its role as the central bank and the lender of last resort, has indicated that it is prepared to make sure that two banks secretly owned by BCCI, First American and Independence Bank of Encino, California do not fail by providing financial support. See *2 Banks Tied to BCCI Get Aid From a Worried Federal Reserve*, *supra* note 46, at A1, col. 5. This is a politically sensitive issue, as well, for bank regulators regard the possible collapse of either of these two banks as "politically dynamite, especially given the criticism of the [Bush] Administration's handling of the BCCI investigation." *Id.*

4. Ease of Fraud

Finally, inadequate supervision creates a climate in which fraud is more likely to occur.¹⁴² Fraud thrived in BCCI, for example, due to the lack of proper supervision.¹⁴³ Among the fraudulent acts committed by some of BCCI's senior management was the disguising of losses that the bank suffered from bad loans and speculation in the money markets.¹⁴⁴ BCCI management allegedly took deposits but failed to enter them on the bank's books. Instead, bank officials used the money directly to cover the bank's losses.¹⁴⁵ Thus, in this instance, a simple decision regarding accounting enabled fraud at BCCI to go undetected.¹⁴⁶ Had there been proper supervision, BCCI fraud might have been detected earlier.

III. REFORM

Gaps in the current regulatory framework—as unveiled in part by the BCCI scandal—demonstrate the need for reform in order to prevent a “BCCI” from recurring and to ensure that the new regulatory system of the 1990s complies with the standards of consolidated supervision. Specifically, closing this gap requires reform in the areas of home- and host-country control and cooperation with foreign supervisors.

Some reform measures have been codified in proposed legislation, both by the EC and by the U.S. Congress. Some aspects of bank regulation, however, do not require more legislation, but simply more cooperation.¹⁴⁷ For its part, the Basle Committee plans to put global regulation of financial institutions at the top of its agenda.¹⁴⁸ Yet while the most significant developments in banking supervision usually occur in re-

Providing federal money to cover depositors' losses, however, would also be anathema to many taxpayers who must already shoulder the burden created by the S&L crisis.

142. See Dale, *supra* note 18, at 12, col. 3.

143. See *The Biggest Bank Fraud in History*, *supra* note 76, at 1, cols. 3-4; see also *BCCI and S. 1019: Hearing Before the Subcomm. on Consumer and Regulatory Affairs of the Senate Banking, Housing and Urban Affairs Comm.*, 102d Cong. 1st. Sess. *3 (May 23, 1991), available in LEXIS, Nexis library, Fednews file [hereinafter *BCCI Hearings*] (statement of Jack Blum, Former Senate Investigator). In his testimony before Congress, Blum said, “[BCCI] operated without a supervisor that could ensure consolidated supervision. The absence of . . . consolidated supervision was . . . critical to BCCI's ability to carry out the manipulation of its books and the concealment of its actual financial condition.” *Id.*

144. See *The Scandal That Remains a Mystery*, *supra* note 133, at 6, cols. 3-4.

145. See *id.*

146. Accounting also contributed to another method of fraud. One former BCCI executive explained that accounts used to be falsified around September before auditors came in. The figures were then reversed after the end of the year. This creative accounting allowed the bank to show more profitable commissions on its books during the last quarter of the year. See *id.*

147. See *infra* notes 206-11 and accompanying text.

148. The new chairman of the Basle Committee is Gerald Corrigan, the former head of the New York Fed. From his previous statements, we can expect the Basle Committee to proceed rigorously with this agenda. See Kraus, *Corrigan Seeks Tighter Global Standards of Bank Supervision*, *Am. Banker*, Aug. 1, 1991, at 6.

sponse to crises,¹⁴⁹ it is important, when analyzing the problems illustrated by BCCI, that legislators not compensate for a lack of regulatory controls over BCCI by merely overregulating banking.

A. Reform In The EC

As the world anxiously monitors the emergence of the proposed Single Market of the European Community, it is clear that this market will present a great challenge for international bank regulators in the 1990s. The Community itself has attempted to address several of the more critical concerns.¹⁵⁰ Under the Second Banking Directive, for example, any bank licensed by a member state would have unrestricted access to any other member state.¹⁵¹ A Consolidated Supervision Directive and several other directives are designed to prevent the potential problems—discussed below—that are likely to stem from such free access.¹⁵²

1. Home-Country Supervision

The EC has adopted a three-faceted approach to banking regulation: (1) the necessary harmonization of capital requirements law, standards of

149. For example, the Basle Concordat was revised after the scandals of the Banco Ambrosiano, Italy and the Herstatt bank in Germany. See *supra* note 7; see also Malloy, *Bumper Cars: Themes of Convergence in International Regulation*, in Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s, 60 Fordham L. Rev. S1, S12-14 (1992) (discussing the reactive nature of banking regulations).

150. See 1987 Single European Act, 1987 O.J. (L 169) 1. For an in depth discussion of the proposed 1992 single European market and its affect on banking, see Note, *Banking on Europe: 1992 and EMU*, in Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s, 60 Fordham L. Rev. S395, S396-418 (1992).

151. See 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. The central element of the Second Banking Directive is the granting of a single license by the home supervisory authority that will allow a credit institution to establish a branch in, or provide cross-border services into, any other member state on the basis of that authorization. See 1992-Financial Services, *supra* note 30, at 40, 53. The Second Banking Directive also calls for the coordination of laws, regulations, and administrative provisions relating to the taking-up and pursuit of the business of credit institutions. The result of this Directive will be the creation of uniform regulatory and supervisory standards for the European Community. See *id.*

152. See Council Directive 89/647 of 18 December 1989 on a Solvency Ratio for Credit Institutions, 1989 O.J. (L 386) 14; Commission Recommendation 87/63 of 22 December 1986 Concerning the Introduction of Deposit-Guarantee Schemes in the Community, 1987 O.J. (L 33) 16; Commission Recommendation 87/62 of 22 December 1986 on Monitoring and Controlling Large Exposures of Credit Institutions, 1987 O.J. (L 33) 10; see also 1992-Financial Services, *supra* note 30, at 58-63 (discussing the contents and provisions of the various directives.)

The Consolidated Supervision Directive places further definite obligations on the national authorities of member states to provide one another with all the information about the operations of the different parts of a group. In case of difficulty, one nation may send its own investigators to check on information coming from another. See Consolidated Supervision Directive, *supra* note 30.

experience for management, and monitoring of liquidity and solvency;¹⁵³ (2) mutual recognition by the national supervisory authorities that each will follow this harmonization;¹⁵⁴ and (3) the theory of home-country control through coordination of national supervisory activities.¹⁵⁵

A bank such as BCCI would have been severely hindered in conducting its suspect activities had the Second Banking Directive and the other Directives been in place earlier.¹⁵⁶ While supervision of banks will remain the responsibility of the member states' own authorities, they will be working within a Community-wide framework of rules designed to maintain strict standards. Specifically, based on the new framework, Luxembourg would have been statutorily responsible for many of the supervisory activities it had declined to perform while BCCI perpetuated its scams.¹⁵⁷ To ensure prudent supervision, Great Britain has further proposed that a bank's home regulator be liable when depositors in another EC country lose money.¹⁵⁸ This would encourage regulators to exercise tighter control over international banks based in their jurisdiction.¹⁵⁹

153. See A Common Market for Services 5 (1988) [hereinafter Common Market].

154. See *id.*

155. See *id.* This will mean that a bank operating in other member states will be under the control of the authorities in its home base. See *id.*

156. See *BCCI Affair Triggers Community Move to Toughen Depositor Insurance Protection*, Thomson's Int'l Banking Reg., Aug. 9, 1991, at 3 [hereinafter *BCCI Affair Triggers Community Move*]; see also *Lessons of BCCI for the Regulators*, *supra* note 141, at 11 (Sir Brittan argues that a series of EC initiatives will lessen the risk of bank failure). The Second Banking Directive and the supporting measures already lay down a clear line of responsibility for authorizing and supervising banks on the basis of home-country control, the single banking license, and mutual recognition between member states.

EC legislation also removes all obstacles, including banking secrecy, to a full and rapid exchange of information between national supervisors. Thus, the home-country supervisor can have access to all relevant facts about every bank under its control. See *supra* note 152 and accompanying text (discussing the Consolidated Supervision Directive).

157. See *EC Weighs Deposit Compensation Scheme After BCCI*, Reuters, Money Rep., July 24, 1991, available in LEXIS, Banks library, Monrpt file. The Consolidated Supervision Directive would deal directly with holding companies based in one country but operating mainly in another. For example, BCCI, was a holding company based in Luxembourg, but did much of its business in other countries. See *BCCI: Till Drugs Do Us Part*, *supra* note 85, at 96. The main supervisory function under such circumstances will lie with the home country or with the country where the main EC banking is located. The underlying principle of the proposed directive, however, is that "supervision should as far as possible be led by the member state in which the group's banking business is done." *Lessons of BCCI for the Regulators*, *supra* note 141, at 12. Thus, the Bank of England would have had the primary responsibility to supervise BCCI, rather than the Luxembourg Monetary Institute.

158. See *EC Weighs Deposit Compensation Scheme After BCCI*, *supra* note 157; see also *BCCI Affair Triggers Community Move*, *supra* note 156, at 3 (BCCI scandal shows the need for new EC measures on deposit insurance).

159. See *BCCI Affair Triggers Community Move*, *supra* note 156, at 3. This will provide additional incentives for countries to insist on tighter regulations for banks licensed in their territory because they will be forced to compensate depositors with their own funds in the event of bank failures.

2. Cooperation with Foreign Supervisors

A crucial aspect of supervising international banks is cooperation and coordination with the home-country regulators of such banks.¹⁶⁰ While the EC has set up a system whereby cooperation is assured within the Community, cooperation between the EC and foreign regulators remains in the domain of bilateral agreements.¹⁶¹

The Basle Committee calls for increased coordination among international regulatory bodies. It can only recommend to its member states how to regulate banks, however; it cannot simply impose conditions. Therefore, the Committee remains no more than an informal arrangement.¹⁶² International regulators still need tighter international collaboration, as well as the imposition of international rules on national regulators to prevent scandals from occurring at all.¹⁶³ Some have called for the Bank for International Settlements ("BIS"), the "central bankers' central bank," to assume the role of supervising the supervisors.¹⁶⁴

The BCCI scandal did demonstrate a certain amount of international cooperation during the clean-up stage.¹⁶⁵ In a recent study, however, the United Nations Center on Transnational Corporations was highly critical of the country-by-country settlements pursued by some of the nations involved with the BCCI closure.¹⁶⁶ The study calls for the appointment of an international group of trustees to oversee depositors' claims and to deal with some of the other "transnational issues."¹⁶⁷

160. See *supra* notes 20-25 and accompanying text (discussing consolidated supervision).

161. See Common Market, *supra* note 153, at 15.

162. See Mendelsohn, *supra* note 16, at 2. Sydney Key, an economist with the Fed and co-author of the G-30 report, a study on the problems of supervising international banks, argues that the Basle Concordat is too narrow in scope and covers too few countries. See *First Step Towards Tougher Regulation*, *supra* note 93, at 13, col. 1.

163. See Dale, *supra* note 18, at 12, col. 3.

164. See Kuttner, *supra* note 98, at 16. The nomination of Gerald Corrigan, current president of the New York office of the Fed, to head the Committee on Banking Supervision of the BIS is an indication that the BIS will most likely play a greater role in international bank supervision. See *Corrigan Nomination to BIS Said to Signal Hands-on Role by U.S. in Monetary Policy*, 57 *Banking Rep. (BNA)* No. 3, at 120 (July 15, 1991). Indeed, following the BCCI operation, Corrigan indicated that it was his job to build on the cooperation exhibited with BCCI. See *id.* In 1987, Corrigan called for a greater centralized international financial regulatory system. As Corrigan explained, "there is a broad-based recognition among commercial bankers and central bankers alike . . . that market conditions dictate a higher degree of convergence in regulatory and supervisory, as well as the operations and legal systems." *More Centralized International Financial Regulatory System Needed, Bankers Told*, 48 *Banking Rep. (BNA)* No. 26, at 1130 (June 29, 1987).

165. The closure of BCCI's international operations took place in several countries on July 5, 1991. Banking regulators from at least eight different countries cooperated, including the U.S., England, Luxembourg, and the Cayman Islands. See *Luxembourg is Left Holding 25% Stake in First American*, *supra* note 130, at 2.

166. See Lohr, *U.N. Study Assails the Way BCCI Was Shut by Western Central Banks*, *N.Y. Times*, Feb. 5, 1992, at D7, col. 1 [hereinafter *U.N. Study Assails*].

167. *Id.* at D7, cols. 3-4.

3. Deposit-Guarantee Schemes

The EC has also recommended that member states set up harmonized systems to protect depositors if a banking institution becomes insolvent.¹⁶⁸ The EC calls for the national authorities in the home country to be responsible for the "winding up" of the bank.¹⁶⁹ If the home country is outside the EC, the authorities in the host-member state would be responsible for the condition of the bank unless there is a bilateral agreement with the home country.¹⁷⁰ This move would aid the jurisdictional problems of lenders of last resort.¹⁷¹

B. Reform In The U.S.

Underlying reform proposals in the United States is, according to former FDIC Chairman L. William Seidman, "the need for a single regulator for financial institutions."¹⁷² Among the competing banking reform bills pending,¹⁷³ only the Fed, in its proposed Foreign Bank Supervision Enhancement Act of 1991 ("FBSEA"),¹⁷⁴ seeks to remedy the gaps in current U.S. regulation and to give meaning to the "super" aspect of supervision.¹⁷⁵ The FBSEA supports the premise of national treatment

168. See Commission Recommendation 87/63 of 22 December 1986 Concerning the Introduction of Deposit-Guarantee Schemes in the Community, 1987 O.J. (L 33) 16. This directive solicits member states' cooperation to introduce, on a voluntary basis, deposit-guarantee schemes that will provide the same level of protection throughout the Community. See 1992-Financial Services, *supra* note 30, at 50-51.

169. See Common Market, *supra* note 153, at 15. The amended proposal to the Deposit Guarantee Directive provides that

measures taken by the supervisory authority . . . in the home country to prevent the failure of a credit institution, or wind it up, will also apply to any branches of that institution in other [m]ember [s]tates. Member [s]tates must ensure that there are no legal obstacles preventing the application of these measures to branches within their territory, by a branch's home supervisory authority.

1992-Financial Services, *supra* note 30, at 58.

170. See Common Market, *supra* note 153, at 15.

171. Jurisdictional problems involve, with respect to banks involved in foreign exchange, the currency that will be used by the lender of last resort. Any agreements in this area would help solve potential conflicts. See Pecchioli, *supra* note 49, at 109.

172. *Fed Hits BCCI with \$200 Million Penalty as N.Y. Grand Jury Hands Down Indictments*, *supra* note 27, at 210. Chairman Seidman made his remarks in reference to the lessons the BCCI scandal demonstrate to U.S. regulators. See *id.*

173. The reform legislation advanced by the Treasury Department would "require foreign banks operating in the United States to establish holding companies [in the U.S.] if they wish to engage in securities and insurance activities." *Greenspan Urges Congress to Amend Section 231 with Proposed Fed Bill*, 56 Banking Rep. (BNA) No. 24, at 1158 (June 17, 1991). Section 231 of the proposal also would require any foreign bank that chooses to engage in such expanded financial activities to conduct all of its U.S. banking business through a U.S. subsidiary bank and to close or "roll up" its U.S. branches and agencies into that bank. See *id.*

174. S. 1019, 102d Cong., 1st Sess. (1991) [hereinafter FBSEA].

175. The FBSEA was proposed by the Fed in response to well-publicized abusive activities by foreign banks operating in this country. See *Foreign Banks Hearings*, *supra*

for foreign banks¹⁷⁶ and recommends that the Fed serve as the primary U.S. regulator of foreign banks' American operations.¹⁷⁷

The IBA subjected foreign banks with American branches and agencies to federal regulation, chiefly requiring them to maintain reserves and generally limiting their activities and geographic expansion in the United States.¹⁷⁸ The IBA did, however, leave foreign banks free of certain federal requirements applicable to U.S. banks.¹⁷⁹

1. Home- and Host-Country Control

The Fed's proposal would ensure that both foreign banks' U.S. operations and U.S. national banks are regulated, supervised, and examined in the same manner.¹⁸⁰ This does not necessarily mean that such supervision entails exactly the same methods as those used for domestic institutions, because there are inherent differences between domestic banks doing business in the United States and foreign based banks doing business in the United States.¹⁸¹

Through the FBSEA, the Fed seeks to create a statutory requirement that "any foreign bank entrant be subject to comprehensive supervision on a consolidated basis by a home country regulator."¹⁸² To this end, the FBSEA requires that any potential entrant into the U.S. banking market identify its principal home-country supervisor.¹⁸³ If this parent organization's supervision does not meet the requirements of the federal

note 1, at *4 (statement of Alan Greenspan, Chairman, Federal Reserve Board). These banking scandals include BCCI and an Atlanta-based bank, BNL.

Weaknesses in the regulatory scheme allowed BNL to provide about 3 billion dollars in unauthorized and illegal loans to Iraq in direct conflict with U.S. foreign policy interests. See *Riegle and Garn*, *supra* note 109, at 918. The state of Georgia examined the Atlanta agency of BNL, with participation by the Fed. See 76 Fed. Res. Bull. 1032, 1033 (1990).

176. See *Foreign Banks Hearings*, *supra* note 1, at *4 (statement of Alan Greenspan, Chairman, Federal Reserve Board).

177. The Fed is best suited for this role because it is the nation's central bank and must therefore, maintain national monetary and fiscal policy. See Mishkin, *supra* note 9, at 387-88.

178. See IBA, *supra* note 48, §§ 4-5, 92 Stat. at 610-14 (codified as amended at 12 U.S.C. §§ 3102-03 (1988)).

179. See 77 Fed. Res. Bull. 572, 578 (1991). For example, Congress did not require prior Federal review of foreign bank entry into the U.S., something the Fed had then proposed. See *id.* at 579.

180. See *id.* at 579. To this end, the FBSEA would establish uniform federal standards for entry and expansion of foreign banks in the U.S., including a requirement of consolidated home-country supervision and the application of the same financial, managerial, and operational standards that govern U.S. banks. See *id.* The proposal would also grant regulators the power to terminate the activities of a foreign bank that is engaging in illegal, unsafe, or unsound practices and provide regulators with the information-gathering tools necessary to carry out their supervisory responsibilities. See *id.*

181. For example, the information necessary for determining the safety and soundness of domestic banks is located within this country. Information on foreign institutions, however, is generally located abroad. Additionally, foreign institutions are governed by rules and regulations of foreign nations. See *supra* notes 119-26 and accompanying text.

182. 77 Fed. Res. Bull. 572, 580 (1991).

183. See FBSEA, *supra* note 174, § (2)(a) (amending 12 U.S.C. § 3105 (1988)).

regulators, the federal regulators can deny entry.¹⁸⁴

2. Cooperation with Foreign Supervisors

The Fed also seeks to mandate cooperation with foreign supervisory bodies. Most regulatory schemes are drawn naturally from domestic systems and are based on legal frameworks and accounting conventions that may vary significantly from country to country.¹⁸⁵ It is thus imperative that banking regulations allow supervisors sufficient flexibility to respond to what is happening in the markets around the world.¹⁸⁶ The Fed, therefore, has proposed that the IBA be amended to clarify that federal banking agencies would be authorized to share supervisory information with their foreign counterparts, subject to adequate assurances of confidentiality.¹⁸⁷ Additionally, there must be a method to ensure that the Fed will have access to the information it needs to determine whether a bank is complying with U.S. banking requirements.¹⁸⁸ Experience with BCCI demonstrates the critical importance of such access.¹⁸⁹

3. Entry into the U.S. Market

As a qualification for entry into the United States, the FBSEA would require adequate assurances by a bank that its home supervisors will provide the necessary information to ensure and enforce the bank's compliance with American banking requirements.¹⁹⁰ This provision may also reduce the attraction of offshore banking secrecy centers. If the United States makes it clear that a banking entity attempting to hide its activities will not be permitted to do business in the United States, many banks might re-think their strategies.

Additionally, under the current U.S. system, each state bases foreign bank entry on its own criteria—which can, and do, differ substantially from state to state.¹⁹¹ BCCI illustrates the need for a common set of

184. See *id.* §§ (2)(a), (d)(5) (amending 12 U.S.C. §§ 3105, 1842(c) (1988)).

185. See *Cross-Border Banking*, *supra* note 1, at 116.

186. See *id.* In the absence of a blueprint that provides for the regulation of the activities of all multinational financial companies, supervisors must work together to try to ensure that business can be conducted efficiently and legitimately.

187. See FBSEA, *supra* note 174, § (2)(d)(5) (amending 12 U.S.C. 1842(c) (1988)). Indeed, the proposed Consolidated Supervision Directive of the EC contains similar provisions. See *Lessons of BCCI for the Regulators*, *supra* note 141, at 11, col. 1. This directive would give the EC Commission the "power to negotiate agreements with third countries to extend consolidated supervision and the exchange of confidential information to banks and other credit institutions established in those countries with subsidiaries in the Community." *Id.* EC Commissioner Sir Leon Brittan states that "[r]eaching formal agreements on effective information-sharing with supervisors from countries outside the Community will be a priority for us in the years ahead. Such agreements are the foundation of effective supervision of banks involved in global business." *Id.* at 11, col. 3.

188. See 77 Fed. Res. Bull. 572, 580 (1991).

189. See *supra* notes 119-26, 130-33 and accompanying text for a discussion of hidden ownership interests and enforcement abilities.

190. See FBSEA, *supra* note 174, § (2)(d)(5) (amending 12 U.S.C. § 1842(c) (1988)).

191. See 77 Fed. Res. Bull. 572, 579 (1991).

standards applicable to all foreign entrants into the U.S. banking system, whether through federal or state charter.¹⁹²

BCCI chose to enter the U.S. banking market by establishing agencies under state regulation.¹⁹³ BCCI likely chose this structure because it believed state regulators would not be as capable as federal regulators in assessing the soundness of BCCI's parent organization.¹⁹⁴ Thus, through the FBSEA the Fed proposes a federal approval process that would apply common standards to the proposed entry by a foreign bank through either a state or federally licensed office, or through a commercial lending company.¹⁹⁵ While the IBA gave the Fed certain duties in the supervision of foreign banks, no federal agency has a voice in deciding whether individual institutions seeking to enter U.S. markets through state branches, agencies, or commercial lending companies meet the standards generally applicable to banking organizations in this country.¹⁹⁶ Under the FBSEA, the Fed would be given the ultimate authority to reject a potential entrant or even to remove a license, once granted, if the Fed determines that certain guidelines are not being met.¹⁹⁷ The Fed proposal also attempts to prevent hidden ownership interests by requiring the reporting of loans secured by the stock of an American bank.¹⁹⁸

In many cases, simply closing a corrupt bank might be too drastic and

192. This would insure against some jurisdictions applying minimal standards to institutions. See 77 Fed. Res. Bull. 569, 571 (1991).

193. See *supra* note 88 and accompanying text.

194. As one would expect, this suggestion is strongly discounted by state regulators. Jill M. Considine, Superintendent of Banking for New York State, argues that the Fed already has all the statutory authority necessary to achieve adequate supervision of foreign banks operating in the U.S., and that the Fed is actively involved in examining both state- and federally chartered banks. See Considine, *Regulation of Foreign Banks Needs No Fixing*, Am. Banker, May 31, 1991, at 4. Considine further argues that "the record of state regulation of foreign banks has been good." *Id.*

195. See FBSEA, *supra* note 174, § 2.

196. See 77 Fed. Res. Bull. 572, 580 (1991).

197. See FBSEA, *supra* note 174, § 2. Support for this provision of the FBSEA was not unanimous. Sidney A. Bailey, Virginia's Commissioner of Financial Institutions, recognizing the apparent rebuke to state authority, told the panel that the Fed did have the authority to prohibit the acquisition of First American Bankshares, Inc. by BCCI in 1981. Mr. Bailey claims that granting the Fed this ultimate authority "will break something that has worked well and effectively for a century"—namely, state authority to control the entry of banks into the state. See *Fed-Drafted Bill on Foreign Control Gets Mixed Reviews Before Senate Banking*, 56 Banking Rep. (BNA) No. 22, at 1041-42 (June 3, 1991).

New York District Attorney Robert Morgenthau disagreed, contending that giving "the Fed authority over the entry of foreign banks into the United States would not preempt state regulations or render state regulators unnecessary." *Id.* at 1042. Mr. Morgenthau argued that only the Fed can deal with the central banks of foreign countries and prevent interstate abuses. He added that "the Fed is 'ideally positioned' to uncover money laundering schemes since it monitors the U.S. cash flow." *Id.*

198. Alan Greenspan assured Congress that this reporting requirement would go a long way toward eliminating the problems of supervising foreign banks. He stated that "we have no way to make absolutely certain, under all conditions, that there isn't a second, third, or fourth tranche of type of ownership which we would be able to extract." *Foreign Banks Hearings, supra* note 1, at *14. Greenspan believes, though, that many of

might, unwittingly, lead to greater difficulties.¹⁹⁹ There will be many additional problems should the Fed start closing every foreign branch it deems under inadequate home-country control, and the Fed and other regulatory authorities should certainly explore other alternatives.²⁰⁰ A United Nations group calls for what would amount to "an international Chapter 11," a reference to the American bankruptcy law under which insolvent companies are allowed to operate under court protection."²⁰¹ When dealing with a corrupt institution such as BCCI, the group suggest regulators should separate the fraud-tainted portions of the entity from the rest of its operations.²⁰²

The Treasury banking reform bill²⁰³ would require that all foreign banking institutions wishing to conduct business in the United States structure themselves as subsidiaries.²⁰⁴ This has indicia of overregulation, however, because it limits the autonomy of the parent bank by forcing it to structure its U.S. affiliate as an independent entity. Foreign regulatory bodies would almost certainly respond to this challenge by applying tougher standards to U.S. banks abroad.²⁰⁵ The FBSEA, however, successfully merges the interests of domestic and foreign banking and has proposed a reform bill that will be a major step in remedying many of the inefficiencies and shortcomings in the current regulatory framework.

the glaring problems that the Fed confronted in the ownership question of First American and BCCI will be addressed. *See id.*

199. Once present in the U.S., a bank would face closure under FBSEA § 2, which provides that the Fed may terminate the activities of a foreign bank if "there is reasonable cause to believe that such foreign bank, or any affiliate of such foreign bank, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States." FBSEA, *supra* note 174, § 2.

200. Repeated closure of foreign-based banks will likely lead to a depositor run every time another bank is closed. Host countries should, therefore, have options for exerting control over dubious institutions within their borders other than simply closing the institution. For example, British law gives the Bank of England "broad discretion" to intervene in the management of corrupt institutions. *See The BCCI Affair: Blaming the Bank of England, supra* note 136, at 92.

When a bank with branches in England keeps its corporate headquarters elsewhere, the Bank of England generally defers to the home regulator. It can take over the British branches, however, if that regulator lacks the capacity for proper supervision, or if the bank's main business is in England. *See id.* In exercising this authority, the Bank of England can, among other things, remove managers, restrict deposit-taking, or demand higher liquidity. If these options do not work, then the regulator can choose to close the bank down. *See id.*

201. *U.N. Study Assails, supra* note 166, at D7, col. 3.

202. *See id.*

203. H.R. 1505, 102d Cong., 1st Sess. (1991).

204. *See id.*

205. *See Foreign Banks Hearings, supra* note 1, at *5 (statement of Mr. Greenspan). Greenspan argues that enactment of the Treasury reform bill would burden foreign institutions with additional costs and that it could scale back commercial lending activity. Thus, even if requiring foreign banks to restructure themselves does not lead to retaliatory practices abroad, the Treasury bill might lead foreign banks, which account for 30% of all commercial lending in the U.S., to cut back on their U.S. operations. Consequently, the share of lending generated by foreign banks may decrease. *See id.* at *9-10.

4. Non-legislative Steps

Not every reform must take the form of legislation, and there are several non-legislative steps that regulators might take. Increased coordination is needed among the primary state and federal supervisors of foreign branches and agencies to ensure that these offices are subject to examination on a regular basis.²⁰⁶ With BCCI, this examination occurred only after regulators detected signs of trouble.²⁰⁷

The Fed has proposed increased sharing of information and resources between the Federal Reserve and the state authorities that license foreign banks.²⁰⁸ Part of this cooperation is a program for conducting simultaneous examination of all the U.S. offices of foreign banks to obtain a comprehensive view of the bank's American operations.²⁰⁹ The Fed also proposes annual on-site examinations as well as other programs now employed for state member banks.²¹⁰ Furthermore, the states might defer to the Fed on matters relating to cooperation with foreign parent institutions, in order to consolidate the U.S. national approach.

Another lesson that the BCCI debacle suggests is that regulators should intervene early in the affairs of a mismanaged bank. For years BCCI operated as an outcast in top financial centers, while regulators simply stood by and hoped things would improve.²¹¹

C. Preventing Fraud: More Emphasis Needed

There are inadequate instruments available for detecting bank fraud.²¹² While banking supervisors monitor banks for prudent conduct, auditors claim that their only job is to check accounts and assert that it is up to management to detect fraud.²¹³ In the case of BCCI, though, the management was perpetrating the fraud. The Luxembourg regulators have stated that their regulatory arrangements were unable to cope with fraud.²¹⁴ Fraud and criminal activity, however, are likely to gravitate to financial centers with a weak regulatory environment and strong secrecy

206. William Taylor, Staff Director for the Fed's Banking Supervision and Regulation Division, claims that stepped-up, on-site examinations of foreign banks are essential to ensure adequate supervision. See 77 Fed. Res. Bull. 569, 571 (1991).

207. See *BCCI: Regulatory Rights and Wrongs*, *supra* note 94, at 1-2.

208. See FBSEA, *supra* note 174, § 3.

209. See *id.* Under the IBA, the Fed must rely on the reports of other regulators to the extent possible. Under this provision of the FBSEA, the Fed would be allowed to call for coordinated or simultaneous examinations and coordinate efforts among the states. Simultaneous examinations would reduce the likelihood of those schemes through which banks move collateral from one branch to the next just ahead of the examiner.

210. See *id.*

211. See *Behind Closed Doors*, *Economist*, July 13, 1991, at 14. While waiting for "proof" of fraud, regulators did set up a "college of supervisors." See *id.* This only served, however, to prolong the regulatory review process since supervision was then split up among seven nations. See *supra* notes 132-33 and accompanying text.

212. See *First Steps Towards Tougher Regulation*, *supra* note 93, at 13, col. 5.

213. See *id.*

214. See Dale, *supra* note 18, at 12, col. 7.

laws.²¹⁵ Therefore, offshore banking centers should be overhauled so as to eliminate them as a magnet for criminal activities.²¹⁶

Additionally, while no regulation can prevent fraud completely, there are ways to stem its growth—through more on-site examinations,²¹⁷ for example, and perhaps through a reassessment of the role of the auditor.²¹⁸ There have also been calls to strengthen U.S. control over money laundering activities through statutes specifically providing investigators with venue choice and jurisdiction.²¹⁹ A money laundering directive in the EC, similarly, will make it more difficult to perpetrate.²²⁰ Finally, laws designed to punish more stringently those convicted of fraud or money laundering may not entirely prevent fraud, but may at least provide some deterrent effect.

CONCLUSION

International banking faces a plethora of problems and issues as the next century approaches. As transnational financial services have increased, the significance of national borders has decreased. Banking regulators will be called upon to coordinate efforts and to cooperate with their international counterparts. The BCCI scandal presents an important illustration of the potential problems faced by international bank regulators. And, as with most banking scandals, BCCI will surely lead to a cathartic reevaluation of the existing framework of international banking regulation and supervision.

Indeed, the future looks promising. The emergence of the Single Market in 1992 will create a unified banking community in Europe. The EC Directives, together with the reforms proposed in the United States and the spirit of cooperation pervading both the U.S. and the EC proposals, bode well for increased collaboration among nations, and indeed, for put-

215. *See id.*

216. Professor Richard Dale suggests that while offshore banking is a legitimate business, it should be conducted in jurisdictions such as Great Britain, which have the financial and regulatory infrastructure to host it responsibly. *See BCCI: Regulatory Rights and Wrongs, supra* note 94, at 2.

217. *See Dale, supra* note 18, at 12, col. 7. Fed General Counsel Virgil Mattingly, testifying before Congress, said that the Fed's proposals will not solve every supervisory problem regarding foreign banks, but will lessen the potential for illegal activities by barring the entry of questionable institutions and providing regulatory and supervisory tools for investigating and enforcing compliance. *See BCCI Hearings, supra* note 143, at *6.

218. *See generally* Lohr, *Auditing the Auditors—A Special Report; How BCCI's Accounts Won Stamp of Approval*, N.Y. Times, Sept. 16, 1991, at A1, col. 1 (discussing the role of Price Waterhouse in the BCCI scandal).

219. Paul Maloney, Deputy Assistant Attorney General for the Justice Department's Criminal Division, suggested these procedural statutes. *See Fed-Drafted Bill on Foreign Control Gets Mixed Reviews Before Senate Banking, supra* note 197, at 1042. In addition, proposals by the Justice Department would allow the U.S. Attorney General to issue administrative subpoenas, and would make it easier for investigators to obtain bank records. *See id.*

220. *See ECs Financial Regulations Should Stand the Test of the Worldwide BCCI Scandal*, Thomson's Int'l Banking Reg., Jan. 20, 1992, at 8.

ting the “super” back in supervision. In the future, there must be a more defined role for both parent and host nations and for their supervisory agencies—a development that will eliminate the most vexatious problem in international banking regulation: the lack of consolidated supervision.