Cross-border Banking - The Road Ahead and Lessons from Emerging Markets in Europe

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I. Introduction

Nigeria's financial sector has flourished in recent years offering the potential to be a key driver of economic development in Nigeria as well as throughout the region. The changes have been dramatic. Banking sector assets have grown from 30 percent of gross domestic product (GDP) in 2005 to about 65 percent of GDP at end- 2008 and Nigerian banks operate in 35 countries compared to just four in the middle of the decade. These are encouraging developments. Yet, the development potential of the growing banking sector will be realized only if financial stability is preserved. More specifically, the regulatory framework must keep pace with the burgeoning banking sector. Thus, plans for more rapid implementation of consolidated and sub-based supervision are underway.

The basic principles of regulation and supervision are well known; the complexity of implementing those principles soars when cross-border activity grows. Cross-border banking involves foreign financial institutions operating in Nigeria on the one hand and Nigerian banks operating in other jurisdictions, and interaction of foreign banks with Nigerian banks. When financial activity crosses borders, monitoring the strength of the Nigerian financial system becomes more complex. Fundamental tasks such as defining adequate levels of provisioning or exposure to risk are considerably more complex for Nigerian supervisors.

The experience of emerging markets in Europe is a good starting point for drawing lessons on the implications of cross-border banking. Europe and sub-Saharan Africa are both comprised of a large number of relatively well-integrated countries. The significant degree

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of economic integration across-borders fosters cross-border financial activity. Moreover, emerging markets in Europe and sub-Saharan Africa are developing market-based institutions from limited foundations. In many cases, countries in both regions had relied on direct control of economic activity and, in recent years, have been seeking to create a favorable environment for private economic activity.

This paper focuses on the regulatory and supervisory challenges posed by the growth of cross-border banking, drawing lessons from the emerging markets in Europe. The second section takes stock of cross-border banking activity in emerging European and sub-Saharan African markets. The third section examines the experience of emerging markets in Europe to identify the challenges that have arisen as financial integration grows. The fourth section looks at the regulatory response to cross-border activity and draws lessons about what worked and what failed. The global financial crisis was a major stress test for the regulatory framework and helps identify weaknesses that need to be addressed in the regulatory framework. The fifth section examines recent proposals to strengthen the regulatory and supervisory architecture. Finally, the paper highlights the lessons that authorities in sub-Saharan Africa, and Nigeria, in particular, could draw from European experience.

II. Cross-border Banking – The State of Play

The changes in the European and African banking systems have been significant and rapid. Regional financial integration has proceeded faster in Europe than in other world regions.[1] Analysis is underway on assessing financial integration in sub-Saharan Africa and while it has been significant, it lags that in emerging Europe. The implications of the rapid financial integration are prominent on the policy agenda in sub-Saharan Africa owing particularly to the rapid increase in activity of South African and Nigerian banks across the continent.

Large cross-border banks are gaining a substantial market share in emerging Europe. Sixteen large cross-border financial institutions account for about one third of European Union banking assets, hold an average of 38 percent of their banking assets outside their home

[1] See De Nicolò and Ivaschenko (2008) who measure the advances in financial integration as a degree of cross-country convergence in equity premiums following the methodology developed by Adjaouté and Danthine (2004).

countries, and operate in half of the other European Union countries.[2] European banking integration is gaining momentum in terms of cross-border flows, market share of foreign banks in several markets, and cross-border mergers and acquisitions are on the increase.[3] The bulk of their cross-border business is in wholesale markets, which are now relatively well integrated, particularly interbank and corporate bond markets. Integration at the retail level is limited, accounting for about 5.0 per cent of activity.[4]

In sub-Saharan Africa, cross-border banking activity involving Nigeria has become significant in the last few years. Major foreign financial groups have traditionally held a significant presence in Nigeria through direct ownership in or involvement with Nigerian banks, and in recent years Nigerian banks have considerably expanded their operations in other countries.

- Citibank, Standard Chartered, and Standard Bank have sizeable operations in Nigeria. Foreign ownership of banks may increase as new investors seek participation in the on-going restructuring of the banking system.

- Nigerian banks operate in 29 countries in Africa, and in 6 countries outside the continent (Table 1). Most large Nigerian banks operate offshore. Ecobank and United Bank for Africa each have activities in more than 20 countries.

[2] See mapping exercise of European Union banking groups carried out by the Banking Supervision Committee of the European System of Central Banks (Trichet, 2007).
[3] Schoenmaker and Oosterloo (2005) and Dermine (2005).
[4] Čihák and Decressin (2007) and Dierick et. al. (2007).

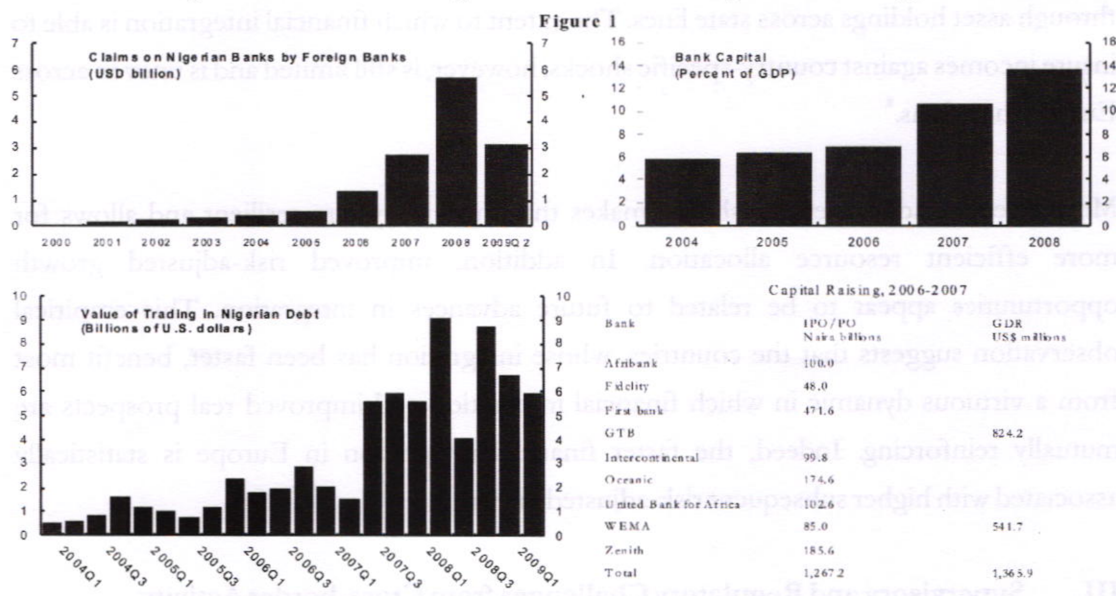
Table 1. Nigerian Banks Operating in Other Jurisdictions

Bank	Subsidiaries	Non Subsidiary or Unspecified
Access Bank	The Gambia, Côte d'Ivoire, Democratic Republic of Congo, Rwanda, Zambia, Burundi	Sierra Leone (head office and one branch), United Kingdom (head office and one branch)
Afribank		Ireland (offshore finance office)
Bank PHB	The Gambia, Ghana, Liberia, Sierra Leone, Uganda	
EcoBank	Benin, Burkina Faso, Burundi, Cape Verde, Cameroun, Central African Republic, Chad, China, Congo Brazzaville, Democratic Republic of Congo, Côte d'Ivoire, France, Gabon, The Gambia, Ghana, Guinea, Guinea Bissau, Kenya, Liberia, Malawi, Mali, Niger, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, Togo, Uganda, United Arab Emirates, United Kingdom, Zambia	
First Bank	France, United Kingdom	
Guaranty Trust Bank		The Gambia, Ghana, Liberia, Sierra Leone.
Intercontinental Bank	Ghana, United Kingdom	
Oceanic Bank		Cameroun, The Gambia, Ghana, Sao Tome
Union Bank of Nigeria		Benin, Ghana, United Kingdom
United Bank for Africa	Benin, Burkina Faso, Burundi, Cameroon, Chad, Côte d'Ivoire, Gabon, Ghana, Guinea, Republic of Congo, Democratic Republic of Congo, Kenya, Liberia, Mali, Rwanda, Senegal, Sierra Leone, Tanzania, Uganda, Zambia, France, United Kingdom, United States.	
Zenith Bank	Ghana, Sierra Leone, South Africa, United Kingdom	

Source: Websites of banks listed in the first column.

- The involvement of foreign banks with Nigerian banks has increased considerably following the consolidation of the banking system at end-December 2005. This has included loan placements with Nigerian banks and, more generally, through credit lines. The scale of this involvement is difficult to measure, but the rapid growth in several indicators such as foreign claims on Nigerian banks, Nigerian banks total capital, value of trade in Nigerian debt, and capital raising by Nigerian banks, reflect to a large extent the increasing involvement of foreign banks in Nigeria.

Figure 1



Capital Raising, 2006-2007

Bank	IPO/PO Naira billions	GDR US$ millions
Afribank	100.0	
Fidelity	48.0	
First bank	471.6	
GTB		824.2
Intercontinental	99.8	
Oceanic	174.6	
United Bank for Africa	102.6	
WEMA	85.0	541.7
Zenith	185.6	
Total	1,267.2	1,365.9

Source: Bank for International Settlements, Central Bank of Nigeria, Emerging Markets Traders Association

The payoff from regional financial integration can be significant. Integration can make financial markets more efficient, reduce economic volatility, and promote economic growth. The payoff is in:[5]

- *Market access and competition*: increased market access can deliver efficiency gains by unleashing competitive pressures through contestability or direct competition.
- *Market scale and structure*: integrating fragmented markets creates a deeper and more liquid market. Pooling liquidity fosters trading opportunities, lowers margins or bid-ask spreads or risk spread, limits the volatility impact of large trades, and contributes to more efficient price formation.

[5] See Decressin et al (2007) and Tobin's (1984) concepts of efficiency in financial markets.

- *Market scope and completeness*: financial integration boosts innovation through new financial instruments that promote more cost efficient hedging of risks.[6]

Cross-border activity can smoothen incomes through cross-border asset diversification and contribute to economic stability in the face of asymmetric shocks.[7] Estimates for European countries show that risk sharing has increased significantly since 1999. In the United States, it is estimated that two-fifths of the income effect from local shocks is smoothed away through asset holdings across state lines. The extent to which financial integration is able to insure incomes against country-specific shocks, however, is still limited and is uneven across European regions.[8]

More effective adjustment to shocks makes the financial system resilient and allows for more efficient resource allocation. In addition, improved risk-adjusted growth opportunities appear to be related to future advances in integration. This empirical observation suggests that the countries, whose integration has been faster, benefit most from a virtuous dynamic in which financial integration and improved real prospects are mutually reinforcing. Indeed, the faster financial integration in Europe is statistically associated with higher subsequent risk-adjusted growth.[9]

III. Supervisory and Regulatory Challenges from Cross-border Activity

Cross-border activity makes regulation and supervision more challenging. Supervisors face greater uncertainty about the magnitude and location of risks because of the increasingly complex linkages across market segments and borders that make the transmission of economic shocks and the pattern of risk dispersion difficult to track. In addition, the difficulty of coordinating national supervisory agencies, whose fiduciary responsibilities are toward national governments, limits their effectiveness in working toward common objectives in the design and implementation of financial regulations.[10]

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[6] Involvement of foreign banks can bring development gains through technology transfer and human capital development.
[7] IMF (2008).
[8] According to estimates presented in IMF (2008), in Europe, less than one-tenth of the income effect from a country-level shock is smoothed away through factor income flows across other European countries.
[9] See De Nicolò and Ivaschenko (2008). The speed of integration is measured by the gap between a country's cost of capital from the regional (or other group) average. The growth opportunities are adjusted for risk and are proxied by the ratio of market price-to-earnings ratios to their volatility.
[10] IMF (2008).

The regulatory framework needs to minimize the negative consequences of financial integration. The main risks of financial integration are:[11]

- *Contagion*: increased likelihood of adverse external or spillover effects transmitted across financial markets beyond what fundamental linkages would predict.

- *Fundamental spillovers*: increased likelihood of the wider spread of financial disturbances through market relationships, transactions, or exposures, reflecting linkages between various entities and markets. Significant financial cross-border spillovers have the potential to amplify the macroeconomic effects of leverage pro-cyclicality.[12] An increase in the pro-cyclicality of lending behavior might boost investment and output volatility in the presence of financial cross-border spillovers than it would do in their absence.

- *Transition risk*: encompasses elements of the preceding factors and concerns the specific risks arising from changes in integration. In Europe, this risk is particularly germane for countries that experience a sharp fall in interest rates and pronounced credit booms during convergence accompanying European Union or Euro area membership. Some of these risks are present in Nigeria and other developing countries that are integrating into global financial markets.[13]

Cross-border ownership is a major transmission channel of financial sector risk. Integration increases possibilities for stronger balance sheet linkages and exposures. As a result, changes in the market valuation of financial firms in one location can have cross-border repercussions. Moreover, ownership links often lead to concentration in off-balance sheet exposures, such as intergroup credit and guarantees.

[11] Faruqee (2007).
[12] Galessi and Sgherri (2009).
[13] In Nigeria, for example, the fiscal and banking reforms in the middle of the decade resulted in both demand and supply side pressures on macroeconomic management and financial stability. Markets positively re-rated Nigeria and, along with global pressures on investors seeking returns, saw an increased supply of funds flowing to Nigeria and its banks. The increased flow of capital to Nigerian banks is reflected on several indicators shown in Figure 1. Nigerian banks were looking to increase their balance sheets to secure market share.

IV. Lessons from Regulatory Arrangements – What Worked and What Failed

Most financial sector regulatory and supervisory activities in Europe are organized on a national basis. For the banking sector, each country is responsible for the consolidated supervision of institutions domiciled in that country for which it is the home supervisor. It also has the responsibility, as host supervisor, to oversee subsidiaries of institutions from other member states operating in its jurisdiction. Several authorities have commitments to cooperate with counterparts abroad expressed in national laws or their mission statements.

Nonetheless, financial oversight has been moving towards the European-wide level since the late 1970s. A series of directives and other instruments created a binding framework for national prudential regulation across the European Union, and new member states are obliged to accept these rules. Since the 1990s, various initiatives, including the Lamfalussy Process, have aimed to strengthen further European financial integration.

The main structure for regulation and supervision at the European level is set out in the Lamfalussy Process. This process is a framework designed to facilitate cooperation among national supervisors.[14] The process is defined by four levels:

- *Level 1*: the framework legislation setting out the core principles and defining implementing powers.
- *Level 2*: the technical details that are formally adopted by the European Commission.
- *Level 3*: advisory committees to the European Commission established for the banking, insurance, and securities sectors committees intended to facilitate exchange of information, cooperation and convergence of supervisory practices.
- *Level 4*: the timely and correct transposition of EU legislation into national law.Within that framework, cross-border issues are addressed by loose collaborative arrangements:[15]

[14] Čihák and Decressin (2007)

[15] Hardy (2009)..

- *Information exchange and consultation*: A number of bilateral and some multilateral Memoranda of Understanding commit the signatories to regular exchange of information and timely consultation on enforcement action.

- *"Colleges" of supervisors*: The colleges follow the activities of cross-border insurance groups and some banks. Colleges are not, however, in operation in all countries.

- *Limited Europe-wide powers*: European Union institutions have powers in three areas: agreed regulations that are directly applicable in all Member States; the Council of the European Union discusses financial sector policy; and the European Union Commission has autonomous powers in areas relating to the completion of the common market, competition and trade negotiations, including trade in services.

- *Lender-of-last resort at regional level:* The European Central Bank (ECB) and the European System of Central Banks (ESCB) are lenders of last resort. Each national central bank is responsible for emergency liquidity to financial institutions domiciled in its jurisdiction with the ESCB and ECB informed in case offsetting monetary action is needed.

The increasing integration of European banking systems was a factor determining the impact of the global financial crisis. Countries with larger bank-related capital inflows were affected.[16] As parent banks experienced increasing liquidity tightness, financial markets reacted adversely to their Eastern European subsidiaries. A sudden interruption in loans from foreign parent banks to subsidiaries had an adverse impact on credit and economic growth as well as placing pressure on exchange rates and reserves. Exchange rate movements eroded credit quality due to the existence of large-scale foreign currency mismatches in the private sector in much of emerging Europe.

In the run up to the crisis, lending was higher on account of weak supervisory capacity on cross-border lending. The lending financed largely activities in the non-tradable sectors and

[16] IMF (2009).

this contributed to overheating of the economies. Apart from currency mismatches and debt roll over needs, the emerging European economies that tackled overheating more effectively were less affected by the crisis.

The failure to build sufficient reserves for loan losses during the pre-crisis boom undermined many banks in emerging Europe even though they had appeared well capitalized and profitable.[17] These banks were generally in compliance with basic micro prudential regulations, but, with the benefit of hindsight, should have gone well above the required minimums to maintain sufficient capital during the financial crisis. Furthermore, Eastern European supervisors did not impose tough provisioning and capital requirements on foreign-owned banks due to possible inconsistencies with Basel II preparations and trusting the effectiveness of supervision in source countries. Moreover, there is the suggestion that there was concern about possible retaliation by parent banks. This was a major problem in Eastern Europe, probably more than other regions, given the large participation of foreign banks.

Regulatory weaknesses exposed during the financial crisis strengthened arguments for a more cohesive system of financial regulation in the European Union. Decentralized supervisory frameworks and accountability for financial stability, hinder cross-banking operations and the capacity to effectively and efficiently supervise large financial institutions. The crisis exposed several weaknesses:[18]

- *Reliance on consensus slowed decision-making*: Consensus decision making impeded progress on the regulatory framework and it increasingly fell behind developments in the rapidly changing financial sector.

- *Decision making structures were dominated by national rather than region-wide interests*: The committees may be biased towards outcomes that favor established interests that are effective in lobbying at a national level, rather than maximize welfare for Europe

[17] IMF (2009).
[18] Čihák and Decressin (2007).

as a whole. Committee decisions may be achieved by recognizing all current national practices, thus hindering integration and adding to the regulatory burden.

- *Decentralized decision making cannot track vulnerabilities*: The costs of decentralization mounted as financial institutions and markets become more integrated; national authorities individually could no longer exercise effective supervision of cross-border groups. Information was dispersed and asymmetry among the supervisory bodies both at the macroeconomic and the microeconomic levels.

- *Regulatory arbitrage*: Financial institutions faced twenty seven different prudential regimes.

The lack of cohesiveness of the regulatory framework in Europe is the main message of the de Larosière report.[19] The significant leeway provided to European Union members in the enforcement of common directives is the main cause of lack of cohesion. "Level 1" directives too often left, as a political choice, a range of national options, which allowed "Level 3" committees to impose different solutions. Even when a directive did not include national options, it led to diverse interpretations that were not eliminated by region-wide committees. Examples of excessive diversity are:

- *Different definitions of financial institutions*: Laxer supervision and regulatory arbitrage resulted from some countries having different definitions regarding the sectoral extent of European Union supervision. Some members had an extended definition of credit institutions compared with other members with much more limited definitions.

- *Definition of core capital differs*: This basic element of assessing financial stability varied from one country to another. This hindered the efficiency and enforcement of the Basel directive on capital requirements.

- *Diverse reporting obligations*: The diverse reporting obligations weakened the transparency of the system.

[19] A report produced by a high-level group on financial supervision of the European Union (EU, 2009).

- *Different accounting practices*: These differences, such as those concerning provisions related to pensions, create serious distortions in the calculation of prudential funds.

V. The Way Forward – Theory and Recent Proposals

The financial crisis increased the urgency of reforming Europe's financial sector. Until recently, political preference, as well as legal and institutional considerations, limited progress on cross-border financial stability arrangements. However, it is recognized that bank recapitalization efforts in emerging Europe will be wasted if not accompanied by a strengthening of the supervisory, regulatory, and macro prudential framework. Stricter capital requirements will need to be accompanied by much stronger cross-border cooperation between home and host central banks, supervisors, and ministries of finance. Regulatory and supervisory convergence remains essential to foster smooth and growth-oriented adjustment among economies characterized by increasingly complex linkages across market segments and borders. This has been recognized and action has been taken in this direction.

Implementing a unified supervision arrangement in financially integrated countries should be the goal according to theoretical analysis. A unified supervisory framework is superior to decentralized supervision in financially integrated regions because:

- *Decentralized regulators may reduce regulatory standards relative to a centralized solution.* Dell'Ariccia and Marquez (2001), show this result in a model in which regulators concerned with their banking system's stability and efficiency set their regulatory policy non-cooperatively. Since bank supervision has externalities due to cross-border spillovers, an independent solution collectively becomes more inefficient with higher financial integration.

- *A unified supervision framework can provide the highest level of safety with the lowest provision of deposit guarantees.* Hardy and Nieto (2008) studied the optimal design of prudential supervision and deposit guarantee regulations in a multi-country, integrated banking market such as the European Union, where policy-makers have either similar or asymmetric preferences regarding profitability and stability of the banking sector. Under this framework, they conclude that full coordination of

prudential supervision and deposit guarantees would result in the highest level of safety and soundness and would involve the lowest provision of deposit guarantees.

- *Decentralized supervision leads to a disproportionate distribution of the total costs of financial supervision.* Nieto and Schinasi (2007) apply two models of decision making, concluding that the larger countries in Europe will end up bearing a disproportionately large share of the overall burden of allocating resources to secure financial stability. Hence, there may not be a close correspondence across countries of the benefits received and the costs incurred in contributing to the financial stability.

Arguments for a unified supervisory system in Europe are strong. Čihák and Decressin (2007) propose a full-fledged European Union level prudential regime that operates alongside national regimes. A European Banking Charter could establish a level playing field for financial sector competition, while closing gaps in Europe's financial stability framework. Hardy (2009) argues for the implementation of an effective European mandate. Such an arrangement would give European Union convergence, cooperation and operational weight at the national level. The mandate would enhance the functioning of the Level 3 committees and supervisory colleges as well as facilitate further development of a more efficient and effective European stability framework. Looking forward to further integration of European financial markets and commercial institutions, it is suggested, that an European-wide financial stability mandate would be required.

Europe is, however, taking a different path relying on harmonization and cooperation based on national financial stability framework rather than a unified system.[20] Support for harmonization and adoption of core minimum standards is the foundation of the approach proposed by the de Larosière report. Consistency, it is argued, does not need a unified system of supervision. The report argues that national approaches that benefit some countries can be implemented without falling into the existing drawbacks of national systems. For instance, allowing a country to adopt safeguards or regulatory measures stricter

[20] Appendix 1 shows division of supervisory responsibilities between the EU and national level as proposed by the de Larosière report.

than the common framework should not be rejected, as long as agreed minimum core standards are harmonized and enforced.

Eliminating regulatory inconsistencies is an essential part of the European approach. Since the application of directives has given too much leeway to national application of critical supervision regulations, the de Larosière report suggests that future legislation should be based on regulations. When directives are used, the implementing agency should strive to achieve maximum harmonization of the core issues.

The central bank will take on the role of macro prudential supervisor. The de Larosière report supports an extended role for the ECB in macro-prudential oversight. The central bank would not be involved in micro-prudential supervision. The report suggests that micro-supervisory duties could impinge on the central bank's fundamental mandate including the risk of political pressure and interference jeopardizing its independence. In any event, micro prudential supervision is extremely complex because in the case of a crisis the central bank would have to deal with a multiplicity of member states.

A new institution - a European System of Financial Supervision (ESFS) - to enhance regional cooperation is proposed. De Larosière finds that the regional committees were ineffective in ensuring financial stability in Europe. The proposed ESFS would be an integrated network of European financial supervisors based on a largely decentralized structure. Since national supervisors are closest to the institutions they supervise, they would preserve the majority of their present responsibilities. The supervisor of the home country will continue to function as the first point of contact, and a European centre should coordinate the application of common standards, guaranteeing strong interaction among supervisors, while safeguarding the interests of host supervisors.

ESFS supervisors should have clear responsibilities, sufficient resources, and a strong mandate. The report suggests that the ESFS be independent from possible vested interests, at both European Union and national levels and neutral with respect to national supervisory structures. It also expects that the ESFS will work with a common set of core harmonized rules and rely on high-quality and consistent information. In times of crisis, the ESFS

should have a strong coordinating role, facilitating cooperation and exchange of information between competent authorities, possibly acting as mediator when needed, verifying the information that should be available to all parties, and guiding the relevant authorities in their decision-making.

The ESFS should continue to rely on the colleges of supervisors. Colleges of supervision should be strengthened by the participation of representatives of the secretariat of the level 3 committees as well as of ECB/ESCB observers. The report also recommends that Level 3 committees be transformed into three European Authorities: a European Banking Authority, a European Insurance Authority and a European Securities Authority.

Reflecting these views, the European Union Commission adopted in September 2009 legislative proposals to strengthen financial supervision. This legislation sets up the proposed ESFS and provides it with broader competencies compared to existing Europe-wide institutions. This includes:

- *Core standards*: Developing proposals for technical standards for stronger regulation principles.
- *Harmonizing rules across countries*: Resolving cases of disagreement between national supervisors, where legislation requires them to co-operate or to agree.
- *Consistent implementation*: Contributing to ensuring consistent application of technical Community rules.
- *Widening the regional regulatory net*: Directly supervising credit rating agencies.
- *Coordinated crisis response*: Coordinating action in emergency situations.

The legislation also creates a European Systemic Risk Board (ESRB), which will issue early risk warnings.

VI. Conclusions - Drawing Lessons for sub-Saharan Africa

Cross-border financial sector activity inherently gives rise to risks to financial stability in one or more jurisdictions. This increased risk arises because:

- there exists no regulatory framework that is targeted to provide an effective

regulatory structure for cross-border activity;

- the technical complexity of supervision of cross-border activity;
- the growth of cross-border activity that is outpacing the development of regulatory frameworks and supervisory capacity; and
- the incentive structure of national jurisdictions that can result in sub-optimal design and implementation of regulation.

All of these weaknesses were demonstrated in European emerging markets particularly during the financial crisis. African regulators and supervisors need to work expeditiously to address cross-border issues. The experience of emerging markets in Europe highlights the need for Africa to initiate promptly a process to design and implement a financial regulatory framework that preserves financial stability in the region in the context of increasing cross-border activity. During the current global crisis, Africa's financial integration may be too limited to generate such a major economic disruption as has been the case in Eastern Europe. Despite this, Africa has a burgeoning cross-border activity, but no formal framework. The European Union has worked for several decades to enhance the coherence of its nationally-based system of financial supervision, and despite accelerated efforts during this decade with full involvement of experts from its advanced member countries, the insufficient cohesiveness of its framework has amplified the effects of the international crisis.

In developing a framework, consideration might be given to:

- Defining a political structure on which the integration process will be based. Africa lacks the structure of the European Union that provides Europe with the political and technical basis to financial integration process. The current structure of Africa-wide and sub-regional groups will need to be assessed. Decisions will need to be made on how to build frameworks for sub-regional groupings as well as continent-wide.
- Establishing core principles of regulation and supervision. These principles could encompass minimum capital and provision requirements as well as harmonization of basic supervisory rules, definitions and framework. Each country will need to adopt common definitions of these principles.
- Designing an operational structure of cross-border financial integration. Although

several commentators on the European process proposed the adoption of a unified framework for financial oversight, Africa will need to start by strengthening the coordination of existing regulators. While the existence of sub-region-wide supervisors is essential to facilitate the process, the design of this structure should define responsibilities in terms of macro and micro prudential supervisions. It could also establish flexible working groups, similar to supervisory colleges in the European Union, to more pragmatically address specific cross-border issues. Through these "colleges" it could establish a mechanism of peer monitoring of the definition and adoption of these core principles as well as operational mechanisms that provide regular and crisis-related lines of communication. Efforts to target gains at the region-wide level will be essential to avoid the narrower interests of individual members leading to weaker outcomes.

Success in establishing an effective cross-border regulatory and supervisory framework will enable the financial sector to become a driver of growth and development in sub-Saharan Africa.

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Appendix 1

Recommendations of the De Larosière Report **Allocation of Competencies Between National and Regional Authorities**		
SUPERVISORY TASKS	**NATIONAL LEVEL**	**EU LEVEL**
Licensing of banks, e.g., fit and proper test, business plan, and minimum capital.	X	
Compliance with CRD minimal capital requirements (Pillar 1)	X	X
Review of bank's internal capital assessment and supervisory review process of bank's adequacy of capital (Pillar 2)	X	
On-site inspections	X	X
Review of banks' disclosure framework (Pillar 3)	X	
Enforcement and sanctions	X	
Internal governance/control	X	
Supervisory assessments of mergers and acquisitions.	X	X (pan-EU, in combination with national assessments)
Hybrid funds, i.e., compliance with eligibility requirements	X	
Large exposures requirements	X	
Qualified holdings	X	
Reporting	X (To be included in an EU database)	
Know your customer rules	X	
Provisioning policy	X	

SUPERVISORY TASKS	NATIONAL LEVEL	EU LEVEL
Provisioning policy	X	
Anti-money laundering rules	X	
Imposition of a conservator and possible revocation of licenses	X	
Development and implementation of harmonized technical EU prudential regulations and requirements, including advice to the Commission	X	X (incl. binding technical interpretation of level 1 and level 2 measures)
Defining overall supervisory policies		X
Ensure consistent supervision, e.g., defining common supervisory standards and practices as well as arrangements for the functioning of colleges		X (incl. binding supervisory standards)
Binding mediation, e.g., in case of disagreement between national supervisors		X
Designation of group supervisor		X

Appendix 1 (continued)

SUPERVISORY TASKS	NATIONAL LEVEL	EU LEVEL
Complaints	X	X (e.g., on discrimination by national supervisors)
Financial stability monitoring		X
Binding cooperation and information sharing procedures with the ESRC for macro-surveillance		X
Evaluate supervisory processes though peer review		X
Aggregate all relevant information pertaining to cross-border institutions		X
Prepare and/or adopt of third country equivalence decisions		X
Represent EU interests in bilateral and multilateral discussions with third countries on supervision		X
Crisis management	X	X (Coordinate national efforts, e.g., create and lead groups of national supervisors)
Crisis resolution	X	X (Coordinate national efforts, e.g., facilitate cooperation and exchange of information, act as mediator and help to define and implement the right decisions)
Source: European Union (2009).		