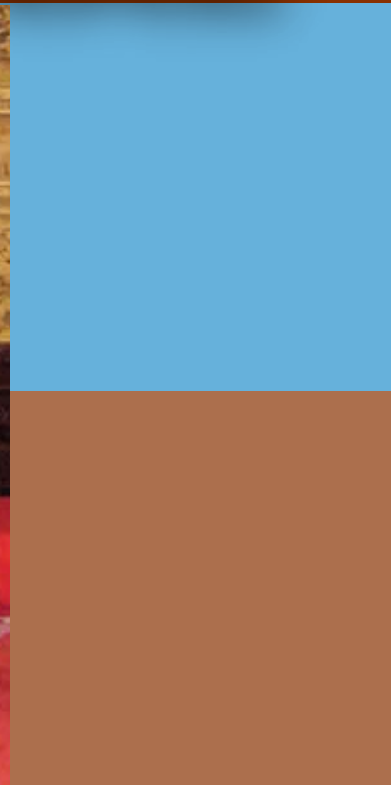




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VI.

International: National Banks and OCC Supervision in a Global Economy

Few industries have been more affected by globalization than banking. Spurred by opportunities in both the developed world and emerging markets, U.S. banks are rapidly expanding their international presence through mergers, strategic investments, and organic growth. Greater economic integration and financial market innovations, as well as the largely favorable global economic conditions of recent years, have fueled this development. Advancements in technology continue to improve banks' ability to manage larger operations at lower costs and from more locations, including geographically remote areas. The general trend toward deregulation contributes to this international expansion by lowering barriers to competition and permitting foreign bank entry into local markets.

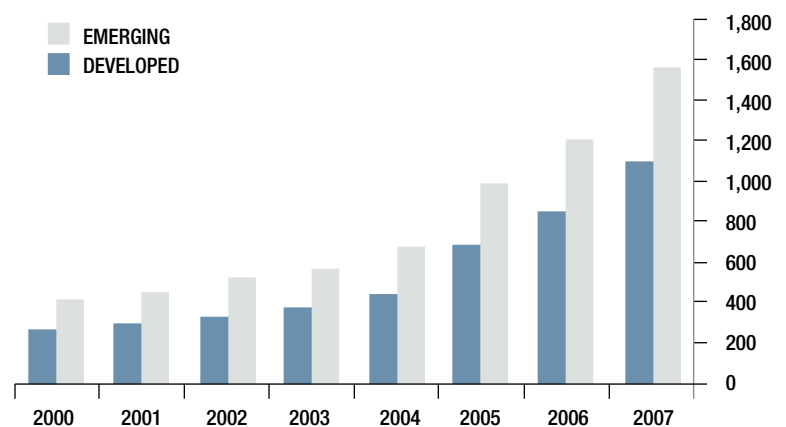
The international efforts of bank supervisors to promote best practices also affect the international reach of globally active banks. These efforts have ranged from promoting strong capital frameworks to fostering standards for effective banking supervision. As a result, they tend to raise standards and promote a level playing field for cross-border banking.

The following sections discuss the size, composition, and growth of national bank foreign exposures. The discussion then turns to the complementary roles played by OCC in assessing international risks and supervising international exposures of the national banking system.

National Banks' International Exposures

U.S. national banks, with their expanded global reach, are an important part of the international financial system. U.S. national banks' direct foreign outstanding claims were \$1.6 trillion as of the second quarter 2007, an increase of 174 percent since 2003, in part because of conversions to a national charter. These claims are made up of cross-border and foreign office claims. In addition, banks had \$406 billion in unused foreign commitments, while the notional value of credit derivatives sold totaled \$1.9 trillion as of the second quarter 2007. These large and growing numbers make the international environment increasingly important to the OCC.

Chart 2: National bank direct outstandings are rising in developed and emerging markets (\$ billions)



Source: Country Exposure Report (FFIEC 009). Note: yearly data reflects 2nd quarter. Direct outstandings include cross-border and foreign office claims. Data for offshore centers are not included.

Internationally active national banks offer an array of products and services, ranging from consumer credit loans to complex capital market instruments. International exposures in the national banking system fall primarily into three groups: large money-center banks, which provide a full range of products and services through an extensive international network of branches and affiliates; other banks, which serve the international financing needs of their domestic, corporate clients; and small banks with close geographic ties to Latin America, Asia, or the Middle-East.

While the majority of exposures and growth has been to developed countries, such as the United Kingdom and Germany, exposures to emerging market (EM) countries also rose in FY 2007, to a total of \$469 billion. The expansion in both the developed and emerging markets is projected to continue, particularly among the largest internationally active U.S. banks.

Growth in emerging market exposures has been broad based, with double digit growth not only in the increasingly dominant economies of Brazil, Russia, India, and China (BRIC), but also in such markets as Korea, Turkey, Chile, and Poland. U.S. national banks are pursuing varied strategies to expand in these countries to take advantage of economic growth and rising income levels. U.S. banks are engaged in a wide variety of business lines in the EM countries. Their businesses have expanded beyond traditional commercial and industrial

(C&I) lending. A retail credit culture is developing in many countries, such as in India, Brazil, and China, with more individuals using credit to purchase consumer goods and automobiles.

Outsourcing to third-party servicers has increased substantially across the global market in recent years. Software development and maintenance, which have been the predominant services, are leveling off, while marked growth has been noted for business processing outsourcing involving asset management and capital market services. As services grow in diversity, so do the countries involved. India, Canada, the Philippines, and the United Kingdom still host the bulk of independent third-party service providers, while emerging countries, such as China, Brazil, Mexico, and Korea, have increasing numbers of service agreements.

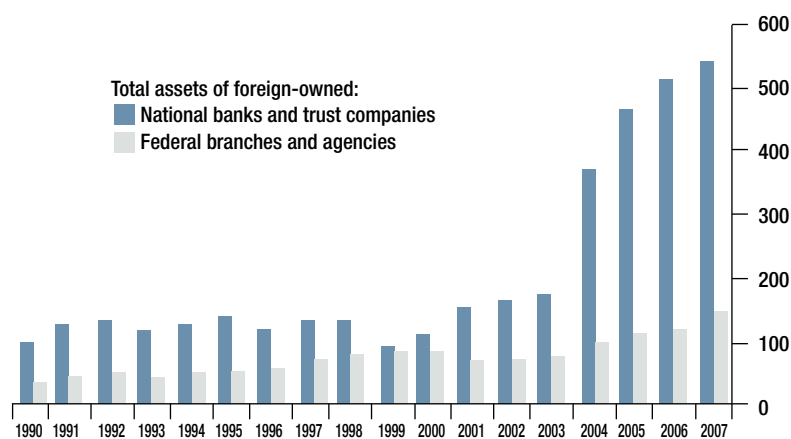
OCC's International Focus

The OCC provides comprehensive supervision relating to the international activities of national banks. The OCC's examination staff regularly evaluates bank activities and risk exposure in this area. In large banks, the OCC has examination staff dedicated to providing supervision on an ongoing basis and specialists in such areas as capital markets, credit, and anti-money laundering who evaluate risk and the quality of bank management across the enterprise. Enterprise risk management incorporates activities that occur overseas—for example, evaluating international vendor activities in the assessment of vendor-service risk management.

Since 1974, the OCC's London Office has been dedicated to evaluating the key risks present in the U.S. national banks' European operations. Top issues facing these banks focus on governance, complex and structured product expansion, major technology initiatives, and compliance with new European directives. OCC large bank examination teams evaluate international activity and exposure in countries where business activity is significant, including emerging market countries in Asia and Latin America.

The OCC supervises 49 federal branches and agencies of foreign banks, from such countries as Austria, Canada, and China. This foreign bank portfolio, with combined assets of \$142 billion, is supervised

Chart 3: Foreign-owned national bank assets increasing



Source: Federal Reserve Board. Data as of June 30, 2007. All other data as of year end.

by the OCC's New York field office located in the Northeastern District Office. The principal business focus of these institutions is generally wholesale-oriented, inasmuch as they provide credit facilities, and capital markets and funding activities to U.S. and home country customers. In addition, the OCC supervises 35 foreign-owned national banks and trust companies with aggregate assets of \$535 billion. This group, led by large, globally active British, Japanese, Canadian, and Dutch financial institutions, offers a mix of retail, wholesale, and private banking products.

Supporting International Risk Supervision

The OCC analyzes global and country risks affecting U.S. banks, collaborates with foreign counterparts to develop international banking policy, establishes relationships with foreign supervisors, negotiates protocols for exchanging information, and provides technical assistance to foreign supervisors.

International Analysis

International risk analyses target issues of emerging importance, such as global financial liquidity conditions and retail lending trends in emerging economies. Scenario analysis and stress-testing are areas of ongoing research. Specialized research into topics, such as global demographic developments and their implications for banking, is also undertaken. These analyses assist the OCC in evaluating factors affecting the condition of the national banking system, and contribute to developing OCC policy and to discussions with other federal bank regulators and foreign supervisors.

International Policy Development

With the increased relevance of the international policy environment to the OCC and the internationally active national banks it supervises, and the trend toward establishment of globally consistent supervisory standards, the agency has devoted increased attention to international policy-setting groups. In addition to its longstanding involvement in the Basel Committee on Banking Supervision, Comptroller Dugan's appointment in September

The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters with a view to enhance understanding of key supervisory issues and to improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques, and by developing guidelines and supervisory standards.

The Joint Forum was established under the aegis of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors to deal with issues common to the banking, securities, and insurance sectors, including the regulation of financial conglomerates.

2007 as Chairman of the Joint Forum has placed the OCC in an even stronger position to influence the direction of global supervisory policy.

The OCC played an important role in the comprehensive revision of the Basel Capital Standards, known as Basel II, published in June 2006, and in the revision of the Basel Committee Core Principles for Effective Banking Supervision in late 2006. This work required the OCC to collaborate with other U.S. regulators in forging a common U.S. policy view that helps inform international discussions. Serving on international policy-setting groups also enables the OCC to promote sound supervisory standards worldwide and to foster policies that help promote competitive equality for globally active financial institutions across markets.

The OCC has an ongoing interest in the development of international financial policy generally and especially in areas like Europe where national banks' activities and exposures are concentrated. The European Union's (EU) policy agenda on banking is influenced by such groups as the Basel Committee, the Joint Forum, and the Financial Action Task Force (FATF). Through OCC's participation in these international groups, as well as through

its relationships with the European Commission and the Committee of European Bank Supervisors (CEBS), the OCC is kept abreast of developments that may affect the operations of national banks.

External Supervisory Relations

The OCC maintains a wide range of relationships, formal and informal, with foreign supervisors across the globe. These relationships enable the OCC to facilitate the exchange of supervisory information about internationally active banks and enter into information-exchange arrangements. During regular meetings, the OCC and foreign supervisors exchange important supervisory and economic information. These working relationships will become even more important as the new Basel II regime is adopted by large, globally active banks operating across national jurisdictions. The OCC conducts bilateral meetings based on the level of current or prospective national bank activity in the host country, regional importance, federal branch activity in the United States, and the need to address issues of supervisory concern. For instance, in 2007 the OCC held bilateral meetings with China, Brazil, India, and Mexico to discuss regulatory changes, anti-money laundering, Basel II capital standards, and domestic and international banking activities. OCC participated in conferences, such as those of the Southeast Asian Central Banks (SEACEN) Research and Training Centre and the Caribbean Group of Banking Supervisors, which provide a forum to exchange supervisory practices. In addition, the OCC provided support to Treasury's Financial Services Working Group (FSWG) dialogue with Japan and China.

FATF—The Financial Action Task Force is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

OCC staff members also periodically participate in international banking conferences, which allow them to communicate directly with international bankers, discuss issues of supervisory importance, and better understand bankers' views and concerns.

SEACEN—The Southeast Asian Central Banks is an organization of Southeast Asian Central Bankers that reviews monetary, banking, and economic developments in the region and facilitates supervisory cooperation and training among its members.

Sharing Information with Foreign Supervisors

Sharing arrangements and the actual exchange of information between supervisors is important in advancing effective consolidated supervision. The OCC is permitted to disclose information to foreign supervisors if the disclosure is appropriate, does not prejudice the interest of the United States, and is accompanied by a confidentiality agreement (to the extent necessary) [12 USC 3109]. Formal information-sharing arrangements, while not legally binding documents, set out the types of information that may be shared, the parameters as to how shared information will be safeguarded, and how it will be used, as well as notification procedures for examining cross-border institutions. The arrangements can facilitate a more expedited process for exchanging information.

Such arrangements, however, are not always required. The OCC may share, and has shared, information with supervisors when no formal arrangement is in place. In such cases, the OCC may provide information along with stipulations about its use and confidentiality, or the OCC may require the supervisor to provide a written agreement regarding use and confidentiality.

OCC often assists foreign supervisors in meeting their supervisory objectives by responding to their requests for:

- Background information on prospective managers.
- Information on a bank's financial condition and examination findings.
- Authorization to perform examinations as home country supervisor of national bank operations overseas.

In addition, the OCC will make a foreign supervisor aware of significant concerns (e.g., an enforcement action) that arise regarding a bank under the foreign supervisor's jurisdiction.

Foreign Technical Assistance

In providing foreign technical assistance (FTA), the OCC helps foreign supervisors to develop, improve, and refine their supervisory systems. The goal is to elevate supervisory standards and provide competitive equality for internationally active banks. At the same time, the program increases the international expertise of OCC employees and helps to enhance the global reputation of the agency.

The FTA program offers training courses to foreign bank supervisors, provides internships, and supports the assistance projects of regional supervisory bodies, the U.S. Department of the Treasury, the International Monetary Fund (IMF), and World Bank, and regional supervisory bodies. In 2007, approximately 72 supervisors from 29 countries took part in OCC international schools for Anti-Money Laundering/Combating the Financing of Terrorism, Operational Risk, and Problem Bank Supervision. Also, OCC instructors assisted training efforts of regional supervisory bodies and the IMF. They served as instructors for the following training: Operational Risk (Partnership for Financial Excellence in Middle East–North Africa); Anti-Money Laundering and Countering the Financing of Terrorism (Arab Monetary Fund/IMF); Economic Stress Testing (SEACEN); and Pillar II Implementation of the Basel Capital Standards (Partnership for Financial Excellence in Middle East–North Africa).

At the request of foreign supervisors, the OCC provides developmental assignments to foreign interns. The OCC hosted interns last year from Korea, Singapore, and China with internships that ranged from two months to one year. Russia, Austria, Egypt, and Lebanon each sent small teams to join OCC on bank examinations for two to three weeks each.

The OCC also receives requests for exam-related assistance from foreign supervisors. OCC examiners who participate in the FTA cadre are selected to assist foreign bank supervisors for a variety of international programs and projects. In 2007, OCC examiners assisted foreign supervisors with anti-money laundering and problem bank issues.

The OCC and China

The OCC has a long-standing relationship with China's banking supervisor, the China Banking Regulatory Commission (CBRC), and its predecessor, the People's Bank of China (PBOC). This supervisory relationship has been cultivated over the years through various programs including formal bilateral meetings and the OCC's international intern program.

Since 2006, the OCC, in cooperation with the other U.S. federal banking regulators, has held formal bilateral meetings with the CBRC on banking supervisory practices and the operating environment. In September 2007, the OCC hosted a bilateral meeting in Washington, D.C., attended by representatives of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

The CBRC is an active participant in the OCC's international intern program. CBRC interns have spent from two to six months at the OCC learning about its examination approaches and practices. They have participated in onsite examinations and learned about supervisory data collection and analyses, supervisory information technology, and banking laws and regulations, among other things. In 2008, the OCC will host two CBRC interns and will provide them with insight into the supervision of bank financing in rural communities and into OCC's economic and industry research, as it relates to supervising the national banking system.

China–U.S. Bank Supervisory Relationship Nurtured by Dugan Visit

In March, Comptroller Dugan visited China to meet with members of the Chinese bank regulation community, as well as executives of U.S. national banks operating in China. Senior Deputy Comptroller for International and Economic Affairs Mark Levonian and Senior International Advisor Susan Hopkins accompanied him.

The trip was designed to gain first-hand knowledge of China’s banking operating environment, and to promote supervisory cooperation with the OCC’s counterpart, the China Banking Regulatory Commission (CBRC).

The Comptroller met in Beijing with CBRC Chairman Liu Mingkang to discuss issues of common interest, such as global liquidity, real estate markets, universal banking, and the implementation of Basel II. In a speech to the CBRC staff, the Comptroller spoke about the challenges of financial innovation, a topic particularly relevant to China’s rapidly changing banking and bank regulation system.

“While each regulator faces certain challenges that are unique, other challenges are shared by all,” he said in his speech. “The candid exchange of experiences and approaches is likely to make all of us more effective.”

Rural finance, a top priority of Chinese financial system reform, is one such challenge. In an effort to gain a deeper appreciation of rural Chinese financial conditions, Comptroller Dugan visited Shaanxi province, in the country’s heartland. While in Shaanxi, he met with the management of a rural credit cooperative, as well as the owner of a local corn starch manufacturing plant in a village served by the cooperative.

Comptroller Dugan believes that effective supervision of U.S. branches of Chinese banks depends on effective communication with home country supervisors and home country management. The only U.S. branches of Chinese banks in operation are federal branches supervised by the OCC (Bank of China and Bank of Communications). During his meetings with Chinese regulators and bankers, the Comptroller discussed Chinese banks’ U.S. expansion plans.

A visit to Shanghai enabled the Comptroller to meet personally with executives of U.S. national banks operating in China. They told him that while China still has a long way to go in reforming its financial system, the overall direction of reform is positive. They agreed that the Chinese financial system might not be ready for fast-paced, more radical changes, such as deregulation of interest rates or the removal of foreign exchange controls.

“As China’s economy rapidly expands, its banking and bank regulatory system will continue to adapt to the demands of modernization,” said Comptroller Dugan. “It is in both our interests for them to continue their significant progress toward first-class, risk-based supervision. Our visit was part of our ongoing effort to do just that.”

EVENTS

October 2006	OCC Signs Statement of Cooperation with Australian Prudential Regulation Authority
May 2007	OCC Holds Anti-Money Laundering and Anti-Terrorism Financing School for Foreign Bank Supervisors
August 2007	Foreign Bank Supervisors Attend OCC Operational Risk School
September 2007	OCC Sponsors and Hosts Second United States–China Banking Supervisors Conference
	OCC Attends Meeting of G–10 Governors and Heads of Supervision
	OCC Problem Bank Supervision School Offers Instructions to Foreign Bank Supervisors
	Comptroller Dugan Named Chairman of Joint Forum, a group of senior financial regulators from the United States, Canada, Europe, Japan, and Australia