



ASSOCIATION OF SUPERVISORS
OF BANKS OF THE AMERICAS

AUTHORIZATION OF BANK LICENSES

2009

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AUTHORIZATION OF BANK LICENSES

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OF BANKS OF THE AMERICAS

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| TABLE OF CONTENTS |

EXECUTIVE SUMMARY	7
<hr/>	
INTRODUCTION	9
<hr/>	
CHAPTER 1	
PRINCIPLES OF THE LICENSING PROCESS	11
1.1. Relevance	12
1.2. Basic Principles	12
<hr/>	
CHAPTER 2	
GENERAL OVERVIEW OF BANKING AUTHORIZATION PROCESSES AND THE SUPERVISOR'S DISCRETIONALITY AND POWER	15
2.1. General Overview of Authorization of Licenses	16
2.2. Overview Regarding the Supervisor's Discretion to Grant or Reject Licenses	17
2.3. Benefits of Discretion in the Licensing Framework	19
2.4. Good Practices and Recommendations	19
<hr/>	
CHAPTER 3	
BASIC ASPECTS OF THE AUTHORIZATION PROCESS	21
3.1. Ownership and Control Structure	22
3.2. Analysis of Shareholder Suitability	23
3.2.1. Moral Suitability	23
3.2.2. Patrimonial Suitability	23
3.3. Assessment of the Capabilities and Suitability of the Members of the Board of Directors and Principal Officers	24
3.4. Assessment of the Strategic and Operational Plan, Internal Controls and Risk Management	25
3.5. Review of the Projected Financial Condition and Minimum Capital Regulations	26
3.6. Assessment of the Origin of Capital and the Final Verification Process	27
<hr/>	

| TABLE OF CONTENTS |

CHAPTER 4

LINKS OF BANKING INSTITUTIONS WITH NON- FINANCIAL COMPANIES

	29
4.1. Overview	30
4.1.1. Countries With Specific Regulation	31
4.1.2. Countries With a Certain Degree of Regulation	31
4.2. Good Practices and Recommendations	32

CHAPTER 5

COORDINATION BETWEEN HOME AND HOST SUPERVISORS

	33
5.1. Overview	34
5.2. Relationship Between Home and Host Supervisors	35
5.3. Good Practices and Recommendations	35

CONCLUSIONS

37

ANNEX 1

38

| EXECUTIVE SUMMARY |

The process of licensing banking institutions is an essential element for achieving the supervisor's goal of contributing to a sound and stable banking system. The licensing process functions like a barrier to entry for financial institutions that do not present the necessary economic, financial, organizational and governance conditions and that might pose a threat to the banking system.

Thus, the licensing of new bank entities is perhaps one of the most important steps for the supervisor, given that an incorrect assessment of the entrance of an institution to the financial market can later result in problems that could even have systemic implications, or fail to generate value in the financial system.

Given the significance and relevance of an appropriate banking licensing process, the Association of Banking Supervisors of the Americas (ASBA) and its Members considered it necessary to assess the bank licensing practices in the Region, recognizing their strengths and weaknesses and, based on that knowledge, recommend practices, processes and policies to improve their licensing frameworks. Therefore, ASBA created the Working Group 7, with the purpose of achieving these objectives.

The first step of the Working Group was to design a survey to make it possible to analyze the conditions of licensing in the countries of the Region. The principal findings of the survey were the following.

- All the Members¹ reported they have a legal basis for licensing new institutions, as well as one or more government bodies with authority to approve new banking licenses.

- Four Members mentioned that the authority to grant a bank license rests solely with the Central Bank. A slight majority of Members reported that other entities also participate in the licensing process, including: Ministry of Finance, the Monetary Authority, Department of the Treasury or the Superintendency of Banks.
- Nearly a majority of the Members reported that their licensing process occurs outside the jurisdiction of the Central Bank, although they have permanent coordination and/or consultation between two or more government entities.
- All Members reported they have written criteria that are used to assess license applications and all reported that one or more of the government entities that grant licenses have the authority to reject licenses whenever they consider necessary. In a few countries, where the power to authorize licenses is shared between the Central Bank and the Superintendency of Banks, the power to reject a license is granted to only one of the authorities.
- Subsequently, the Working Group determined best practices and recommendations, among which the following are highlighted.
- Without exception, all institutions that perform banking activities and take deposits from the public must have a license to do so and be subject to supervision in accordance with their size and complexity.
- A legal framework must exist that grants to the supervisory agency or the compe-

¹ Members that responded to the survey are Argentina, Bahamas, Bolivia, Brazil, Cayman Islands, Colombia, Dominican Republic, El Salvador, Jamaica, Mexico, Panama, Peru, Spain, Surinam and the United States.

tent authority the power to regulate resolutions on licensing as well as a process for legal appeal of the agency's decisions.

- The supervisory agency, or the competent authority, must have the power to reject a license application from a bank when it considers that it does not meet adequate financial and organizational conditions or when its structure is a source of weakness or contagion for the other units of the banking group or for the financial system.
- The supervisory authority must have sufficient powers to reject licenses for banks or banking groups that operate under shareholding structures that make the exercise of consolidated supervision difficult or impossible.
- When the license of a bank or banking group is being assessed, the ownership structure should be evaluated. Shareholders should have sufficient capital to address any contingency and/or request for contribution from the bank to be constituted.
- The technical capabilities of the Board of Directors and senior management of the institution must be analyzed. In addition, the strategic planning and organization chart of the institution requesting a license should be evaluated.
- When an economic group includes financial and non-financial units, internal control measures must be adopted to achieve a clear separation between both types of businesses.
- Exchange of information between home and host supervisors should be promoted and streamlined, so the opinion of the former can be considered in a timely fashion during the licensing process of an institution.

| INTRODUCTION |

The current international financial crisis has shown the impact that weak banking institutions, with insufficient capital and inadequate risk management policies and practices, can have on the economies of countries. In this context, the work of the banking supervisor is progressively more important for its contribution to stability of the banking system and promoting sound and prudent financial intermediation. Banking supervision must be carried out in an effective way, preventing the creation of problems at the level of an institution or, owing to their size or interconnection with the rest of the market, create a crisis in the financial system.

An appropriate licensing process² for banking institutions is very important for maintaining a solvent and stable financial system. Licensing constitutes a barrier of entry to banking institutions that are considered by the entity that grants the license as unsustainable in the medium and long term. Although nothing guarantees that, once a license is granted to a banking institution, its management will not implement actions and policies that undermine its soundness and solvency, at least licensing impedes the entrance of institutions that are clearly unsustainable and that would damage the stability of the financial system.

The licensing process should be rigorous, analytical, comprehensive and sound and it should review structural, financial, legal, strategic and operational aspects of institutions that intend to enter the banking system.

Given the significance of this supervision issue and in order to strengthen the licensing frameworks of countries in the Region, ASBA and its Members decided it was important to

consider the issue of banking authorizations. Therefore, ASBA created Working Group 7, which was made up of representatives of six Associated Members: Brazil, Colombia, México, Paraguay, Peru and the United States. Its objective was to propose a series of guidelines and good practices for granting banking licenses.

A first step towards this objective was to learn about the banking licensing models and practices of countries in the Region. Therefore, a survey was applied among the countries in the Region, which inquired about licensing models, items considered in the evaluation process, the degree of autonomy, power and discretion of the supervisor to reject the license, etc. The survey got responses from fifteen Associated Members³.

The information obtained served as an input for the members to find patterns in the licensing process in the Region and to establish guidelines and good practices for the assessment and granting of banking licenses.

The document consists of five chapters. The first chapter establishes core principles for the licensing process. The second chapter presents a general overview of banking authorization models in the Region and discusses the topic of discretionary and power of the supervisor to grant the banking license. The third chapter addresses basic aspects of the authorization process, while the fourth chapter deals, in the context of the authorization process, with the links that banking institutions can have with non-financial companies. The fifth and last chapter treats the topic of coordination among home and host supervisors in the context of the authorization process.

² "Licensing" and "authorization" will be used indistinctly.

³ Countries mentioned in footnote 1.

CHAPTER 1

Principles of The Licensing Process

1.1 RELEVANCE

In recent years, financial and technological innovation increased competition in the provision of services previously offered only by banks and implied the growing use of electronic means for processing these services. These circumstances stirred a debate about the need for strong controls and requirements to enter the banking industry, with many arguments in favor of self-regulation.

However, recent evidence has discredited these proposals. The lack of control and supervision of various aspects of banking activity in many financial institutions contributed to the current financial crisis and generated a high cost for the banking system and for the State. Insufficient supervision allowed certain financial institutions to take positions in assets with risks that were not properly detected, understood or reduced. This triggered considerable, rendering capital resources insufficient to finance obligations.

With the purpose of avoiding situations such as excessive risk-taking and lack of capital, supervision must be conducted on a permanent basis. Many situations of unviability of financial institutions can be pre-empted in the licensing stage. The supervisory agency or the authority in charge must adopt as a strict norm that entrance to the banking market will only be allowed to institutions that are operationally sound and that have shareholders with a proven moral, economic and financial suitability. Nothing guarantees that once the license is granted an institution will take sound actions and preserve the same structure and characteristics shown in the licensing process. However, establishing a first filter at least helps to block the entrance of institutions that are clearly unsustainable, and so contributes to the maintenance of a stable banking system.

1.2

BASIC PRINCIPLES

The philosophy behind banking authorization should be to contribute to the stability and proper functioning of the banking system and to limit the number of banking institutions failures, without inhibiting, on the other hand, competition, creation of value and efficiency in the banking industry.

As a basic principle, institutions that perform banking activities and take deposits from the public should obtain a license and be subject to permanent supervision to guarantee protection of the public's savings. Even if the deposits of these institutions are partially or totally guaranteed by some publicly backed deposit insurance scheme to minimizing the possibility of important losses for the public treasury, nonetheless only sound institutions should participate in the system.

In this sense, the banking authorization process helps detect whether an institution is suitable for operating in the system, verifying if its legal, administrative, operational and ownership structures could present obstacles to effective supervision, both at the individual and at the consolidated level.

Furthermore, the process helps exclude those institutions that have greater possibilities of presenting liquidity and solvency problems and causing damage to the banking system. However, it is important to reiterate that the authorization process does not guarantee that the bank will be well managed in the future and that it will remain solvent and liquid. Finally, it should be stressed that the authorization process should not be used as an instrument to prevent competition in the banking system.

CHAPTER 2

General Overview of Banking Authorization Processes and the Supervisor's Discretion and Power

In order to analyze bank licensing in the Region, the Working Group conducted a survey among ASBA Members at the beginning of 2008

2.1

GENERAL OVERVIEW OF AUTHORIZATION OF LICENSES

The survey's general results were the following

1. All Members that responded reported that they have a legal basis for licensing new institutions, as well as one or more government bodies with the authority to approve new banking licenses.
2. Four Members responded that the authority to grant licenses rests solely with the Central Bank (Argentina, Bahamas, Brazil and Surinam), while eight countries responded that one or more entities other than the Central Bank have the authority or responsibility for granting licenses. Examples of these independent bodies include the Ministry of Finance (Jamaica), Monetary Authority (*Cayman Islands* and Dominican Republic), Department of the Treasury (Spain) or the Superintendency of Banks (Bolivia, Colombia, El Salvador).
3. Seven countries with licensing processes that occur at least partially outside the Central Bank have coordination or consultation processes between two or more government entities. The consultation process generally occurs between the Superintendency of Banks (or its equivalent) and the Central Bank (Dominican Republic, Jamaica, Spain). In some cases, the authority to grant licenses is shared equally between the Central Bank and the banking authority (Mexico⁴, Paraguay).
4. The United States has multiple licensing authorities and they do not necessarily consult with the Federal Reserve. However, the licensing authorities have to collaborate with the FDIC, given that all new banks in the United States must have deposit insurance. See Annex 1 to review complete information about the licensing framework in the Region.
5. In the case of Peru, the authority to grant licenses falls exclusively in the Superintendency and, even if it requests the opinion of the Central Bank and that of other local and foreign regulation and supervision bodies, such opinions are not binding.

⁴ See Box 1.

BOX 1

Licensing Process in Mexico

In Mexico, pursuant to the regime that took effect in June 2008, the organization and operation of a universal banking institution requires authorization by the Federal Government [through the National Banking and Securities Commission (CNBV)] and the favorable opinion of the Bank of Mexico. That is, the approval of the Central Bank

is necessary to grant authorization. Notwithstanding, the CNBV has sufficient discretionary power to deny such authorization.

Thus, it must be noted that the authorization or the denial of the organization and operation of a banking institution belongs to the superior deciding entity of the CNBV, which

is its Governing Board, which, besides CNBV officials, has the participation of representatives of the different authorities of the Mexican financial system, such as the Ministry of Finance, the Bank of Mexico, Comisión Nacional de Seguros y Fianzas (Insurance Commission) and Comisión Nacional del Sistema de Ahorro para el Retiro (Pensions Commission).

2.2
OVERVIEW REGARDING THE SUPERVISOR'S DISCRETION TO GRANT OR REJECT LICENSES

An overview of the supervisor's discretion and power to issue or reject a license is described below.

1. All ASBA Members that responded to the survey reported they have written criteria that are used to assess license applications, and all reported that one or more of the government bodies that grant licenses have the authority to reject them when it is considered necessary. Only one country indicated that the framework to reject licenses is not clearly designed.
2. In a few countries, where the power to grant licenses is shared between the Central Bank and the Superintendency of Banks, the power to reject a license is granted to only one of the two authorities. In Paraguay, the Central Bank and the Superintendency of Banks share the authority to grant licenses, but the authority to deny a license rests with the Central Bank.

3. In contrast, in Peru and Colombia, opinions and coordination carried out between the Superintendency and the Central Bank and other local and foreign regulators are not binding because the Superintendency is the only authority with power to accept or reject licenses. This could indicate that, while the process of granting a license is shared in most of the countries, the degree of power conferred to the two entities is not necessarily equal. See Annex 1 to obtain more complete information related to the framework for rejecting license applications in the Region.

4. With respect to the rejection of licenses (See Box 2), most of the Members commented that denial of a license is infrequent. A few commented that no licenses have been rejected during the past ten years (Jamaica) or that there has never been a rejection (Dominican Republic). Others did not comment on the frequen-

cy of the rejections (Bahamas, Cayman Islands). Some countries indicated that their supervision authorities offered an informal rejection mechanism in addition to the formal process of license rejection. This consists in informing an applicant

in advance that the license will not be granted, allowing the would-be bank to correct any deficiency in the application or to withdraw the application so that the official rejection does not become public, avoiding reputational damage.

BOX 2

Example of a License Application that Does Not Meet Suitability Standards

An investor group consisting of an existing financial company (proposed bank's parent company), seeks to form a new banking organization and submits a request for a new banking license. The purpose or intent stated in the proposal is for the financial company to diversify its funding sources by virtue of owning a bank, leveraging synergies that could exist with the parent entity and the existing customer base.

Despite injecting sufficient equity capital to support the new banking organization, the parent company is under financial stress and borrows funds from its working capital facilities in order to inject equity into the proposal. Funding for the balance will emanate exclusively from wholesale liabilities, which in financial theory and reality, become credit sensitive and subject to instability during adverse market conditions. The business model proposes to concentrate its lending efforts solely for new

business ventures, establishing itself as a niche banking institution. Forecasted earnings are positive only because of assumptions regarding low loan losses and the management group's record of past success in the strong economy, which included vast credit market liquidity for venture capital.

The supervisory agency identifies significant quantitative and qualitative risks in the proposal, noting the following:

- weak financial condition and weak support from the proposed parent company;
- concentration of funding sources for the proposed bank and concentration of lending in new start-up ventures, signifying a high risk business model,
- weak earnings assumptions tied to optimistic projections of net losses on the loan portfolio.

The supervisory agency also notes that the high risk business model and assumptions are the product of the proposed management team and reflect unfavorably on their abilities as future financial managers of a bank.

As a result of its analysis, the supervisory agency concludes that the new bank proposal does not satisfy the supervisor's criteria for authorizing a new banking license. The supervisory agency notifies the applicant of its decision and rationale for its conclusion. In order to mitigate negative press or market sentiment toward the existing financial company and preserve their reputation as business persons in the country or community they operate in, the applicant withdraws the proposal without prejudice, and instead concentrates its efforts on strengthening the existing company via a recapitalization.

2.3

BENEFITS OF DISCRETION IN THE LICENSING FRAMEWORK

The supervisory authority's power and discretion to deny bank licenses to high risk or unfit institutions is an important component of control of risks in the banking system. The rationale for building a licensing framework with discretion and power to reject new banking licenses stems from inherent risks that typically accompany the launch of a new banking institution. In their first stage, new banking institutions have strong incentives and motivations to make their operations and credit portfolios grow in order to obtain adequate returns for their investors. An integral part of this stage is leverage in the balance sheet which can leave the institution unprotected against losses that might occur if its business model faces stress situations during the growth phase.

In a study of the various factors present in banking crises in the eighties and beginning of the nineties in the United States, the FDIC noted that a disproportionate number of new institutions failed during the financial crisis of the eighties compared to mature institutions.⁵

Any deviation from the minimum standards of suitability set out by the licensing authority should result in the rejection of a bank license application. This principle should hold whether or not the technical or functional mode of authorization is a coordinated effort among several government agencies or is bestowed on a single agency.

2.4

GOOD PRACTICES AND RECOMMENDATIONS

In relation to the legal licensing framework and the supervisor's discretion and power to grant licenses, the Working Group endorses the following practices and recommendations.

1. It is necessary to have a legal framework that grants the supervisory agency the authority to regulate licensing resolutions.
2. It is advisable to have formal criteria for rejecting a licensing application that does not meet conditions and/or requirements for solvency and risk management established by the supervisor. The supervisory agency or the competent authority must have the power to reject a license application when it considers that the structure of the group is a source of weakness or contagion for the remaining units of the

group or for the banking system and when this structure does not allow the exercise of consolidated supervision.

3. The supervisory agency's decisions must be based on an objective procedure of evaluation of specific licensing criteria and requirements. However, there should be a formal, clear and efficient procedure for protest licensing decisions.
4. It is advisable to have close coordination between two or more government agencies in the licensing process, as well as effective coordination with other local and foreign supervisors and regulators as needed.
5. In case an application does not meet the necessary requirements for obtaining a

⁵ Federal Deposit Insurance Corporation. History of the Eighties – Lessons for the Future (Washington, DC: 1997) 32-33.

license, the official rejection should be communicated in timely fashion to the applicant. Unless the licensing process produces a bad evaluation regarding the moral character of the principal shareholders, an eventual rejection should not represent an adverse precedent for a new application.

6. At any stage of the licensing process, the supervisory agency should have the unrestricted right to request the applicant provide any information considered relevant.

7. The necessary time to process an application for a license should be clearly established, as well as the way to proceed if the timetable is not met.

8. When a foreign bank is evaluated, the host authority should have the prior consent of the home supervisor to operate in the proposed location.

CHAPTER 3

Basic Aspects of the Authorization Process

In the process of granting a license to natural or legal persons to constitute a banking institution, basic aspects related to the ownership and control structure, competence of shareholders, capabilities of the members of the

Board of Directors, strategic and operational plans, internal controls, risk management, projected financial condition, origin of capital and final verification process, among other items, should be considered

3.1 OWNERSHIP AND CONTROL STRUCTURE

It is important to know the way in which ownership structure, is distributed through shares of stocks held among each of the partners of the new institution or banking group. For that purpose, a sound practice is to obtain a detailed list of the most important stockholders of the institution, a list of persons or corporations to which these are linked as well as a list of the persons or legal entities that, along with the shareholders, form an economic group. This last list should include the ownership and management structure of the economic group, as well as relationships among directors, managers and principal officials to evaluate whether there could be conflicts of interest, according to regulations in each country.

The goal of this is to avoid the formation of banks that are part of conglomerates and end up being funding agents for the non-financial units of the conglomerate. It is also very important to have detailed information

about the stockholders of the institution. The stockholders should provide a declaration that clarifies who are the beneficiaries of the profits from the investment.

Once this information is provided to the supervisor, it must be updated when control transfers occur that directly or indirectly represent 10% or more of the shares. That percentage stake could be adjusted to 5% applying more conservative criteria and in line with the international regulatory standards to prevent laundering of assets (*Patriotic Law of the United States* and recommendations of the Financial Action Group -GAFI-).

Finally, it is important to point out that in extreme cases in which shareholders are legal entities of recent creation, or holding companies that only possess a mail box, and it is difficult to obtain information regarding its soundness and stability, it is recommended not to authorize a license.

3.2 ANALYSIS OF SHAREHOLDER SUITABILITY

Several aspects referred to shareholder suitability are treated below.

3.2.1

Moral suitability

The tools used to verify minimal criteria for moral suitability should be expressed in documents subscribed by the shareholders as a sworn statement, in order to certify or bear witness to the non-existence of legal impediments. It is a sound practice to review whether the shareholder has a criminal record (jail sentence, lawsuit or police record) and its nature, as well as past or ongoing lawsuits and to analyze any situation that could bring into question his moral suitability.

It is important to establish as a requirement that shareholders not be part of the list issued by the Office of Foreign Assets Control (OFAC) of the Department of the Treasury of the United States. This list has been used by different countries and governments as a source of information to prevent problems of asset laundering by individuals or institutions related to drug trafficking and/or terrorism financing. The individuals mentioned in the list are called *Specially Designated Nationals*, or SDNs, and their assets are blocked.

Another sound practice to ensure the moral suitability of the shareholders is through the submission of a credit/financial history, which can be verified through original reference letters, attesting that he or she is a client of one or more financial institutions and that he/she does not show payment delays.

3.2.2

Patrimonial suitability

The shareholders should have enough capital to face any contingency and/or contribution required by the bank to be constituted. This is

This information can also be verified through credit bureaus.

To assess the moral suitability of shareholders that are legal entities of a foreign financial system, it is a sound practice to require that the supervisory agency of the home country issue its opinion regarding the institution in question and that it report on administrative sanctions applied to it in recent years, if such was the case. Therefore, it is important to strengthen the relationship with the home supervisor since to facilitate the exchange of communication and information.

Finally, to complement and enrich the evaluation to be made, once complete information is submitted by the applicant, the supervisor should request that the institution publishes an advertisement in a newspaper of broad circulation in the country, announcing its intention to constitute the entity, disclosing at the least the name of the future entity, names of shareholders, the proposed initial directors and general manager, organizers accountable to the supervisor, the amount of initial capital and the planned location for future operations. This announcement should be published at least twice in order to create the opportunity for reports to be made to the supervisor of impediments or relevant information

a crucial issue especially during the first years in which the institution is positioning itself in the market.

In order to determine the capital solvency, the supervisor should require the shareholder being evaluated to declare his or her property holdings, indicating if these are subject to any lien or other type of restriction. This is done with the purpose of foreseeing that there is no eventuality relating to the availability of resources from the shareholder, that his or her real situation of solvency and/or liquidity will not be affected and, therefore, his or her capacity to inject funds into the company in case it is required.

The statement of assets should be submitted not only by local shareholders but also by non-residents, who could submit a document from the fiscal authority of their country of origin attesting to their adequate fiscal situation as a taxpayer.

To complement the evaluation of financial solvency, in the case of shareholders that are legal entities, it is recommended to request from them their annual reports and audited financial statements, as well as those of the companies that are part of the economic group to which the entity belongs.

3.3

ASSESSMENT OF THE CAPABILITIES AND SUITABILITY OF THE MEMBERS OF THE BOARD OF DIRECTORS AND PRINCIPAL OFFICERS

In order to assess the technical suitability of the members of the Board of Directors and principal officers in terms of their experience in the financial sector or in executive or control positions, an evaluation of their curricula vitae is recommended.

It should be verified that Members of the Board of Directors and senior management have appropriate professional training and that they possess relevant academic degrees, in order to increase the probability that they have the suitable technical background. Furthermore, it is very important that members of the Board of Directors and senior management have experience in the management of or success-

ful leadership of another similar banking or financial institution, either local or international. It should be pointed out that Directors and principal officers alike should present the same requirements for moral suitability as the shareholders, pursuant to the criteria and mechanisms contemplated under 3.2.1.

It is worth noting that, in addition to evaluating the capabilities of the Directors and principal officers, it is very important to review that the institution intends to establish an adequate framework of corporate governance that rules the relations between all participants of the institution and those of the participants with other interested parties.

3.4

ASSESSMENT OF THE STRATEGIC AND OPERATIONAL PLAN, INTERNAL CONTROLS AND RISK MANAGEMENT

This chapter refers to the evaluation of the potential strategic, operational, control and risk management capabilities of institutions that intends to operate in the banking system. These aspects should be congruent with the type of institution to be built and with the objectives proposed by the shareholders. The assessment process for the above is fundamental, and its period of duration will mainly depend on the size and complexity of the applicant institution.

The prudential aspect should be centered mainly in analysis of management that must include:

- the strategic plan, which should incorporate the corporate philosophy, the objectives and mission of the institution, its strategies, product development plans, initial plan for opening offices, etc.;
- the organization plan that includes the corporate governance plan, the organization chart, staff requirements, etc.
- general policies and procedures in different areas.

It is a sound practice to verify the outfitting of the installations, information systems and the appropriate location of the headquarters, offices and cashiers, including the security of the latter.

Similarly, it is recommended to demand a prudential framework for internal controls and risk management.

- Regarding internal control, it is a sound practice to verify that there is a description of the different governance bodies, and of the different committees that will support

management tasks and functions that each one of them will perform.

- Regarding risk management, it is recommended to verify that the entity has defined the risk management policy and that it is properly documented. This policy should be aligned with the strategic plan of the entity (goals and objectives) and with the nature of its business.
- Likewise, it is a sound practice to verify that the responsibility and authority of the personnel directly involved in risk management has been defined and documented. Furthermore, a review must be made to verify the implementation of procedures for the identification, measurement, evaluation and monitoring of each type of risk and that the corresponding manuals exist.
- The control unit should verify that the institution has identified requirements of material resources and has planned to provide those resources in order to be able to perform adequate risk management.

To reinforce those controls, regulators must place special attention on the technological platform selected for operations of the applicant entity. It is recommended to consider aspects such as: computing centers and equipment, communications network, software applications for the entity's products and services, service channels and security of software and data. Likewise, it is recommended to request a certification stating that the technological platform has been tested with satisfactory results and that there is a:

- plan to evaluate the custody and security of written and electronic information;

- plan to ensure adequate operation and security for electronic banking services and
- business continuity plan and contingency plans with which the entity would initiate operations.

3.5

REVIEW OF THE PROJECTED FINANCIAL CONDITION AND MINIMUM CAPITAL REGULATIONS

An issue of the utmost importance is the analysis of the financial condition of the institution to be authorized. In this regard, the financial information to be provided by the institution should incorporate a feasibility study that includes a market study which contains:

- an analysis of the economic context of the country and the general overview of the banking and financial sectors;
- the current profile of the banking market;
- the characteristics of the target market: size, geographical area, market niche and
- an analysis of the future prospects of the market and the relevant competition.

When analyzing the market study, the supervisor should revise whether the strategic and business planning have short, medium and long-term goals, as well as the financial analysis of the institution. This analysis should include the amount of capital with which the institution intends to initiate operations, which must be greater than or equal to the minimum set by law. Furthermore, reporting must be completed about:

- the opening balance and the investment and financial budgets;
- the characteristics and conditions of operations for obtaining funding;

- financial projections under at least three distinct scenarios and a sensitivity analysis and break-even point; and
- criteria for evaluating the project feasibility (internal rate of return, net present value, etc.).

Supervisors should require specification of the economic assumptions of projections, including the following items: exchange rate, interest rate, growth rates of the economy and the sector in which the company will operate. Furthermore, the operating assumptions of the banking institution should be specified, including: prices for products and/or services, average size of operations, estimated number of operations and clients, financial and administrative expenses, costs of personnel and third-party services, among others.

Other aspects that supervision should review include:

- projection of the credit portfolio according to the quality of assets;
- the estimated calculation of provisions and projection of the credit portfolio according to risk category of the borrower;
- the projection of investments according to their classification (negotiable, available for sale or at maturity), together with the calculation of their exposure to market risk;

- the projection of leverage or minimum capital, with detail of the calculation of risk-weighted assets and of the capital;
- the dividend distribution policy;
- the depreciation and the taxes to be applied.

Finally, it is recommended that the financial information maintain a standard format in accordance with accounting norms approved by the regulator, and include annual projections for the first 10 years and monthly projections for the first year.

3.6

ASSESSMENT OF THE ORIGIN OF CAPITAL AND THE FINAL VERIFICATION PROCESS

As part of the licensing process, it is important to carry out a profound analysis of the origin of the resources that will constitute the capital of the institution with the goal of confirming that the funds do not have an illicit origin.

To this end, the evaluation of the origin of the capital must concentrate on shareholders or owners of the financial entity to be constituted. Therefore, a detailed list of their personal assets should be requested and, when appropriate, the shareholder should inform whether these assets are subject to any type of encumbrance or limitation on their liquidity.

In addition to this analysis, it is recommended the supervisor examine the financial and tax statements of the shareholders, determining the availability of their resources either in cash, banks or highly liquid investments.

If these assets come from debt operations, it is recommended to verify that a certification has been attached to the approval of the corresponding loan, specifying the loan terms.

If the verification of the origin of the resources is done through financial statements, these should be revised by an external auditor. On the other hand, in cases where investors take on debt, it should be verified that at least two

thirds of the capital consists of their own resources.

The supervisor should make a validation visit to the institution being organized in order to verify that minimum capital and capital origin requirements are met. This visit should also verify compliance with all other quality requirements demanded for the institution's functioning, reviewing the certainty of the written information submitted in the organization stage.

During the validation process, and also in the stage between application and functioning, the supervisor should have the faculty to conduct, at any time, meetings with the organizers, directors and principal officials, as well as to request any information and documentation that is considered necessary. It is important to highlight the need to have a *compliance officer* to verify compliance with regulations associated with asset laundering.

In this regard, the supervisor should have the power to demand more information from the institution, after receiving a report from the applicant about compliance with all the requirements necessary for conducting the validation visit. This is necessary given that changes might have been made in the original application filing and/or given the time that

might have elapsed between the issuance of the organization certificate and submission of the report about compliance with the requirements to operate. This is necessary since the initial assumptions about the project and/or the economic context might have changed, and these factors could have affected the company's risk profile.

On the other hand, it is recommended that the institution to be authorized indicates the date foreseen for starting of its operations, and that this date be no later than one year after the license is granted.

The basic aspects of assessment in the validation process are the following.

- Verify that the institution meets all the security guidelines and/or conditions established by the relevant authorities for that end. Furthermore, the office must have the appropriate infrastructure for serving the public.
- Review the purchase of insurance policies, as well as the implementation of internal and external information and communication systems.
- Verify the implementation of an information system that allows the registering and processing of the institution's operations in an effective way, the existence of a contingency plan and plans for the conservation of documents and that there is custody and security of the written and electronic information. Certification that the information security systems have been tested should be attached.
- Review in situ the effectiveness of internal accounting processes, in accordance with the description in the corresponding manuals.

- Verify the formation of minimum capital before operations commence.
- Review that the documents presented (feasibility study, organization chart, manuals, operating budgets, strategic plan, etc.) are in accordance with the characteristics of the institution.
- Verify the inscription of the new entity in a public deposit insurance scheme.

This phenomenon has contributed to the efforts of governments in the Region to increase access to banking among the population. However, this convergence in activities can give rise to problems relating to the transparency of operations of an economic group. This can occur when the banking and non-financial segments of a group offer services jointly or when the infrastructure of commercial entities supports the banking operation. In this regard, there is a need to delimit and separate clearly the banking from the non-financial businesses. This should be done, if possible, from the outset of the licensing process, with the aim of avoiding harmful contagion and inappropriate practices that can affect healthy competition in financial markets.

Before presenting an overview related to the issue in question, it should be noted that, given the current financial crisis and its impact, it is expected that many countries will implement much stricter regulation and supervision in the banking sector. In this sense, harsher restrictions could be applied to the operation of economic groups with banking and non-financial activities, including the possibility that some countries will prohibit institutions that participate in non-financial sectors from participating in the banking sector.

CHAPTER 4

Links of Banking Institutions With Non-Financial Companies

As part of the liberalization of trade and investment and the integration of world economies, corporate groups traditionally operating in non-financial sectors have shown a growing interest in diversifying their investments and making forays into the banking sector.

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4.1 OVERVIEW

The results of the survey applied by the members of the Working Group report that only some countries have a specific regulation or guidelines on links between financial and non-

financial groups, and the prevailing trend is the absence of any regulation or policy. Box 3 shows the results of the survey on this issue.

BOX 3

Regulation or guidelines on links between banking institutions and non-financial companies

Countries with specific regulation	<i>Mexico United States</i>
Countries with a certain degree of regulation	<i>Argentina Brazil Colombia Dominican Republic Jamaica Paraguay Peru Spain</i>
Countries without regulation	<i>Bahamas Bolivia Cayman Islands Surinam</i>

4.1.1

Countries with specific regulation

UNITED STATES

In general terms, the regulation does not allow that non-financial companies control entities that handle insured deposits, except in the case of industrial loan companies, credit card banks and trust companies. However, when authorizing institutions that handle insured deposits owned by commercial companies or significantly related to these, financial authorities can impose conditions aimed at preserving their independence.

Such conditions might consist, among others, in the implementation of different business plans; the formation of management units with an independent majority; the designation of experienced and independent directors and the formalization of written contracts signed by the Board of Directors of the institutions, when employees and other resources are shared, in order to guarantee the necessary control of the banking business.

MEXICO

The legislation establishes the obligation of banking institutions to maintain operational autonomy vis-à-vis non financial commercial companies, notwithstanding the existing links of assets or businesses. The banking and non- financial units should have working places that ensure independence of physical

spaces of the administrative offices and the other members of the consortium or business group to which they belong.

Furthermore, there are guidelines that banking institutions that maintain the links of assets or businesses should follow. Regarding the composition of their Boards of Directors, a majority of members are not allowed to have a formal relationship with the consortium or business group.

In addition, standards are set that must be met when banking institutions perform operations of any type with the rest of the units of the economic group or consortium to which they belong. These established obligations include such items as performing operations under market conditions, conducting studies on transfer prices and reporting to financial authorities.

It is also established that banking institutions that in any way become associated with legal entities that perform non-financial activities must undertake the necessary actions so that dissemination of their publicity avoids generating confusion among clients regarding the independence between the banking institution and the non-financial company.

4.1.2

Countries with a certain degree of regulation

BRAZIL

The direct control of banking institutions, regardless of the business activity of the controlling group, can only be executed by individuals or financial institutions authorized by the Central Bank of Brazil. The same applies to enterprises (holdings) whose exclusive objective is stock ownership in institutions authorized

by the Central Bank of Brazil. Corporate governance standards of the banking institution should seek the total segregation of its activities from those of the controlling group.

COLOMBIA

The legal regime for granting licenses for the constitution and operation of financial

entities is the same for all the institutions, independently of their legal nature. Special requirements are formulated on the issue of corporate governance and conglomerates. For example, controls that will be adopted regarding eventual conflicts of interest as operations develop must be presented.

JAMAICA

Jamaican authorities do not grant banking licenses to industrial or commercial entities, but only to institutions that receive deposits. However, commercial or industrial entities can acquire banks. In these cases, it may become necessary for the Bank of Jamaica to instruct a restructuring of the group.

PARAGUAY

There is no legal provision that treats the issue of financial groups that also include commercial and industrial enterprises. It is important to note that in the Paraguayan market, that type of financial group does not exist and to date no operation of this type has been submitted to the supervisory body.

PERU

Evaluation and legal requirements are similar for all institutions. However, the supervisory function has given more importance to the is-

sue of consolidated supervision. In practice, there have been cases in which the inexistence of an appropriate consolidated supervision framework in the home country has resulted in the rejection of applications of banking companies seeking entry into the Peruvian market.

Thus, extra situ supervision procedures for the evaluation of filings for authorization for organization contain aspects related specifically to verification of information about an economic group and individuals related directly or indirectly with the company to be constituted.

Recently, in cases of licensing financial entities associated with commercial and/or other non-financial companies, a restriction has been expressly established regarding the acceptance of deposits during their first years of operation. The entity must demonstrate during those first years that it is solvent and has prospects of remaining in the market to the satisfaction of the control unit before it can have access to the deposits of the general public as a source of funds. This allows, in the case of these companies, during their initial operations and consolidation in the system, the safeguarding of the potential deposits that could be captured by these institutions.

4.2

GOOD PRACTICES AND RECOMMENDATIONS

In relation to the granting of licenses to banking institutions that belong to an economic group that has non-banking activities, the Working Group subscribes to the following good practices and recommendations.

1. Transparency in the economic group's operations must be ensured, appropriately separating the activities of the different units of the group. Measures of internal control should be adopted that aim to achieve a clear separation among the units

regarding infrastructure, staff, information, accounting and security systems and management.

2. Banking institutions which belong to an economic group with financial and non-financial activities should be encouraged to avoid generating confusion among their clients in their advertising, principally in regard to the independence of the banking institution with respect to other units of the economic group.

CHAPTER 5

Coordination Between Home and Host Supervisors

Transactions among economies of different countries and their corresponding financial systems have increased notably in recent decades. As mentioned, financial groups have sought to participate in other markets within their country or have extended their activities to other jurisdictions, establishing increasingly complex and international groups. This

situation has generated challenges and opportunities that require a coordinated action among the supervisory entities involved.

In this last chapter, the Group sought to analyze the degree of interaction between the home and host supervisor.

5.1 OVERVIEW

Regarding the issue of home-host supervisor communication to grant license to a foreign bank that operates in the local market, fourteen of the fifteen supervising authorities that responded the questionnaire indicated that, in general, they consult with the home supervisor when evaluating the license application of a foreign branch. Authorities in the Bahamas, Cayman Islands, Jamaica, Dominican Republic, Peru and Surinam replied that the communiqué of “no objection” from the home supervisor is a required condition for authorizing a branch of a foreign bank in the local market.

In Mexico and Paraguay, the “no objection” communiqué is required if it is established in the legislation of the home country.

Generally, host supervisors consult with home supervisors regarding the installation of foreign banks’ subsidiaries in their jurisdictions. In many countries this practice is required by the legislation and/or regulation in force.

It should be noted that, besides the approval or declaration of “no objection” on the part

of the home supervisor, some jurisdictions demand other requisites as well regarding the “home-host supervisor” relation,” such as:

- access to information, accounting data and documents of the foreign branch necessary for implementing global consolidated supervision of the financial conglomerate;
- information related to the foreign legislation to know if the operations to be carried out by the branch comply with the legislation of the home country and with that of the host country.

Regarding the requirement of “no objection” of the local supervisor so that a local bank may constitute a branch in a foreign jurisdiction, greater homogeneity was found. The supervision authorities that responded the questionnaire reported that the operation could only be carried out after the “no objection” from the local home supervisor, except in the case of Surinam which, according to its report, intends to insert this guideline in future legislation.

5.2

RELATIONSHIP BETWEEN HOME AND HOST SUPERVISORS

It must be recognized that there is fertile ground for fostering information exchange among authorities involved in the process of authorization of bank branches, given the complementary nature of such information. In this regard, the home supervisor probably has a greater knowledge of the financial group/institution that pretends to establish a branch, principally in regard to:

- its main operations and client target (“core business”);
- its method of operation and adherence to applicable legislation and/or regulations (“compliance”);
- the quality of its accounting data;
- the level of risk to which it is exposed and the quality of management of such risks

(including their measurement, control and mitigation);

- the way in which the institution interacts with its shareholders, investors, depositors and society at large (corporate governance) and
- the technical quality and reputation of its managers.

The host supervisor has relevant information related to the context in which the branch will operate. This information is useful to the home supervisor when analyzing the legal and regulatory structure of the financial group and macroeconomic data of the host country, the type of banking supervision the branch will be subject to, the competition environment, the specific features of the target market, etc.

5.3

GOOD PRACTICES AND RECOMMENDATIONS

In regard to coordination between the home and the host supervisors for granting a license to a banking institution, the Working Group subscribes to the following good practices.

1. A way to expedite the exchange of information between home and host supervisors is by creating formal agreements, such as a Memorandum of Understanding. This document would have the purpose of establishing principles of cooperation between both supervisors.
2. Both supervisors should create special administrative units with the following attributions:

- a. to receive consultations formulated by foreign supervisory authorities regarding the installation of banking institutions’ branches and other topics;
- b. to identify the relevant technical area for responding to the matter and send the consultation to that area;
- c. to ensure that the data provided by the technical area is sent to the foreign supervisory authority by the requested deadline or, at least, within a time frame compatible with a reasonable effort.

| CONCLUSIONS |

The Members of the Working Group consider that the main objective of the authorization process should be to limit the number of bank failures and thus contribute to minimizing systemic risk in the financial system. Thus, supervisors should impede the entrance of entities that are economically and financially unsustainable, although they must be careful not to inhibit competition among banking institutions.

In this sense, the Working Group considers that institutions that perform banking activities and that take deposits from the public should, without exception, have a license to perform such activities and should be subject to a comprehensive supervision.

At the same time, it is of the utmost importance that there be a clear legal framework giving the supervisory agency the authority to establish resolutions on licensing, as well

as a process for legal appeal of the agency's decisions.

Furthermore, the Group agrees that the supervisory authority should have discretion and the power to reject banking licenses to high-risk institutions, when they do not meet appropriate financial and economic conditions or when their structure is a source of weakness or contagion for the rest of the units in the group or for the banking system.

Finally, it should be made clear that the recommended practices in this paper do not pretend to be an exhaustive list of practices that a supervisor should implement to guarantee an adequate licensing process. Such a list must be a project that is continually updated, adapted to the new challenges and circumstances of the banking systems of the countries in the Region.

ANNEX 1

RESULTS OF THE INFORMATION SURVEY

ASBA MEMBER COUNTRY	LICENSING FRAMEWORK & AUTHORITY TO ASSESS PROPOSALS	AUTHORITY TO REJECT PROPOSALS	FRAMEWORK TO REJECT PROPOSALS
Argentina	<p>Yes – According to national law, there is a government body to assess and grant licenses to new financial institutions.</p> <p>The Central Bank keeps its function of evaluation and approval of financial institutions.</p> <p>The superintendent of financial institutions' also keeps his/her function but reports to the Central Bank.</p>	<p>Yes – The country has the authority to reject new proposals from banks.</p> <p>The country has rejected new banks' applications; however, those are isolated cases.</p>	<p>Yes – The country has an administrative process to reject proposals that do not meet the national regulatory requirements.</p>
Bahamas	<p>Yes – Under a national law, the Central Bank keeps the authority to assess and grant licenses to banks.</p>	<p>Yes – The Central Bank has the authority to reject proposals that do not meet requirements and the suitability tests.</p> <p>The Central Bank does not report nor make comments on the frequency of license rejections.</p>	<p>Yes – The country has a legally established framework and can reject any proposal that does not meet the country's six score criteria.</p>
Bolivia	<p>Yes – The country preserves a legal framework for assessing proposals and licenses.</p> <p>The Superintendency of Banks is the authority that approves licenses.</p>	<p>Yes – The Superintendency of Banks has the authority to reject new license applications.</p>	<p>Although the Superintendent of Banks can reject a proposal for a new bank's license, the framework is not well outlined.</p> <p>During the last five years, there have been no applications for new banks.</p>

ASBA MEMBER COUNTRY	LICENSING FRAMEWORK & AUTHORITY TO ASSESS PROPOSALS	AUTHORITY TO REJECT PROPOSALS	FRAMEWORK TO REJECT PROPOSALS
Brazil	<p>Yes – The country has a legal framework to assess applications for new banks.</p> <p>The Central Bank of Brazil has the authority to evaluate and approve new banks.</p>	<p>Yes – The Central Bank keeps the authority to reject new banking licenses.</p>	<p>Yes – The country has a framework to reject applications. Rejections are rare.</p> <p>The country has a system to inform the applicant in advance of an unfavorable decision, which generally causes the applicant to withdraw the application.</p>
Cayman Islands	<p>Yes – The country has set up a legal framework to grant licenses to new banks. The Monetary Authority of the Cayman Islands has the power to grant new licenses.</p>	<p>Yes – The country maintains the authority to reject a license to a new bank. Information about the frequency of rejections is not available.</p>	<p>Yes – The country has a formal process to deny application for new banks that do not meet requirements.</p>
Colombia	<p>Yes – The country has a legal framework to grant licenses to new banks. The superintendent was given the attribution of approving new banking licenses.</p>	<p>Yes – The country has the authority to reject applications for new banking licenses.</p>	<p>Yes – The country has a framework and criteria that should be met in order to obtain the license.</p> <p>Applications that do not meet regulatory criteria may be rejected.</p>
Dominican Republic	<p>Yes – The country has a formal process to assess licenses to new banks. The country has the authority to assess and approve licenses to new banks.</p>	<p>Yes – The country has the authority to deny license to a new bank. The country has reported that there have not been rejections for licensing new banks.</p>	<p>Yes – The country has a legal framework and guidelines that should be met prior to granting the approval. Therefore, if the applicant does not meet these requirements, recommendation can be made that the application be rejected.</p>

ASBA MEMBER COUNTRY	LICENSING FRAMEWORK & AUTHORITY TO ASSESS PROPOSALS	AUTHORITY TO REJECT PROPOSALS	FRAMEWORK TO REJECT PROPOSALS
El Salvador	<p>Yes – The country has a formal process for review of applications for new banks.</p> <p>The country confers to the Superintendent of Banks the authority to approve licenses for new banks.</p>	<p>Yes – The country has the authority to deny authorization for a new bank; however, those cases are very few and infrequent.</p>	<p>Yes – The country has a process to deny the authorization to new banks that do not meet existing regulatory guidelines.</p>
Jamaica	<p>Yes – The country has a framework to grant licenses to new financial institutions. Collaboration between the Central Bank and the Ministry of Finance is evident. By law the Ministry of Finance is the final authority to approve licenses for new banks.</p>	<p>Yes – The country has legal authority to deny licenses to new banks. Rejections are not frequent. During the last ten years, there has not been information of a rejection.</p>	<p>Yes – The country has a process to deny license to banks. After review by the Central Bank, recommendations for rejection are sent to the Ministry of Finance.</p>
Mexico	<p>Yes – The country has a legal framework and regulations to assess and authorize new banks. The authority to approve and grant licenses for new banks is shared with the Central Bank of the country.</p>	<p>Yes – The country has the authority to reject a new bank, although these events are few and infrequent.</p>	<p>Yes – The country has a process to reject new banks that do not adhere to current regulatory guidelines. The country is not accustomed to giving an opportunity to the applicant to correct deficiencies nor withdraw its application before receiving a formal unfavorable determination.</p>
Paraguay	<p>Yes – The country has a framework for bank licensing. This authority is shared between the Central Bank and the Superintendency of Banks.</p>	<p>Yes – The country has the authority to deny a new banking license. This authority is defined by law and has been conferred to the Central Bank.</p>	<p>Yes – The country has a process for not accepting new banks that do not meet the regulatory guidelines of the country.</p>

ASBA MEMBER COUNTRY	LICENSING FRAMEWORK & AUTHORITY TO ASSESS PROPOSALS	AUTHORITY TO REJECT PROPOSALS	FRAMEWORK TO REJECT PROPOSALS
Peru	Yes – The country has a framework to license banks. The authority to grant licenses is held solely by the Superintendent, who requests the opinion of the Central Bank and other local and foreign regulators and supervisors, but they are not binding.	Yes – The country has legal authority to deny the license to a new bank. This authority is held by the Superintendent of banks. Rejection of applications are few and infrequent.	Yes – The country has a process to reject applications that do not meet the regulatory guidelines of the country.
Spain	Yes – The country has a structure to grant licenses to banks. While the authority to grant licenses is held by the Treasury Department, the process requires collaboration with other government bodies, such as the Central Bank.	Yes – The country has the authority to deny license to a new bank. Rejection of applications is rare and infrequent.	Yes – The country has a process to reject new banks that do not meet their regulatory guidelines.
Surinam	Yes – The country has a framework to assess applications for new banks. The authority to grant licenses rests with the Central Bank. The licensing process is a joint effort conducted by the Central Bank with another government agency.	Yes – The country has the authority to reject an application for a license to a new bank. These cases are rare.	Yes – The country has a process to reject proposals that do not meet the criteria.
United States	Yes – The country has a framework to grant licenses to banks and saving associations. The framework considers collaboration between at least two government bodies. The authority to grant licenses to banks and saving associations is the authorizing agency while the authority to grant the deposit insurance is held by the FDIC. The final step to grant a license depends on receiving approval from the authorizing agency as well as from the FDIC.	Yes – The country has the legal authority to reject or deny an application to constitute a new bank. Since applicants are given the opportunity to withdraw the application, rejections from the FDIC and the authorization agency are very few.	Yes – The country has a legal framework. Applications should fulfill certain statutory factors in order to receive the deposit insurance and should comply with the requirements of the authorization agency.

MISSION

To develop, disseminate, and promote banking supervisory practices throughout the Americas in line with international standards. To support the development of banking supervision expertise and resources in the Americas, through the effective provision of training and technical cooperation services.

INSTITUTIONAL OBJECTIVES

The Association of Supervisors of Banks of the Americas is formed by the entities in charge of banking supervision in each of the countries of the American continent and Spain. Its main objectives are:

- Promote and maintain close communication among the Association's Members, in order to facilitate co-operation among them, and to promote the improvement of their respective capabilities;
- Provide its members with a high-level discussion forum for the exchange of information, ideas, techniques, experiences and knowledge over their scope of competence ;
- Promote research as well as systematic and permanent training programs, with the purpose of establishing training standards in the region and providing technical co-operation services among its Members;
- Promote co-operation and exchange relationships with non-member bank supervisors, with similar associations as well as with international and multilateral institutions, engaged in activities similar to those of the Association; and
- Perform any general activity related to its purposes.