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Remarks by the Governor to the Financial Times

Full interview

Pablo Hernández de Cos, Governor of the Banco de España and Chair of the Basel Committee on Banking Supervision (BCBS)

Supervisory and regulatory co-operation needed to face new challenges on the banking sector

“There are many risks that will keep us busy. The optimal response to the new challenges might not necessarily be new regulations but rather enhanced supervisory co-operation or more disclosure via pillar 3 requirements. Either way there will be an important role for the BCBS. Global supervisory coordination is just as important as global standard setting.

On the prospect of further Basel Capital Packages, Mr. Hernández de Cos explained “It’s not on the agenda but, in the end, it will depend on the evolution of the sector, of the economy as a whole, or the risk associated to the sector, to what extent these new risks can be covered by the requirements that we have today or have to give a different policy response.”

The Chair of the BCBS stated discussions ahead of agreeing global rules are productive and that legislative processes around implementation were necessary to give the global agreements “legitimacy”. Still, he said that “ideally” things should move faster: “Once we know how the solution should look like, then we should strive to be quicker in reaching global agreement and speedier in the process of transposing that response in individual jurisdictions”.

Strengthening supervision, the priority after the banking turmoil

“(After completing the October report on the response to the banking turmoil) there is no perception in the BCBS for a pressing need to make regulatory changes. While there are certainly areas for further regulatory work, the regulatory priority for now is implementation of Basel III. The quickest and most effective way to address some of the weakness highlighted by the banking turmoil is through strengthening supervision. That is therefore our priority.

Governor, Hernández de Cos said improving supervision globally could be done through promoting greater information sharing among supervisors, building consensus around best practices on several topics, such as assessing the sustainability of banks business models, and potentially issuing more global supervisory guidelines in some areas. “There is no

deadline to deliver on this but I expect we will make progress over the course of 2024. In any case, sooner rather than later”

“It’s obviously more difficult to harmonise supervision than regulation. On supervisory matters, ultimately supervisors need to make their own judgements, they face different legal constraints, and have their own culture.”

When asked if the exchange of information during crisis management could be improved, he answered: “In a very globalised world where the interconnections are so strong, I believe there is also some room for improvement when it comes to exchanging information.” (Oct. [report](#) on lessons learned)

The role of central banks as last resort lenders

Governor Hernández de Cos said proposals around the lender of last resort role of central banks (CBs) could potentially change liquidity dynamics more meaningfully than changes in the treatment of IRRBB (interest rate risk in the banking book) and microprudential liquidity metrics. “Further discussion and thought is needed on pre-positioning of collateral with the CB and more generally enhancing the CBs lender of last resort function - I think some jurisdictions might go in this direction.” He said he expected any movement to be on a country by country basis, rather than a global policy. But there would still need to be significant coordination across jurisdictions and between central banks and supervisors.

Banking sector outlook

“The degree of resilience in the banking system is high but at the same time it is also important to emphasize that this is not the moment to be complacent,” Hernández de Cos said, noting that while higher interest rates had so far been “positive” for banks as interest rate margins increased, “we know that the second round effect of increased credit risks comes with a delay and will negatively affect the profitability of banks.” He also stressed that economic forecasts from the ECB, Banco de España and other jurisdictions included a “high degree of uncertainty and risk”. “You have the war in Ukraine, the tragic conflict in the Middle East, and other geopolitical tensions. We don’t know how they will evolve but the implications of adverse developments in geopolitical risks can have an adverse effect on the world’s economy. That’s another argument for not being complacent.”

US Basel III implementation

“What is on the table is full implementation of Basel III. By their very nature Basel agreements only set minimum regulatory standards. If any jurisdiction thinks that for its own banking sector the implementation of Basel III is not enough in order to reach the same degree of assurance of financial stability, then it’s absolutely justified to go beyond the minimum requirements. And that not only is acceptable, I would say that it is needed in certain cases.”

“One of the main reasons why we incorporated the output floor was precisely because the divergence in capital requirements derived exclusively from modelling techniques was so significant that, in the end, we thought it was needed to put a limit to the use of the models.

In Basel III it was done through the output floor. If any jurisdiction wants to go beyond this, that is perfectly fine in my view, and compatible with Basel III.”

“Now it is absolutely crucial that Basel III is implemented in full by every jurisdiction.”

The Chair of the BCBS said he did not see the US proposals as undermining the Basel Committee’s proposals to maintain internal models for credit risk. The international agreement already foresees that jurisdictions which opt to implement only standardised approaches are compliant with the Basel framework.

Risks associated to Non Banking Financial Institutions (NBFIs) sector

“For the work on NBFIs we will continue our close co-operation with the Financial Stability Board (FSB),” Hernández de Cos said. “We are always emphasizing that NBFIs are probably one of the main areas of concern. Also because in that part of the financial system there is less transparency in terms of what we know, with insufficient data and opacity about the interconnections. It’s also more heterogeneous. As a source of risks we might even be more concerned about this sector than the banking sector itself. At the same time, I want to emphasize the links between the two. What we have observed in recent years are several examples of problems in the NBFIs sector that, in the end, are transmitted to specific banks.”

1st part of the interview (published on Monday 15th January 2024)

“Financial stability is a global public good and that is why we need global institutions like the Basel Committee and the FSB to effectively deliver in terms of improving citizens’ welfare. In the context of a challenging geopolitical environment, the degree of global co-operation we are achieving in the domain of financial stability is very strong and I think it is important for the people to be aware of that.”

“Why are we more effective in this area than in others? Maybe because we started earlier (in the 70s); have learnt from valuable experiences; honoured our commitments and have since created a strong culture of global co-operation based on the positive reinforcement of trust and being effective”

Governor Hernández de Cos said he did not get the sense from colleagues in the international community that global co-operation in financial regulation was under threat “but I am aware of the bigger picture in geopolitics and that is why, precisely, I think it is important for the public to know how well global cooperation is working in the domain of financial stability.”

“We have delivered, the global financial system has remained resilient despite the various shocks that we have experienced over the past four years. Let’s imagine the counterfactual of a pandemic, even with strong public support, but with a weak banking sector if Basel III rules had not been implemented. I believe the market reaction would have been far more severe and led to fragmentation and greater financial instability.”

A co-ordinated international response is also needed to face other global challenges

“I also believe that the basis of our positive experience in the financial domain can, to a certain extent, be applied to other areas needing more effective global co-operation.”

“The fact that we are keeping this degree of coordination on financial stability is really remarkable, in particular because in other domains we are not seeing the same and perhaps we can to a certain extent leverage from this experience.”

“We know that it is impossible to solve the challenges posed by topics such as AI or climate without a common international agreement.”

“Today, compared to 40 years ago, or even 10 years ago, the number of issues and problems in our economies and our societies that are really global has clearly increased; which of course should lead to the conclusion we need more of a role for international institutions and co-ordination at international level to give an effective and optimal solution to those problems.”

“However, what we are observing at the geopolitical level shows that reaching common agreements is becoming more and more difficult...That is a concern for me and is a concern for many people.”

“The example of financial stability shows that there is still a very significant appetite to reach global agreements in this domain... and maybe that could be used as an example for other topics.”

Basel Committee to publish a report on the financial stability implications of technology, including AI

The Chair of the BCBS said the Committee was already looking at the financial stability implications of technological developments including AI/ML and would publish a report on that and the associated supervisory and regulatory implications in the coming months.

“Financial stability is only one dimension, there are many other potentially more important consequences related to AI. Issues that if not properly managed could change the course of history not necessarily for the good.”

"If we are not able to give a co-ordinated global response, the likelihood of getting the right solution to these challenges will be reduced".