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Climate, crypto and carrying through Basel III

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The dual shocks of the war in Ukraine and resurgent inflation have darkened the outlook. Growth is losing its momentum. The transition from pandemic to endemic is proving tortuous and wracked with uncertainty.

Against this backdrop, elevated financial vulnerabilities will continue to test the resilience of the global banking system – with challenges coming from increased debt levels, stretched real estate valuations and proliferating links with non-bank financial intermediation.

What's more, structural trends continue to brew, with important implications for banks. In particular, climate-related financial risks and the digitalisation of finance loom increasingly large in the risk priorities of banks and supervisors over the medium term.

While there is no shortage of work for the Basel Committee, I would highlight three “Cs” that are of particular relevance right now: climate, crypto and carrying through the implementation of Basel III.

Climate change will result in physical and transition risks that could undermine the safety and soundness of individual banks, as is now generally accepted, to say nothing of the broader financial stability implications.

Banks worldwide are potentially exposed to such risks regardless of their size, complexity or business model. The scale of such risks is potentially tremendous: a recent study estimates that G20 financial institutions have exposures worth almost \$22 trillion to carbon-intensive sectors, of which on-balance sheet bank lending accounts for 60%.

The transition to net zero is likely to be a bumpy one, as recent geopolitical events have shown. So it is crucial to ensure that banks are resilient to climate-related financial risks as we navigate the uncertain path towards net zero.

To that end, the Committee is pursuing a comprehensive programme to mitigate climate-related financial risks to the banking system. A series of analytical reports have assessed the transmission channels of such risks to the banking system and measurement methodologies. And, to follow these up, we recently published a set of high-level principles that seek to improve risk management and supervisory practices. We are now assessing

whether additional global measures are needed, spanning supervision, regulation and/or disclosure.

Another area of focus is cryptoassets. Despite the frenzied activity in such markets over the past few years, banks' exposures to cryptoassets are still relatively limited; at their peak last year, cryptoassets represented only about 1% of total global financial assets.

Yet we know that such markets have the potential to scale up rapidly, posing risks to individual banks and financial stability. This calls for a forward-looking approach to regulation and supervision to ensure that we meet our mandate both today and in the future as technology and markets evolve.

This is why we are in the process of finalising a prudential treatment for banks' crypto exposures. The Committee will be guided by three principles in this area: (i) simplicity and caution in the design and calibration; (ii) treating assets with the same risk profile and activity in a similar manner; and (iii) setting global minimum standards for jurisdictions to build on. Collaboration on both climate risks and cryptoassets is key. For this reason, the Committee is closely liaising with other global standard setters and forums. It will also continue to actively seek the views of a wide range of interested stakeholders.

But the benefits of global agreements will not materialise if the Committee's agreed standards, endorsed by the G20, are not implemented in a full, timely and consistent manner. This takes me to my third "C": carrying through the implementation of all aspects of the Basel III framework. I take heart in seeing that all member jurisdictions have recently reaffirmed that they expect to implement the outstanding standards as soon as possible. It is now crucial to translate this willingness into action. Otherwise, the regulatory fault lines from the Great Financial Crisis will remain unfixed.

Finally, the Committee recently published a set of high-level considerations on proportionality. These aim to support authorities that seek to apply proportionality in their regulatory and supervisory frameworks in a way that will not compromise financial stability. They provide another lever for implementing Basel III.