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Where next for the Basel Committee?

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The work of the Basel Committee over the past decade has been substantive and substantial. The Basel III framework, which encompasses a number of reforms, has fixed many of the fault lines in the pre-crisis regulatory framework. Capital requirements have increased. Greater focus has been placed on truly loss-absorbing resources in the form of Common Equity Tier 1 capital. The risk-weighted framework has been overhauled to enhance risk capture and improve comparability in banks' reported capital ratios. A leverage ratio complements this framework by constraining excess leverage in the banking system. Macroprudential buffers – capturing both cross-sectional and time-varying risks – provide an overlay against system-wide risks. And we now have an international framework for mitigating excessive liquidity risk and maturity transformation, through the Liquidity Coverage Ratio and the Net Stable Funding Ratio.

These reforms are a testament to the strong willingness of Basel Committee members to cooperate on global financial stability issues. At a time of growing strains on multilateralism, the accomplishments of the Basel Committee over the past decade highlight the determination of central banks and supervisory authorities to work constructively towards finding global solutions to enhance the resilience of the global banking system.

So, what is next for the Basel Committee? After a few months on the job, I want to outline a set of guiding principles that will help me steer the work of the Committee. These will be complemented by a set of longer-term strategic priorities, which the Committee will set out in due course.

Principle 1: Remembering the lessons of the past

The history of banking crises is rich and deep. There have been over 150 systemic banking crises around the globe since 1970. The Basel Committee itself was established in the aftermath of a series of banking crises in 1974, the most notable being the failure of Bankhaus Herstatt in then West Germany.

Systemic banking crises have a profound impact on our economies and social welfare. The scars of the Great Financial Crisis (GFC) of 2007–09 are still raw. The IMF estimates that output levels remain below pre-crisis trends in more than 60% of economies.

And yet, despite the painful experiences of the many occurrences of banking crises, history suggests that the lessons from such events can sometimes be forgotten as part of a so-called "regulatory cycle".[1] Memories of banking crises fade over time, whether because of the mere passage of time or due to succeeding events. Vested interests start to gain momentum, and the fallacy of "this time is different" recurs. It tests our will to persevere with the implementation of post-crisis reforms. We convince ourselves that some reforms may no longer be needed or warranted, or even that rolling back reforms may be the key to achieving other short-term economic objectives.

This is not a path that I intend to embark on with the Basel Committee. The Committee's work will be guided by a medium-term perspective and will avoid the temptation of falling into a regulatory cycle.

I will be relying on three core safeguards to ensure that we do not deviate from this medium-term perspective. First, the Committee will resolutely pursue its mandate of strengthening the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. This will define the scope and nature of our work. Second, the Committee will continue its Regulatory Consistency Assessment Programme to promote full, timely and consistent implementation of its reforms. Third, the Committee's policy work will be anchored by rigorous empirical analysis, including a comprehensive evaluation work programme to assess the effectiveness of the reforms, while remaining mindful of any regulatory gap in a context of evolving financial markets

Principle 2: Global engagement and transparency

The Committee has a long and well established history of engaging with external stakeholders. This includes an extensive and transparent consultation process; a permanent forum for deepening engagement with central banks and supervisors around the world through the Basel Consultative Group, the biennial International Conference for Banking Supervisors; and regular speeches and discussions with interested parties on the work of the Committee. Our role as the global standard setter for banks demands nothing short of this.

I intend to build on this commitment to engage transparently with a wide range of stakeholders as part of the Committee's future work and its evaluation of post-crisis reforms. We will continue to seek the views of all stakeholders on the relevant aspects of our work, including academics, analysts, central banks and supervisory authorities, international organisations and public bodies, market participants and the general public.

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[1] A Carstens, "The role of regulation, implementation and research in promoting financial stability", keynote address at the Bank of Spain and CEMFI Second Conference on Financial Stability, Madrid, 3 June 2019; available here.

Banking crises impact all of society, so it is important that society as a whole can input into the work of the Committee.

Principle 3: A disciplined focus on global financial stability issues

My third guiding principle is to focus on financial stability issues that require global responses, and to consider the full spectrum of possible policy and/or supervisory responses to such issues.

Financial stability is a global public good. The cross-border spillovers of financial distress can result in an underinvestment in financial stability by individual jurisdictions. So an open global financial system requires global prudential standards. Failure on this count could result in regulatory fragmentation, regulatory arbitrage and an uneven playing field for internationally active banks.

Accordingly, the Committee will continue to focus its work on those areas that require a global and coordinated response. This is how the Committee adds value and complements the work of its individual members.

The need for global standards is not incompatible with additional financial stability measures at the national or regional level. The Committee sets minimum standards to provide a common financial stability baseline across jurisdictions. Jurisdictions are of course free – and in fact encouraged – to go beyond this baseline if the size and structure of their banking system and the associated risks warrant additional measures. Such measures only reinforce global financial stability.

Principle 4: Adopting a forward-looking approach

My fourth and final principle relates to the need to adopt a forward-looking approach to our work.

The financial system is constantly evolving. We are witnessing rapid developments in financial innovation and changes to the structure of the financial system. Some of these changes may contribute positively to financial stability, while others may be more dubious in nature. In the face of such developments, regulation and supervision must keep pace. Put simply: standing still means going backwards.

I occasionally hear the assertion that policymakers are forever “fighting the last war”, and that the next financial crisis will be different from the previous one. This framing of the issue entails a false dichotomy, suggesting that one can either look back and respond to a previous crisis or look ahead and mitigate future risks. In fact, both of these courses of action can, and must, be pursued. The Basel III reforms have indeed been mainly shaped in response to the material weaknesses in the banking system exposed by the GFC. But these reforms are complemented with an active forward-looking approach to the Committee's current policy and supervisory work.

There is no shortage of risks affecting the banking system today. Banks are navigating in a river filled with conjunctural risks, including low or negative interest rates, and increasing corporate and government debt levels. More fundamentally, the landscape itself is being reshaped in response to structural risks such as cyber attacks, the growth of financial technology and crypto-assets, and the transition towards new benchmark rates. These examples underline the importance to the Committee of continuously scanning the horizon and assessing emerging vulnerabilities in the banking system as well as, where relevant, mitigating such risks.

Conclusion

The Basel Committee's post-crisis reforms have helped enhance financial stability by strengthening the resilience of the banking system, and improving the capacity and sustainability of the provision of financial services to the real economy.

Looking ahead, the Committee will continue to be guided by its mandate of strengthening the regulation, supervision and practices of banks worldwide. In this endeavour, we will not forget the lessons of the past. We will continue to engage actively with all interested stakeholders in a transparent manner. We will focus on global financial stability issues that require a global response. And we will adopt a forward-looking approach to assessing emerging vulnerabilities.

Link to the publication:
http://www.thebanker.com/Comment-Profiles/Pablo-Hernandez-de-Cos-where-next-for-the-Basel-Committee