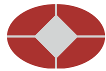


Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Basel III: the implementation imperative

Speech by Pablo Hernández de Cos
Chairman of the Basel Committee on Banking Supervision and Governor of the Bank of Spain

Keynote address at the 15th BCBS-FSI High-level Meeting for Africa on *Strengthening financial sector supervision and current regulatory priorities*

Cape Town, 30 January 2020

Introduction

Good morning, and welcome to the 15th BCBS-FSI High-level Meeting for Africa. Let me start by thanking Governor Kganyago and the South African Reserve Bank (SARB) for hosting this meeting in Cape Town.

As the global standard setter for banks, the Basel Committee places great importance on reaching out to a wide range of stakeholders to inform its work. Events such as these high-level meetings are of particular value to the Committee in seeking the views of central banks and supervisory authorities across different regions of the world.

With a population of over 1.2 billion and a median age of 19 years, Africa will play an increasingly important role in shaping the future world economy. The average annual GDP growth in Africa has exceeded the global average over the past several years, and six of the world's 10 fastest-growing economies hail from this continent.[1]

These growth prospects are also reflected in Africa's banking systems, which are among the fastest-growing and most profitable of any region. During the period 2012–17, African banks' revenue grew at a compound annual rate of 11%, and these institutions are projected to continue to be among the fastest-growing banking systems over the coming years (Figure 1).[2] Indeed, with a retail banking penetration of just under 40% of GDP, there is incredible potential for African banks to continue to grow.[3]

And Africa has been at the forefront of using technology for banking services, long before "fintech" become a household term.[4] Whether it is established fintech companies such as Kenya's M-Pesa mobile money service or Nigeria's Interswitch digital payments – which were set up over 15 years ago – or more recent fintech startups, there are now over 250 active fintech companies operating in sub-Saharan Africa (Figure 2). There is much that we can learn from Africa's rich history of fintech.

But these tantalising prospects for Africa's banking systems will require a robust and resilient regulatory foundation. Such a foundation helps deliver sustainable and healthy banking systems that can serve the real economies at all points of the financial cycle.

So, my remarks today will focus primarily on the imperative of implementing the Basel Committee's post-crisis reforms. I'm pleased to note that the SARB takes this imperative seriously: it has a

---

1 Signé and Gurib-Fakim (2019).

2 McKinsey (2018).

3 Ibid.

4 Hernández de Cos (2019c).

strong track record of implementing the Basel III standards in a timely and consistent manner. And Governor Kganyago's chairmanship of the Financial Stability Board's Standing Committee on Standards Implementation underscores the SARB's commitment to this imperative.

I will frame my remarks around four questions:

(i) Why does implementation matter?

(ii) What has the Basel Committee done to meet the implementation imperative?

(iii) What have we seen to date among our members?

(iv) Where does this leave us?

Why does implementation matter?

At face value, the answer to this question may appear obvious. Any global regulatory standard will have no durable impact if it is not actually implemented! But the response to the question is deeper than this in at least two ways.

Implementation is integral to policymaking

First, implementation is a core element of any policymaking cycle (Figure 3). While the features of such a cycle may differ across organisations, they generally comprise the following sequential elements:

(i) identifying a policy issue/objective;

(ii) developing and appraising possible policy options;

(iii) implementing and monitoring the finalised policy measures;

(iv) evaluating the effectiveness of the policy measures and the extent to which they meet their objectives; and

(v) incorporating any insights and lessons learned for future policymaking.

So, only by implementing global regulatory standards can we reap their full benefits, understand and assess their impacts, and draw any takeaways for future policymaking. I have previously discussed the increasing focus of the Committee and other international forums on evaluating post-crisis reforms.[5] But such evaluations can only be conducted in a rigorous manner after the relevant reforms have been implemented.

Implementation and global financial stability

Second, safeguarding financial stability is a matter of global collective responsibility.[6] In a world with cross-border capital flows, no jurisdiction can preserve financial stability domestically through its own policies.[7] Preserving global financial stability requires jurisdictions to cooperate in identifying and mitigating risks to the financial system.

---

[5] Hernández de Cos (2019b).

[6] Hernández de Cos (2019a).

[7] Schoenmaker (2011).

The costs of the global financial crisis of 2007-09 were profound and are still raw. Estimates from the IMF suggest that output levels remain below pre-crisis trends in more than 60% of economies.[8] And the broader societal impact of the global financial crisis is no less jarring – we have yet to full the full impact of these changes.[9]

In response to the global financial crisis, Basel Committee members developed a comprehensive package of post-crisis reforms collectively known as Basel III. These reforms seek to address some of the glaring fault-lines in the banking system exposed by the global financial crisis, including unsustainable levels of leverage, insufficient high-quality loss-absorbing capital, excessive variability of banks' modelled risk-weighted assets, a mispricing of liquidity risk and the build-up of system-wide risks.

In developing the Basel III reforms, the Committee carefully weighted the costs and benefits of regulation. There is strong empirical evidence suggesting that the net macroeconomic benefits of capital requirements are positive over a wide range of capital levels (Figure 4). The benefits of Basel III accrue both to society as a whole, in the form of reduced frequency and impact of banking crises, and to banks directly, in the form of lower funding costs and better-quality lending.[10]

But the benefits to global financial stability of Basel III can only be fully realised if these global minimum standards are implemented across jurisdictions based on the following criteria:

- Full implementation: the full scope of globally agreed reforms are expected to be implemented. The Committee's post-crisis reforms collectively enhance the robustness of the regulatory framework. These reforms are complementary in nature, as they seek to address different fault-lines exposed by the global financial crisis. A selective implementation of Basel III will result in a frail regulatory foundation, exposing banks and the real economy to vulnerable pockets of unmitigated risks.
- Timely implementation: the reforms are expected to be implemented no later than the agreed implementation dates (Figure 5). For example, for the recently-finalised Basel III reforms, that means an implementation date of no later than 1 January 2022.
- Consistent implementation: the reforms are expected to be implemented in a faithful and compliant manner. This means meeting both the letter and spirit of the standards (while allowing for any non-substantive drafting variations for the purpose of domestic legislation).[11]

Failure to meet this implementation imperative could undermine global financial stability and the provision of credit to the real economy. Global cross-border bank claims exceed $30 trillion, which includes claims on not only other banks but also non-bank counterparts (Figure 6). If certain parts of this globally interconnected banking network are not subject to the same degree of resilience provided by Basel III, this could result in a build-up of risks in certain banking systems, which could ultimately impede the continued provision of credit across jurisdictions.

Importantly, the implementation imperative refers to the minimum standards set out in the global Basel framework. Jurisdictions are free, and 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.

A non-consistent implementation of Basel III across jurisdictions could also result in market fragmentation and cross-border regulatory arbitrage. As noted in a report by the Financial Stability Board

[8] International Monetary Fund (2018).

[9] Hernández de Cos (2019a).

[10] *Ibid*.

[11] Carstens (2019).

on this topic, which drew on inputs from the Committee, the potential impact on market fragmentation as a result of a non-consistent Basel III implementation could include:

- creating an unlevel playing field among banks that can result in a race-to-the-bottom in terms of regulatory standards and/or supervisory practices, which in turn can have adverse consequences for the safety and soundness of the banking system;
- overstating the capital and liquidity ratios reported by banks in jurisdictions that have not implemented Basel III consistently, which would erode comparability across banks and impair market discipline; and
- adding operational costs and complexity for internationally active banks.[12]

What have we done?

So, what has the Committee done in practice to help meet the implementation imperative?

Commitment to implementation

First, the Committee's Charter explicitly notes that members are committed "to implement and apply BCBS standards in their domestic jurisdictions within the pre-defined timeframe established by the Committee".[13] The Committee does not possess any formal supranational authority, and its decisions have no legal force. The power of the Committee's standards lies therefore in the common willingness and understanding that member jurisdictions will adopt them into domestic laws or regulations. This commitment was most recently reaffirmed by the Group of Central Bank Governors and Heads of Supervision when finalising the outstanding Basel III reforms in 2017.[14] And G20 Leaders have repeatedly and unequivocally stated their commitment to a full, timely and consistent implementation of Basel III.

Regulatory Consistency Assessment Programme

Second, the Committee set up the Regulatory Consistency Assessment Programme (RCAP) in 2012 to achieve three objectives: (i) monitor the timely adoption of standards by members; (ii) assess the completeness and consistency of the standards adopted by members; and (iii) evaluate the outcomes of the application of these standards. Let me say a few words about what has been done thus far to meet those objectives.

The Committee submits semiannual monitoring reports to G20 Leaders on the implementation status of Basel III.[15] These reports provide a high-level overview of Committee members' progress in adopting all of the Basel III standards. The publication of these reports provides an incentive for member jurisdictions to adopt the Committee's standards in a timely manner.

In addition to periodically reporting on the status of adoption, all Committee members undergo an assessment of the completeness and consistency of their domestic rules with the Basel standards. The jurisdictional assessments consist of peer review exercises that assess the extent to which domestic

---

[12] FSB (2019).

[13] BCBS (2018).

[14] BCBS (2017).

[15] See BCBS (2019b) for the latest report.

regulations are aligned with the minimum Basel standards and identify any deviations from the Basel framework. The assessment reports are published and include an overall compliance grade, which provides an incentive for member jurisdictions to take any corrective actions to address findings identified in assessments. The Committee also publishes follow-up reports to track the actions taken by member jurisdictions after the publication of the RCAP report.

To date, the Committee has published assessment reports for all its member jurisdictions regarding their implementation of the capital requirements, Liquidity Coverage Ratio (LCR) and global systemically important bank (G-SIB) framework.[16] In 2018, the Committee started assessing the consistency of implementation of the Net Stable Funding Ratio (NSFR) and the framework for measuring and controlling large exposures. The review of the implementation of these standards for all member jurisdictions is expected to be completed in 2021. The Committee will then commence its review of members' implementation of the leverage ratio framework and the revised risk-weighted capital framework.

With respect to evaluating the outcomes of the application of Basel standards, the Committee has published a series of thematic reports on the consistency of risk-weighted assets for credit risk, market risk and counterparty credit risk.[17] These reports highlighted a material and worryingly large degree of variability in banks' risk-weighted assets (Figure 7) and in turn motivated the recently finalised Basel III reforms that seek to reduce this excessive variability.

What have we seen to date?

Where do we stand with the implementation of Basel III?

On the timeliness of implementation, I'm pleased to note that all member jurisdictions have implemented the initial (2010) Basel III capital standards and the LCR (Figure 8). And most jurisdictions have implemented the leverage ratio framework on time as well.

But we are seeing increasing signs of delay with regard to the implementation of some of the other standards. For example, only 70% of jurisdictions have thus far implemented in a timely manner core reforms such as the Net Stable Funding Ratio and the large exposures framework. And a similar pattern can be seen with regards to various reforms related to the risk-weighted capital framework, including the standardised approach for measuring counterparty credit risk, the revised securitisation framework and capital requirements for banks' exposures to central counterparties.

From a consistency perspective, the Committee's RCAP reports on the implementation of the Basel III capital framework found that, of the 19 member jurisdictions, 15 have been assessed as compliant, three were largely compliant, and one was materially non-compliant (Figure 9). With respect to the LCR, 16 jurisdictions have been assessed as compliant and three were largely compliant. Finally, the RCAP reports on the G-SIB framework found that all jurisdictions in which the G-SIBs are headquartered were compliant. And the RCAP reports conducted thus far on the NSFR and large exposures framework for seven jurisdictions have found them all to be compliant.

Importantly, most member jurisdictions have actively rectified observed deviations by amending their domestic regulations in the course of the RCAP assessments. The assessments of the capital framework, LCR and G-SIBs framework identified a total of 1,450 deviations, of which around 60% were rectified during the assessment. Of the remaining deviations, 85% have been assessed as not material,

[16] The reports are available at www.bis.org/bcbs/implementation/rcap_jurisdictional.htm?m=3%7C14%7C656%7C60.

[17] The reports are available at www.bis.org/bcbs/implementation/rcap_thematic.htm?m=3%7C14%7C656%7C61.

ie not expected to give rise to concerns related to financial stability or an international level playing field. This is evidence of the tangible benefits derived from the Committee's RCAP.

Where does this leave us?

So, where do we go from here to meet the implementation imperative? I will offer two observations.

The regulatory cycle and excessive complexity

First, it is concerning to see signs of delays in implementing the outstanding Basel III standards among some member jurisdictions, and even more worrying to see indications of potential deviations in a few instances. In my view, such delays and potential inconsistencies are a result of two broad factors: (i) the unfortunate dynamics of the "regulatory cycle"; and (ii) the significant volume and excessive complexity of some of the post-crisis reforms.

I have previously discussed the concept of the regulatory cycle, whereby memories of banking crises fade over time, vested interests start to gain momentum, and the fallacy of "this time is different" recurs.[18] It tests our will to persevere with the implementation of post-crisis reforms. And 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.

There are worrying signs that we may be entering the later stages of this cycle. For example, it is disconcerting to hear claims made by some that a jurisdiction or region needs to "adapt" Basel III to suit its domestic circumstances. This points to a lack of understanding or misrepresentation of how the Basel standards are developed.

The Committee has a comprehensive approach to designing its standards, which includes: (i) an extensive outreach with a wide range of stakeholders through a transparent and structured consultation process; (ii) rigorous empirical analyses of the impact of any proposed policy measure, with the results of many quantitative impact studies made public; and (iii) discussions among Committee member jurisdictions regarding the final design and calibration of any standard.

So, the Committee's approach to finalising its standards already takes into account any relevant differences in viewpoints among its members or different structural features across its jurisdictions. For example, during the finalisation of the recent Basel III standards in 2017, over 50 adjustments were made by the Committee during its development of the standards relative to the proposals that it initially consulted on.

A related cause for delayed implementation is the excessive complexity and volume of post-crisis reforms. Both banks and supervisors are facing operational challenges in implementing some of the standards. In some instances, some of this complexity reflects relentless lobbying efforts by some stakeholders to continuously seek further 'fine-tuning' of Basel III, which would purportedly result in greater risk sensitivity. Instead, it has increased the operational obstacles for banks to implement the standards in a timely manner. When combined with the length of the domestic legislative process in some jurisdictions, this further undermines the ability to meet the implementation imperative.

---

18 Hernández de Cos (2019a).

This underscores the importance of ensuring that standards are designed in a simple and robust manner.[19] Such an approach is in the interest of all stakeholders, as it facilitates the ability to meet the implementation imperative in a timely manner, and provides a resilient regulatory foundation that stands the test of time. In finalising Basel III, the Committee reviewed the appropriate balance of simplicity, comparability and risk sensitivity in the regulatory framework.[20] It is important that we continue to ensure that the right balance is struck going forward.

Proportionality and the Basel framework

My second observation relates to the role of proportionality in helping to meet the implementation imperative.

The Core Principles for Effective Banking Supervision embed the role of proportionality, including that "supervisory practices should be commensurate with the risk profile and systemic importance of the banks being supervised".[21] These principles are relevant for all banks and jurisdictions around the world, and provide the basis for a resilient banking system.

The Committee supports the use of proportionality in implementing the Basel framework in a manner consistent with the Core Principles.[22] The Basel framework includes a range of approaches, from simpler standardised approaches to advanced approaches. Accordingly, proportionality can take different forms, including, but not limited to, the following:

- implementing the most appropriate approaches among those available in the Basel framework (ie among the range of standardised and internally modelled approaches) for internationally active banks in member jurisdictions. There is no expectation – even for internationally active banks – that they must use internally modelled approaches; and
- implementing standards for banks in non-BCBS member jurisdictions that are broadly consistent with the principles of the applicable Basel standards.

A proportionate framework should not reduce the resilience of banks or dilute the prudential regulatory framework, but rather reflect the relative differences in risk and complexity across banks and the markets in which they operate. Crucially, a proportionate framework should also consider supervisory capacity and resources, particularly when implementing more complex standards. Going forward, the Committee will continue to exchange views on the role of proportionality in the Basel framework, and whether any additional work is needed at the global level.

I would encourage jurisdictions in Africa to pursue a proportionate approach to their implementation of the Basel framework along these lines, where relevant. And I look forward to hearing your views on how proportionality can best be used in your jurisdiction to provide a resilient and robust regulatory framework for African banks.

---

[19] Ingves (2015), Coen (2018).

[20] BCBS (2013a).

[21] BCBS (2012).

[22] BCBS (2019c).

Committee work programme and outlook

Before I conclude, let me say a few words about the Committee's current work programme. In addition to its unremitting commitment to meeting the implementation imperative, the Committee's work programme comprises three broad strands of work.

First, the Committee is undertaking a targeted set of policy initiatives related to topical issues including: operational resilience and cyber risk; the prudential treatment of crypto-assets; the regulatory impact of benchmark rate reforms; and the implications of expected credit loss accounting for banks' regulatory capital requirements.

Second, the Committee is continuing its efforts to promote strong supervision, including with regard to assessing the implications of financial technology for banks and supervisors and mitigating climate-related financial risks.

Third, while the Basel III reforms are being implemented, the Committee will be devoting a substantive part of its agenda over the next few years to carefully evaluate the impact and effectiveness of its post-crisis reforms.

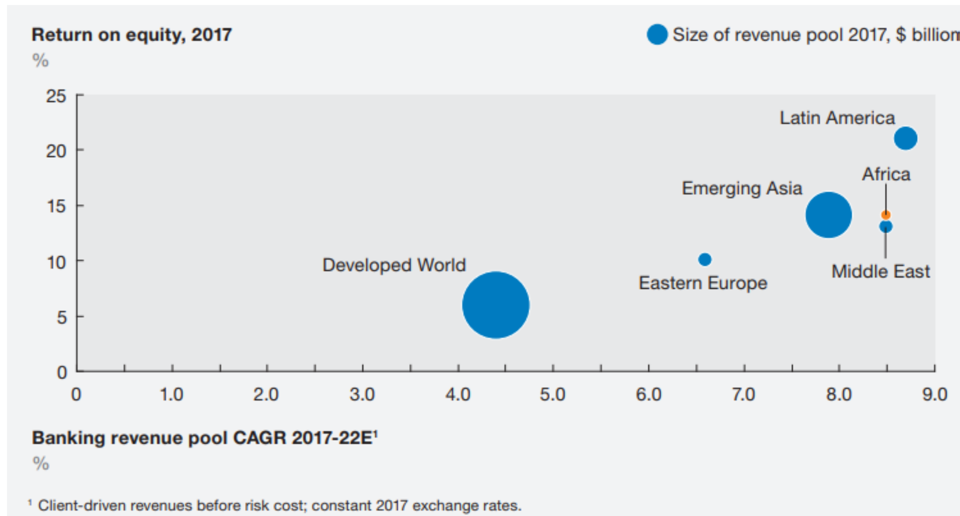
Conclusion

To conclude, the Basel Committee's post-crisis reforms, centred around Basel III, are a comprehensive and wide-ranging set of measures that seek to fix the many fault lines in the pre-crisis regulatory framework. But the benefits from Basel III can only be enjoyed if these standards are implemented by all Committee member jurisdictions.

The time for adaptation is passed, and the focus should now be on adoption. This is of particular importance for those jurisdictions and regions with the biggest banking systems. More than ever, it is in their interest to lead by example and contribute to global financial stability by implementing Basel III in a full, timely and consistent manner.

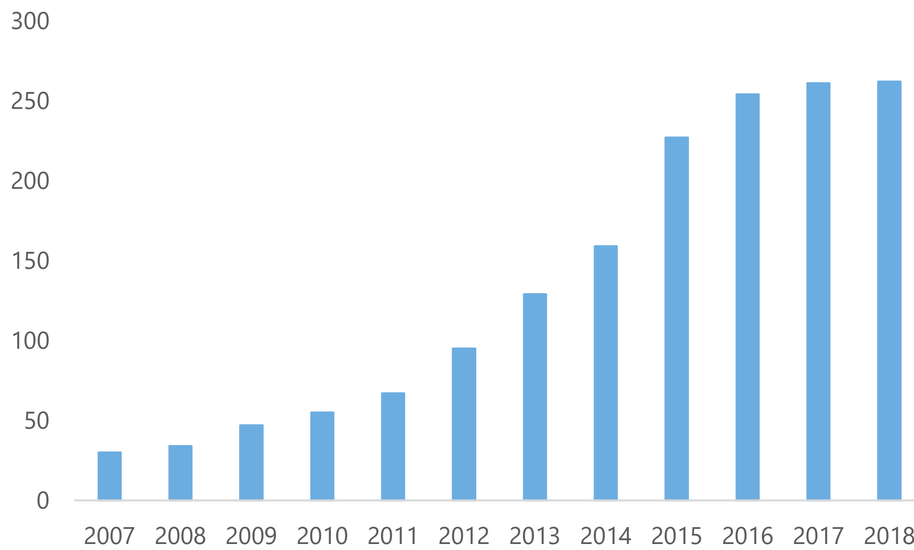
Figures

Figure 1: Banking return on equity and projected revenue growth by region



Source: McKinsey (2018).

Figure 2: Total number of fintech companies in sub-Saharan Africa



Sources: EY (2019); Secretariat calculations.

Figure 3: Stylised example of policymaking cycle

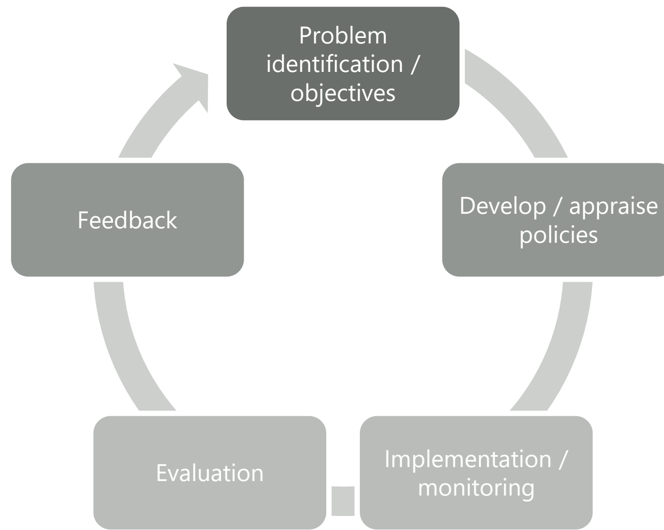
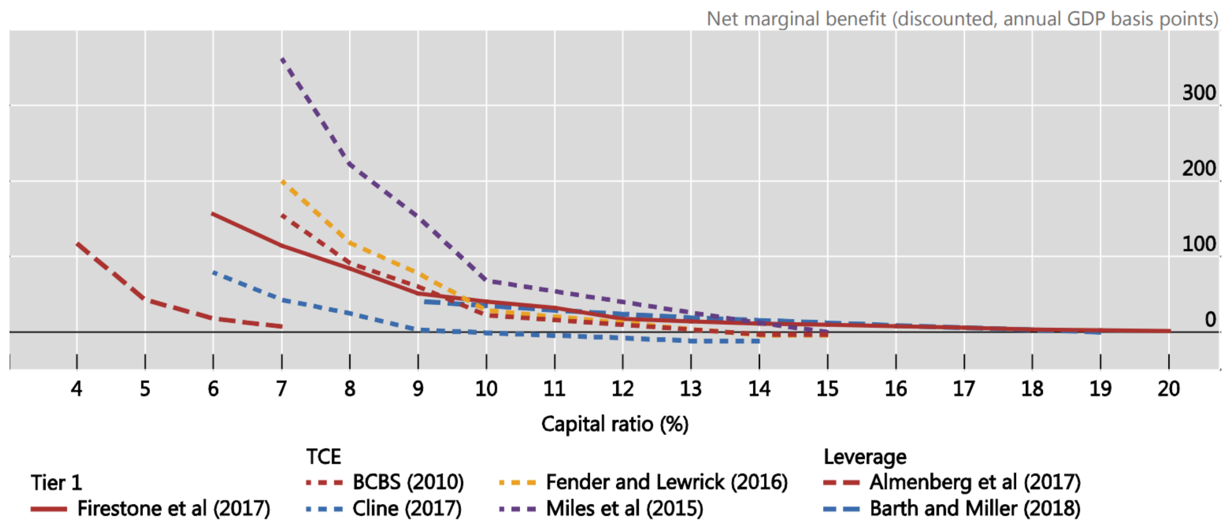


Figure 4: Net marginal macroeconomic benefits of capital



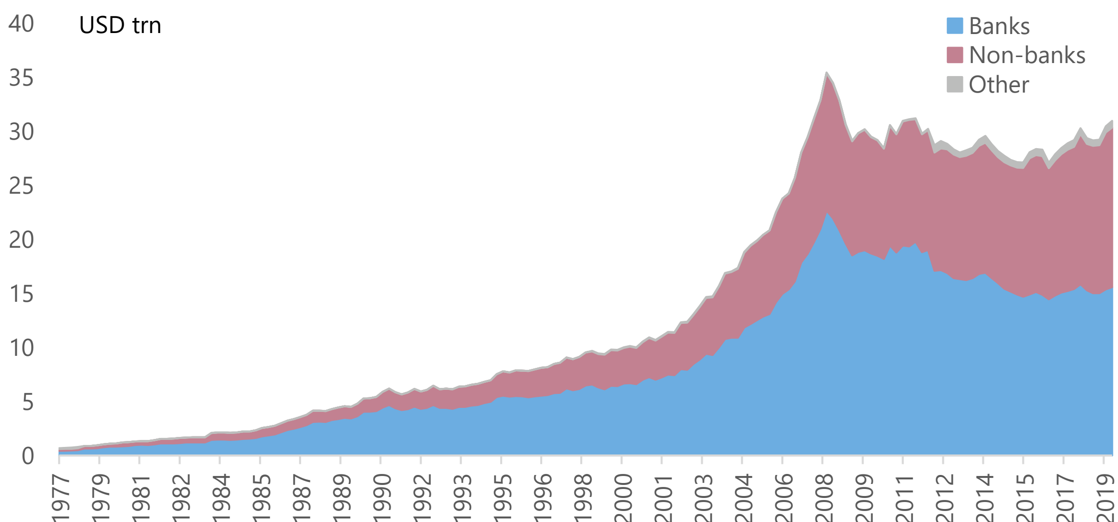
Source: Basel Committee on Banking Supervision (2019a).

Figure 5: Basel III transitional and implementation arrangements

		2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Leverage ratio		2014 exposure definition				Revised exposure definition G-SIB buffer					
Capital	Capital conservation buffer	1.25%	1.875%	**2.5%**								
	Minimum common equity plus capital conservation buffer	5.75%	6.375%	**7.0%**								
	Minimum total capital plus conservation buffer	9.25%	9.875%	**10.5%**								
	Phase-in of deductions from CET1[1]	80%	**100%**									
	Capital instruments that no longer qualify as non-core Tier 1 or Tier 2 capital	Phased out from 2013										
Risk coverage	Capital requirements for equity investments in funds and exposures to CCPs	Implementation										
	Standardised approach to counterparty credit risk	Implementation										
	Revised securitisation framework		Implementation									
	Interest rate risk in the banking book		Implementation									
	Large exposures framework			Implementation								
	Revised standardised approach for credit risk						Implementation					
	Revised IRB framework						Implementation					
	Revised CVA framework						Implementation					
	Revised operational risk framework						Implementation					
	Revised market risk framework						Implementation					
	Output floor						50%	55%	60%	65%	70%	**72.5%**
Liquidity	Liquidity Coverage Ratio	80%	90%	**100%**								
	Net Stable Funding Ratio		**100%**									

Source: Basel Committee. (1) Including amounts exceeding the limit for deferred tax assets, mortgage servicing rights and financials.

Figure 6: Global cross-border bank claims by counterpart[(a)]



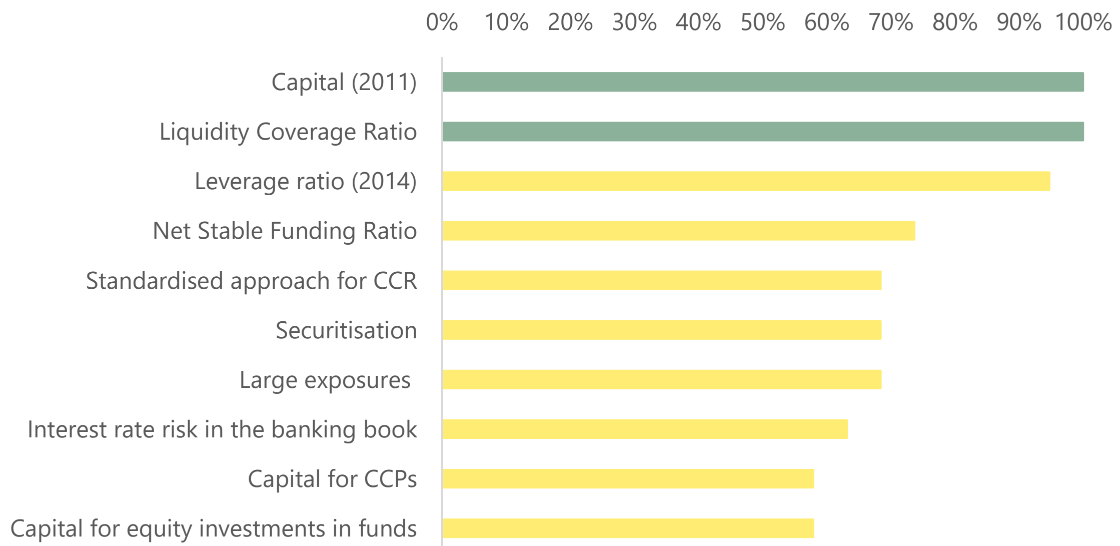
[(a)] Non-bank claims include non-bank financial institutions and non-financial corporates. "Other" includes general government, households and non-profit institutions serving households (data available as of 2014 onwards only).

Source: BIS; Secretariat calculations.

Figure 7: Excessive variability in risk-weighted assets: Internally-modelled capital requirements for hypothetical portfolios[(a)]

Source: BCBS (2013b); Secretariat calculations.
(a) The chart shows the normalised distribution of risk weights (with 100% representing the cross-bank median risk weight as the benchmark) reported by banks as part of the Committee's analysis of risk-weighted assets for credit risk in the banking book..

Figure 8: Percentage of BCBS member jurisdictions that have issued final rules[(a)]

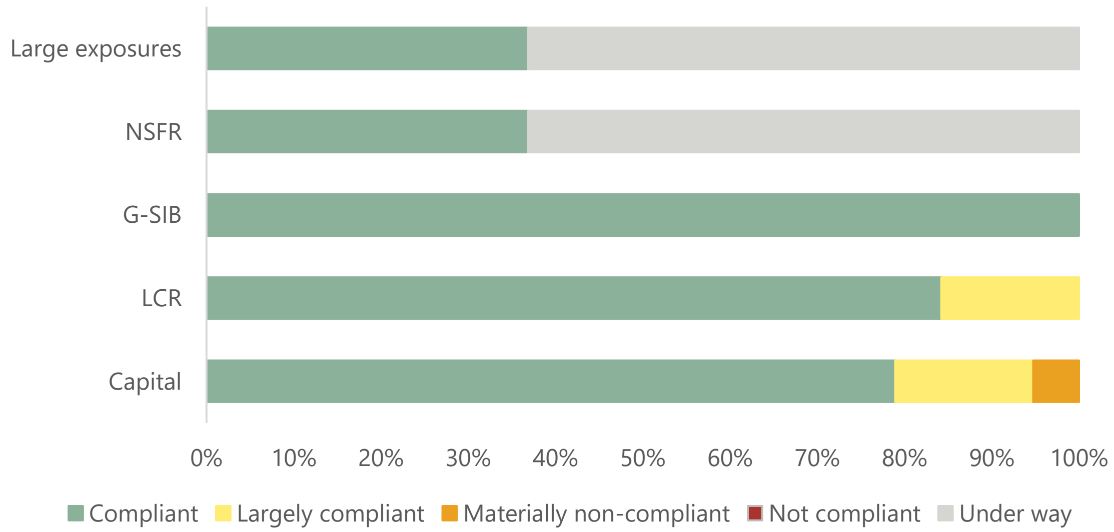


[(a)] As at end-September 2019.

Source: Basel Committee; Secretariat calculations.

.

Figure 9: RCAP compliance grade of Basel III standards



Source: Basel Committee; Secretariat calculations.

References

Basel Committee on Banking Supervision (2012): *Core Principles for Effective Banking Supervision*, September.

——— (2013a): "The regulatory framework: balancing risk sensitivity, simplicity and comparability", July.

——— (2013b): "Analysis of risk-weighted assets for credit risk in the banking book", July.

——— (2017): "Governors and Heads of Supervision finalise Basel III reforms", press release, 7 December.

——— (2018): Basel Committee Charter, June.

——— (2019a): "The costs and benefits of bank capital – a review of the literature", June.

——— (2019b): *Seventeenth progress report on adoption of the Basel regulatory framework*, October.

——— (2019c): "Joint BCBS-BCG statement on proportionality", November.

Carstens, A (2019): "The role of regulation, implementation and research in promoting financial stability", June.

Coen, W (2018): "The market risk framework: 25 years in the making", keynote speech by the Secretary General of the BCBS at the ISDA Annual General Meeting, Miami, 25 April.

EY (2019): *Fintechs in sub-Saharan Africa: an overview of market developments and investment opportunities*.

Financial Stability Board (2019): *FSB report on market fragmentation*, June.

Hernández de Cos, P (2019a): "The future path of the Basel Committee: some guiding principles", keynote speech by the Chair of the BCBS and Governor of the Bank of Spain at the Institute for International Finance Annual Membership Meeting, Washington DC, 17 October.

——— (2019b): "Post Basel III: time for evaluation", keynote address by the Chair of the BCBS and Governor of the Bank of Spain at the 14th ASBA-BCBS-FSI High-level Meeting on Global and Regional Supervisory Priorities, Lima, 1 October.

——— (2019c): "Financial technology: the 150-year revolution", keynote speech by the Chair of the BCBS and Governor of the Bank of Spain at the 22nd Euro Finance Week, Frankfurt, 19 November.

Ingves, S (2015): "From the Vasa to the Basel framework: the dangers of instability", speech by the Chair of the BCBS and Governor of Sveriges Riksbank at the Annual Convention of the Asociación de Mercados Financieros, Madrid, 2 November.

International Monetary Fund (2018): *World Economic Outlook*, October.

McKinsey & Company (2018): *Roaring to life: growth and innovation in African retail banking*, February.

Schoenmaker, D (2011): "The financial trilemma", *Economics Letters*, no 111, January.

Signé, L and A Gurib-Fakim (2019): "The high growth promise of an integrated Africa", *Project Syndicate*, August.