The evolution of the Basel Committee

Stefan Ingves
Chairman, Basel Committee on Banking Supervision and Governor, Sveriges Riksbank

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25 years of international financial regulation: Challenges and opportunities
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Good morning everyone.

On behalf of the Basel Committee, I would like to welcome you to today's symposium, which the Committee is hosting to mark 25 years since the first Basel Accord on bank capital was established. And let me at the same time also acknowledge Jaime Caruana and the BIS, not only for hosting this event, but also for their unwavering support of the Committee over the past almost 40 years.

As many of you know, the Basel Committee started out in 1974 as the *Basel Committee on Banking Regulations and Supervisory Practices*. In the aftermath of the Herstatt collapse, the G10 Governors of the day were seeking ways to preserve and promote the stability of the international financial system. It is worth reflecting during the morning, as we discuss the Committee's achievements to date, that the basic problems we encounter today – poorly run institutions, interconnectedness and financial instability – are the same as those faced by the Committee when it was founded.

This is not to imply that nothing has been achieved: on the contrary, a great deal has been done and the world has benefited greatly. But, despite our efforts, banks regularly lose money in the same old way: while pursuing profits, growth and market share without adequate heed to risk. Unfortunately, they often find clever new ways of doing this, so that it isn't always easy to see how the same old habits will be repeated.

While today's Committee members are, I'm sure, looking for some respite from the ambitious work programme of post-crisis reforms, we also need to recognise that nobody can guarantee a crisis-free future. Therefore, we must remain vigilant against old risks re-emerging in new shapes and forms.

I will speak shortly about some of the key influences that have shaped the evolution of the Basel Committee over the years. Before I start, however, I would like to warmly welcome a number of special guests today:

- First let me welcome Peter Cooke. Having headed the Committee for more than a decade, Peter has been our longest-serving Chair – and, probably more than any other person, he was instrumental in laying the foundations for the Committee's subsequent achievements. Indeed, his contribution is best highlighted by the fact that, for many years, people did not refer to the Basel Committee, but to the "Cooke Committee" and the "Cooke ratio" – although I know Peter is the first to acknowledge that the credit for the Accord is shared by many. Peter – we are very pleased that you and your wife Julia can be with us today.

- Let me also acknowledge a number of Peter's colleagues on the Committee through the critical period of 1986–88 when the Accord was settled. I am delighted that you were all able to join us today.
- Finally, I would especially like to welcome Paul Volcker to the symposium. Paul was instrumental within the G10 Governors in pushing for an international benchmark on bank capital. In particular, together with Robin Leigh-Pemberton of the Bank of England, he was critical in forging the agreement that produced the world's first international standard for bank capital. Paul – I don't think it is too much to say that a great deal of today's global financial regulation was founded on your original vision.

As a scene-setter for this morning's discussions, I would offer some thoughts on the key influences on the evolution of the Committee to date.

The Basel Committee and its activities have changed almost beyond recognition since its establishment in 1974, or even since 1988 when the first Accord was agreed. I doubt whether the founding Governors really foresaw what the Committee would eventually become: not just an international standard setter, but also one that now conducts peer reviews of members' compliance with their agreements. Indeed, if they had, I suspect that a few of them might have been against the Committee's establishment in the first place!

But times change, the financial sector has evolved, and the Committee has moved with the times. Among the many factors that have influenced the work of the Committee over the years, I thought I would identify five that have shaped what the Committee is today and will continue to guide its activities in the future.

The first and most obvious is the evolution from ***a coordinating and information-sharing group to one that has become a standard setter***. Although the 1975 Concordat was the Committee's first substantive agreement, and its first public document, it was not a standard *per se*: rather, it was a sensible agreement on how supervisory responsibilities could be divided for banks operating across national boundaries. Its goal was modest: to make sure no bank could escape supervision. It did not try to harmonise supervisory standards. And, of course, it was primarily directed at supervisors, not banks themselves.

In subsequent years, the Committee pronounced on international lending and foreign exchange positions. These documents began to set expectations for the way in which banks should manage these risks, but they were not standards in the way we use the word today. It was the first Basel Accord that really marked this new role for the Committee. As in 1974, a severe crisis triggered this step – in that case, the Latin American debt crisis of the early 1980s, which raised the political pressure for banks to increase their capital base and for the regulators to create an international level playing field in this respect.

Since then, the Committee's role as a standard setter has only grown – to the extent that, today, this is seen as its primary purpose. Whereas the Committee took 10 years to publish its first 10 documents, this year alone it has published more than 30 – with more to come. But with all the public focus on standard-setting, it is important not to forget the critical "behind the scenes" role of information-sharing, since we all well know that regulation cannot be successful without strong supervision and cooperation to back it up.

The second important influence on the Committee has been ***the growing sophistication and complexity of international financial markets***. The original Basel Accord was beautiful in its simplicity – something that many people long for today – but it could not keep up with the development of increasingly complex financial instruments. These may have offered substantial benefits to society, but they strained the simple Basel I methodology. The Committee's response was most obviously manifested in Basel II. This marked another turning-point in the Committee's evolution, moving us from a "one size fits all" regime to differential approaches using internal models. This meant the regulatory regime was better aligned with banks' underlying risk profile, but regulation was now no longer simple or completely uniform across banks. Like any change, it has delivered some undoubted benefits, but it has also created a whole new range of challenges that we are still grappling with today.

The third key influence on the Committee stems from ***increasing globalisation***. As a creature of the G10, the Committee could originally lay claim to coverage of most of the world's truly internationally active banks. But as banks and financial markets became increasingly integrated across national borders, this claim to be the standard setter for all internationally active banks became more and more difficult to justify.

During the 1990s and 2000s, the Committee made good use of its Core Principles Liaison Group to seek advice from members outside the G10. The CPLG's contribution was highly constructive when Basel II was developed, for example. But as the size and importance of jurisdictions "outside the tent" grew, even this arrangement became increasingly untenable. And so, in 2009, the Committee essentially stepped up from a G10 to a G20 foundation as it sought a truly coordinated response to the global financial crisis. Indeed, we now have more than 40 organisations representing 27 member jurisdictions around the table. As a result, the Committee's coverage of global banking assets has gone from about 60% to 90%. This much greater inclusiveness lends, in turn, greater legitimacy and credibility to the Committee's standards, as they are now set by a process that is truly reflective of international markets.

The fourth key influence is a more recent one – ***the shift in thinking from a micro- to a macroprudential perspective***. For much of its life, the Committee focused primarily on microprudential issues. That is not to say the macroprudential angle was ignored, but there was certainly a view – quite prevalent in the pre-crisis world – that if banks were individually stable, the financial system would itself stay upright. During the Great Moderation, little appetite existed for new tools and international regulations of a macroprudential nature, even if the Committee could have foreseen all of the looming threats.

The financial crisis brought home the lesson that financial stability could not be assured only through the use of microprudential tools. And so Basel III represents another important step in the Committee's development. Basel III has substantially enhanced the microprudential framework. And, in the countercyclical buffer, it has also introduced the first international agreement on a macroprudential tool. Subsequent work on the framework for systemically important banks (both global and domestic) has further expanded the Committee's input into this relatively new field – a trend that is unlikely to be reversed.

My fifth key influence on the Committee's evolution is also quite recent, and hence its eventual impact on the Committee's work is still difficult to foresee: ***its role in monitoring the implementation of Committee standards.***

Post-crisis, the Committee has not only expanded its membership, but it has also taken on the role of monitoring the implementation of the standards agreed by its members. To an outsider, that may not sound significant – indeed, some might reasonably ask why the Committee wasn't already doing this – but it is notable if only as an idea that the Committee had previously considered and rejected on more than one occasion. Indeed, in his authoritative history of the Committee's early years, Charles Goodhart notes that, as far back as 1983, there was discussion whether the Committee might also monitor the practical application of agreements. At the time, though, this was seen as somewhat awkward and a step too far. That the Committee now has just such a mandate shows that the commitment to consistent international regulation is undiminished – indeed, it is stronger than it has ever been.

Let me conclude by once again welcoming you to Basel, particularly those of you who have played a role in the Committee's earlier years – we hope that returning here brings back many good memories. For the current Committee members, it is a wonderful opportunity to learn from the wisdom of those who have grappled with these issues before us. We also hope to hear some different perspectives, from the banking industry, and from academia, on the challenges and opportunities that face the Committee. I am therefore looking forward to some productive – and hopefully provocative – discussions this morning.