BANK FOR INTERNATIONAL SETTLEMENTS

A level playing field in banking

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Introduction

Thank you very much for giving me the opportunity to address you on this occasion. Special thanks are due to my former central bank colleague, Axel Weber, and to Tim Adams and the IIF for their hospitality.

I've been asked to cover the closely related topics of the future of regulatory cooperation and institutions, and the risks of regulatory fragmentation. Linking these two topics is the issue of level playing field, and I will concentrate on this.

I won't go into the details of why this is an important topic – there is no group of people who appreciate this more than you do. Just to say here: there is widespread agreement that a level playing field in banking is a key condition for a competitive banking sector that rewards the more efficient business models – not the most risky ones or those protected by implicit guarantees.

But before addressing this topic, let me get something very important out of the way. As you know, the BIS is not only about regulatory cooperation. Indeed, we spend plenty of time talking about macroeconomic developments, financial market conditions and monetary policy. On this basis, allow me to share a few observations from our recent economic discussions at the BIS which I think will be of interest to you.

Conjunctural developments

The global upswing has continued at a strong pace, with growth in most advanced economies at or above potential and labour markets tightening further. Conditions across emerging market economies are seen as somewhat less buoyant, but overall quite positive.

Inflation is still low, especially when judged against real activity indicators. At the same time, uncertainty persists as to how far this is explained by structural or conjunctural factors. Globalisation and technological progress may partly account for low inflation and wage growth. For example, the share of temporary and part-time jobs is up, and the bargaining power of labour has generally declined. Various transitory factors are (also) keeping inflation down in a number of economies, raising the possibility of inflationary surprises ahead.

This implies that central banks might be facing difficult trade-offs. On the one hand, there may be a desire to bring inflation back to target rather quickly and push rates away from the zero lower bound – to gain some room for manoeuvre in case of future economic weakness. On the other hand, accommodative policies could further lift equity and other asset prices and maintain easy credit conditions, which may complicate any future adjustment.

Well, how to handle this will be for each central bank to figure out. For commercial banks, however, growth is up on a broad basis – supporting the demand for bank loans and other financial services. Interest margins, in turn, are bound to gradually widen.

In short, even though there are risks (including that of a snapback in rates), banks are enjoying broadly improving business conditions, which should help them to finally emerge from the shadow of the Great Financial Crisis (GFC).

Level playing field: good news/achievements

With that, let me turn to the level playing field issue. As with any interesting story, this is one of good and bad news; of opportunities and risks, of achievements and challenges. I'll start with the good news, and then move on to the challenges.

The international policy framework

My starting point is the recent crisis experience. It brought home the point that while crises often span borders, the pain is always domestic. At the political level, therefore, the temptation is for a narrow, national policy response that tends to make the playing field uneven – the very opposite of what we should be aspiring to.

When the GFC hit in 2007–09, for example, national approaches prevailed – notably in the form of ad hoc ring-fencing and recapitalisation of domestic banks by governments. Cross-border banking receded significantly.

To work against such tendencies and to avoid the associated costs is not easy. This is where the BIS and other international forums play a role in coming to common understandings that limit the fragmentation brought about by policy responses that take a narrow, national approach.

A key achievement is that this international framework for policy cooperation has grown much more robust – for example, with the Financial Stability Board becoming accountable to the G20, thus bridging between elected politicians, on the one hand, and experts and standard setters, on the other. There is some hope, therefore, that future crises will not only be less likely – I'll return to this point in a moment – but also less likely to trigger uneven policy responses.

Minimum standards

This brings me to the next point: regulation. Recall that the original Basel Accord was introduced back in 1988 with the very aim of harmonising capital regulation across jurisdictions. In other words: to keep the playing field level.

How? Via internationally agreed minimum standards. This was a great leap forward.

Of course, the Basel framework has evolved significantly since, not least because of the need to respond to the GFC. The latest step, as you know, was taken in December, when the Committee of Governors and Heads of Supervision (GHOS) – the Basel Committee's oversight body – finalised the Basel III framework.

This decision brought to a close eight years of rule-making, and leaves banks able to plan with less regulatory uncertainty.

The agreed regulatory framework redresses the key shortcomings exposed by the GFC, such as insufficient bank capital, too much leverage, insufficient liquidity buffers and overstretched maturity transformation. What's more, it employs multiple regulatory metrics, with complementary constraints backstopping each other and providing protections against undue variation in risk weights across banks. The resulting, more robust regulatory approach better deals with the inherent uncertainties of risk management and measurement.

Let me add one point on calibration, which, as you are aware, was the main sticking point in the final negotiations. It is sometimes argued that the capital shortfalls (relative to new minimum requirements) that have been generated by the recent decision indicate an un-level playing field. That's true only in the sense that an un-level playing field was the starting point, not the end point. Levelling out these differences *ought* to affect banks differently. The recent measures are precisely intended to move outliers towards their peers.

Level playing field: bad news/challenges

Having achieved so much, what are the challenges we now face? One issue, of course, is that the political climate appears to have changed. There are signs that economic nationalism might be entering the scene, which may influence regulation. We need to keep an eye on three areas.

The environment for international policy reforms

As I have just argued, the international policy framework is much improved. In principle, we now have a mechanism in place that can offer future policy responses to difficult circumstances and that will help safeguard agreed standards.

The main risk is that support for further measures may be waning. You may say none too soon. But not so fast. It is important not to take just a narrow banking perspective. Policy work continues, and for good reasons: from resolution frameworks for central counterparties, through shadow banking monitoring and regulation, to cyber-security and similar issues.

It is key not to neglect regulation of non-banks, where much remains to be done. Also, recall that consistent implementation does not preclude supervisors going beyond the agreed minimum standards, which brings me to the second area.

Implementation and supervision

This is precisely implementation and supervision. Standards are one thing, implementation is another. Safeguarding Basel III's level playing field requires consistent and timely implementation. National authorities need to translate the new standards into legal requirements in their own jurisdictions. This has not always happened in the past, in terms of both timing and substance.

The Basel Committee has established the Regulatory Consistency Assessment Programme (RCAP) to monitor this process and to align incentives across jurisdictions. This is a major step forward.

But private financial institutions also have a role to play: achieving a level playing field requires upfront investment in IT systems and other tools to avoid unnecessary technical delays. Capacity building is needed among both banks and supervisors.

Financial innovation and regulation

The third – closely related – area concerns the regulatory approach to financial innovation, especially fintech. Regulators have a difficult role to play here, as they have to provide a level playing field for all participants (banks and non-banks alike), while at the same time fostering an innovative, secure and competitive financial market.

What defines a level playing field in this context? When banks and fintech firms vie for the same customers with similar services and by taking similar risks, they should be similarly regulated: "same risk, same regulation".

But different players may be operating under very different regulatory regimes. This may create unintended regulatory gaps (eg with regard to the collection and sharing of client data), with new business models shifting critical activities outside their current regulatory environment.

All of this puts a premium on regulatory and supervisory cooperation at both the international and the sectoral level. The Basel Process has much to offer here – for example, in the context of information-sharing on experience with new practices, such as innovation hubs and regulatory sandboxes. Support for such cooperative activities will be a key BIS focus in the coming years.

Thank you very much.