Workshop 2
From policy to action: Implementation of the Basel framework

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The year 2018 marks the 10th year since the financial crisis. The Basel Committee has spent much of the last decade learning the lessons of the crisis and reforming the global prudential framework for internationally active banks. These standards look very different to those in place in early 2008, including higher capital requirements, more emphasis on higher-quality capital, enhanced risk capture in the risk-based capital framework, multiple metrics to complement that framework (including those capturing liquidity risk) and a layer of macroprudential elements to mitigate systemic risks.

Agreeing these rules amongst Basel Committee members was an important step. However, on their own, Basel standards have no legal force. Instead, their power relies on implementation into domestic rules by national regulators and supervisors. This workshop aims to elicit a discussion on implementation activities currently under way in participants' jurisdictions, as well as the challenges faced and ways to address them. This should strengthen the ability of jurisdictions to implement these mutually agreed standards.

Implementation of Basel III: a summary

Basel Committee members agree to implement and apply Basel standards in their domestic jurisdictions. The main elements of the Basel III reforms agreed directly after the crisis were implemented in a timely manner by Basel Committee members, in particular the reforms to the definition of capital, enhanced risk capture for trading book exposures and securitisations, frameworks for systemically important banks and the Liquidity Coverage Ratio (LCR). Surveys by the Financial Stability Institute also show widespread adoption of the core elements of the Basel III reforms by non-Basel Committee members.

Banks have made steady progress in building capital and liquidity buffers in recent years. Since 2011, the amount of CET1 capital held by large internationally active banks has increased by around 84%, or almost EUR 1.7 trillion (end-December 2017 figures). The leverage ratio steadily rose until the end of 2015 and has remained stable since, showing a considerable reduction in leverage since the financial crisis. With regard to the LCR, the pool of high-quality liquid assets and inflows has increased by around EUR 4 trillion (between end-2012 and end-December 2017).

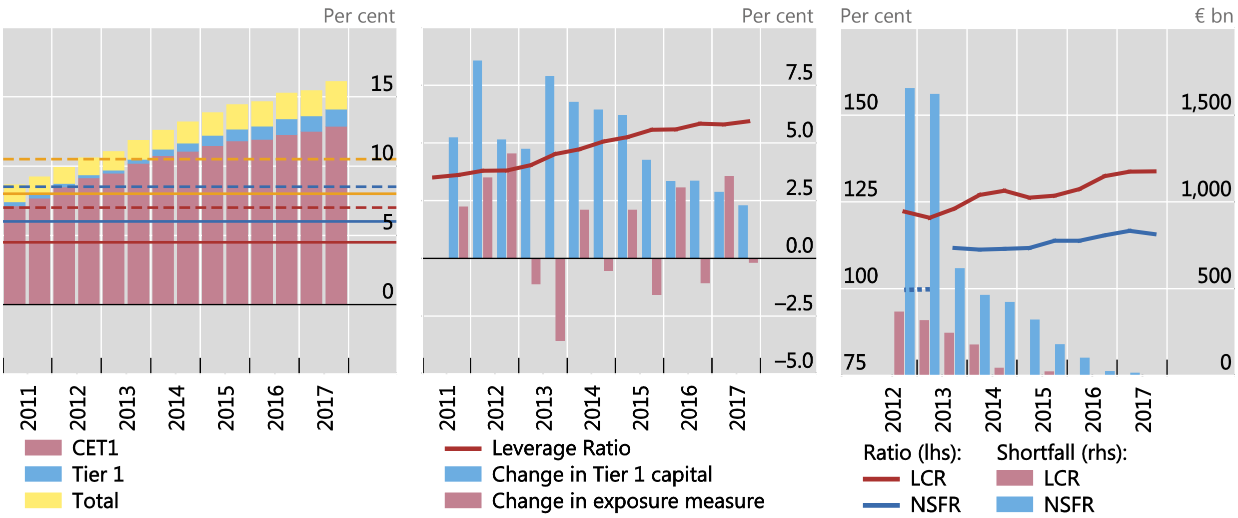
Changes in bank capital, leverage and liquidity

Graph 1

CET1, Tier 1 and total capital ratios[1]

Leverage ratios and their determinants

LCR, NSFR and related shortfalls[2]



[1] The solid lines depict the relevant minimums, the dotted lines the minimums plus the capital conservation buffer. [2] Exchange rates as at the reporting dates.

Source: Basel Committee on Banking Supervision.

Full, timely and consistent implementation

The G20 Leaders have repeatedly stated their commitment to the full, timely and consistent implementation of the financial sector reform agenda, including the post-crisis reforms to the Basel standards. This focus was reaffirmed by the Group of Central Bank Governors and Heads of Supervision, the Basel Committee's oversight body, in December 2017. Although much work has been already been done, there is still more to do.

Full implementation

The Basel framework has expanded considerably since the risk-based capital framework was introduced in 2006 as Basel II. The first part of Basel III was published in 2010 and since then the Basel framework has expanded considerably in terms of its risk coverage and the number of metrics used for supervision. In particular, the standards now cover large exposures, a leverage ratio, liquidity requirements, margin requirements for non-centrally cleared derivatives and revisions to many of the Basel II approaches and disclosure requirements.

Most recently, the Basel III standards agreed at the end of 2017 included important changes to the calculation of risk-weighted assets, which were designed to restore their credibility and make them more robust. Once implemented (by 2022), these reforms will:

- enhance the robustness and risk sensitivity of the standardised approaches for credit risk and operational risk, which will make banks' capital ratios more comparable;
- constrain the use of internally modelled approaches, including by removing the use of the most advanced modelled approaches for operational risk and for certain credit risk asset classes; and

- complement the risk-weighted capital ratio with a revised leverage ratio and robust output floor.

> Q1. Which standards are you finding most difficult to implement in your jurisdiction?

Timely implementation

In 2016 and 2017, Basel Committee members reported delays in the timely regulatory adoption of some standards. For example, members reported challenges adopting domestic rules on the standardised approach for counterparty credit risk, capital requirements for exposures to central counterparties and capital requirements for equity investments in funds.

Delayed implementation may have implications for the international level playing field, and puts unnecessary pressure on jurisdictions that have already implemented the standards based on the agreed timelines. A concurrent implementation of global standards is all the more important as many jurisdictions serve as hosts to internationally active banks.

The Committee has discussed the reasons for implementation delays, where they have occurred. The reported reasons were relatively common across standards and included the complexity of standards (or difficulties in interpreting them and transposing them into domestic rules); operational challenges for banks (eg IT issues); and concerns over the pace of implementation in other jurisdictions.

> Q2. How do delays in or inconsistent implementation of global standards affect day-to-day supervision?
>
> Q3. How could international standard setters increase their focus on "implementability"?

Consistent implementation

The Basel Committee introduced its Regulatory Consistency Assessment Programme (RCAP) in 2012. As well as monitoring the timely adoption of Basel standards across jurisdictions, the RCAP conducts peer reviews of whether domestic regulations implement these standards completely and consistently. The reports of these peer reviews, published on the Basel Committee's website, highlight any deviations from the Basel framework.

This programme has increased transparency on implementation practices across jurisdictions, as well as helping many jurisdictions improve the consistency of their regulations with international standards. As a result of the RCAP assessments of the implementation of the risk-based capital framework, over 1,200 deviations were identified, most of which were addressed during the assessment process. Two thirds of Basel Committee members have risk-based capital standards that are considered compliant or largely compliant with the Basel standards. The Basel Committee has also reviewed the implementation of the Liquidity Coverage Ratio and the framework for global systemically important banks, which have generally been implemented consistently across jurisdictions. Through these reviews, the Committee also identifies areas for further policy follow-up and may issue clarifications where interpretation has proved difficult in practice.

Consistent implementation does not imply identical rules and regulations. Jurisdictions have different legislative and procedural arrangements for regulating and supervising banks, as well as different cultures, traditions and business practices. What is important is that domestic implementation achieves an outcome at least as prudent as the international minimum requirements.

In developing its standards, the Committee encourages feedback from many stakeholders, including academics, market analysts, banks, finance ministries, legislators and trade associations. Many jurisdictions adopt similar consultative procedures when transposing the Basel standards into national regulations. As time passes, recollections of the financial crisis may fade, and with them the support of some involved in public policy for tough prudential regulations and supervision. Several Committee members report lobbying efforts by some banks and other stakeholders to undo or dilute aspects of the agreed Basel standards. If these efforts are successful, or the tone of public debate does indeed soften on these important issues, there are risks of regulatory fragmentation and, potentially, a race to the bottom.

Q3. What challenges have you faced implementing international standards in a domestic context?

Q4. How do you approach stakeholder management with respect to international standard-setting?

The Basel Committee's future agenda

The sections above have focused on the role for national authorities in implementing Basel standards. But implementation also forms part of the agenda of the Basel Committee, and one with a high priority. The Basel Committee, its Supervision and Implementation Group and the Basel Consultative Group (which includes non-Basel-Committee members) regularly discuss implementation matters. This helps members understand the timetable in other jurisdictions and their experience, supporting more consistent and coherent implementation for internationally active banks.

The RCAP is one way in which the Basel Committee addresses implementation issues. The Committee will continue to monitor the timely adoption of standards and, in due course, review the consistency of implementation of all Basel standards. Reviews of the implementation of the net stable funding ratio and the large exposures framework are currently under way.

The RCAP focuses on standards but, alongside its standards, the Basel Committee also issues a large number of supporting guidelines, principles and sound practices for both banks and supervisors. While these are not in the scope of RCAP assessments, their adoption and implementation is an important complementary condition for achieving a resilient banking system. This is why the Committee places great emphasis on promoting strong supervision. The Committee will continue to strengthen and supplement the guidance where appropriate and will give greater encouragement to its implementation as a means of improving the quality of supervision in jurisdictions and helping ensure the safety and soundness of banks. For example, the Committee has been monitoring banks' implementation of the Principles for effective risk data aggregation and risk reporting through the Risk Data Network. The most recent progress report – the fifth in this series of follow-ups – was published last June. Another example relates to supervisory colleges. The Committee has been monitoring the implementation of the Principles for effective supervisory colleges. The outcome of this monitoring work is published every two years and the latest progress report on the implementation of principles for effective supervisory colleges was published last December.

Q5. How can regulators and supervisors help each other in promoting consistent implementation of international standards?

References

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