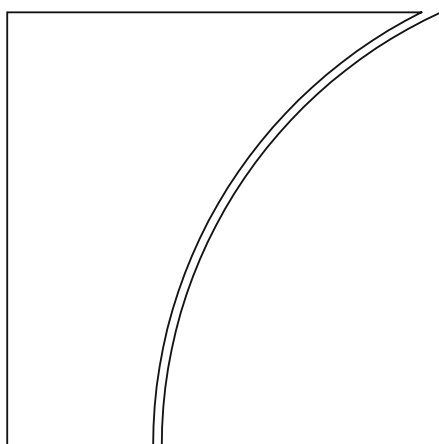


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The Basel framework in 100 jurisdictions: implementation status and proportionality practices

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Contents

- Executive summary 1
- Section I – Introduction 3
- Section II – General framework for the application of proportionality 5
 - Application of proportionality in Basel Core Principles and prudential standards..... 5
 - Defining criteria for the application of proportionality 6
- Section III – Adoption of the Basel framework 7
 - Overview 7
 - The journey towards Basel III adoption.....11
 - Risk-based capital and leverage11
 - Liquidity and large exposures13
- Section IV – Application of proportionality in non-BCBS jurisdictions14
 - General observations14
 - Proportionality approaches in Basel I and II RBC regimes.....15
 - Proportionality approaches in Basel III RBC regimes17
 - Proportionality approaches in the leverage ratio.....22
 - Proportionality approaches in quantitative liquidity standards: LCR and NSFR23
 - Proportionality approaches in large exposure regimes.....27
- Concluding remarks29
- References31
- Annex32
 - Jurisdictions covered by the study32

The Basel framework in 100 jurisdictions: implementation status and proportionality practices¹

Executive summary

The Basel regulatory framework comprises a set of minimum global standards that are designed, in principle, for internationally active banks. As such, national authorities have the flexibility to determine the regulatory requirements for non-internationally active banks operating in their jurisdictions. In practice, Basel standards are imposed on a wider set of banks in many jurisdictions.

Following the financial crisis, the Basel Committee on Banking Supervision (BCBS) revamped the international regulatory framework by introducing additional measures to strengthen the resilience of the global banking system. While this has resulted in a more risk-sensitive framework, it has also increased complexity. In this context, many non-BCBS jurisdictions have been grappling first, to understand the numerous changes made to the prudential framework; and second, to determine what aspects of the revised rules are the most applicable for their jurisdiction-specific circumstances.

The lack of global prudential standards for non-internationally active banks has led national authorities to implement a range of proportionality approaches. While all jurisdictions oversee at least a subset of banks that are not internationally active, the policy challenge of devising an appropriate rule book for these banks is more critical in non-BCBS member jurisdictions, where the bulk of the banking system may consist of locally incorporated banks that are not internationally active.

This paper surveys 100 jurisdictions that are not members of the BCBS on how far they have adopted key prudential requirements of the Basel framework and, if so, whether and how they apply proportionality in their regulatory regimes. The prudential requirements covered in our study include risk-based capital (RBC) rules, leverage requirements, two quantitative liquidity standards and the large exposures standard, which are collectively referred to as Pillar 1 requirements.

Of the Pillar 1 requirements, most of the surveyed jurisdictions have adopted the RBC regime in various forms, the Liquidity Coverage Ratio (LCR) and some version of the large exposures standard. All 100 jurisdictions have adopted some iteration of the RBC regime (Basel I, II or III), while 81 countries reported the adoption of either the LCR (54) or domestic liquidity rules (27). Similarly, 91 jurisdictions have adopted the large exposures rule, based on either the 2014 large exposures standard (14), some variation of the 1991 standard (38) or their own domestic large exposure rule (39).

Little progress has been made on adopting the leverage ratio, the Net Stable Funding Ratio (NSFR) and the latest large exposures standard. Despite its relative simplicity, the leverage ratio has been adopted by only 16 surveyed jurisdictions, with another four countries applying a domestic leverage rule. Similarly, the NSFR has been adopted by 15 jurisdictions. In addition, while some form of a large exposures rule has been adopted by most countries, only 14 jurisdictions have introduced the 2014 large exposures standard.

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The implementation of various Pillar 1 requirements, particularly the RBC regime, differs across jurisdictions. This is due to a combination of factors, including the adoption of different versions of the RBC regime across jurisdictions and variations in how proportionality is applied. Of the 100 jurisdictions that have adopted the RBC regime, 60 have adopted key elements of Basel III, 10 are using Basel II, while 30 remain under Basel I.

These differences are accentuated by the numerous proportionality approaches taken in nearly all countries. Virtually all (97 of 100) jurisdictions apply proportionality to the RBC regime, with the type and materiality of their modifications varying across jurisdictions. As jurisdictions migrate to the Basel III RBC regime, proportionality strategies become more nuanced. This is driven largely by the number of new elements that have been added to the numerator, the denominator, and applicable RBC ratios.

In practice, jurisdictions follow one or a combination of three proportionality strategies with respect to the Basel III RBC regime. Some jurisdictions segment their banks and apply the Basel III RBC regime to their larger banks, while applying different rules to different types of smaller institutions. Others tend to focus on applying proportionality to specific rules and exempt banks that meet pre-specified thresholds from certain requirements (eg the market risk capital charge). A third approach consists of applying a modified version of some aspects of the RBC regime (eg minimum capital ratios) to all banks in the system.

Within the RBC regime, the market risk capital requirement is most often subject to a proportionate approach. The perceived complexity of the market risk framework has led many countries to either exempt all banks from the market risk capital requirements (Basel I countries) or to exempt banks with small trading books from the market risk capital charge (Basel III countries).

With respect to the LCR and large exposures, the primary proportionality approach taken for both standards is the application of simplified domestic rules. When domestic rules are imposed in lieu of relevant Basel standards, they generally apply to all banks in a given jurisdiction.

Proportionality is generally associated with simplifying rules for smaller or less complex banks. Nevertheless, many jurisdictions also exert "conservative" proportionality by imposing more stringent rules in all Pillar 1 requirements. In several jurisdictions, the relaxation of a particular aspect is often accompanied by tightening of rules for another element of the same prudential standard.

There is demand from non-BCBS jurisdictions for the international community to provide some clarity on the application of proportionality. On the one hand, national authorities have latitude to tailor the Basel standards to the risk characteristics of non-internationally active banks in their jurisdictions. On the other, they need to ensure that their regulatory framework is perceived internationally as being sufficiently rigorous. Therefore, some direction at the international level on the application of proportionality may help individual jurisdictions to address the relevant trade-offs when designing their prudential framework.

Section I – Introduction

1. **The Basel Committee on Banking Supervision (BCBS) is known for developing the Basel capital framework.** The Basel capital framework has its origin in 1988, with the introduction of Basel I, the first globally harmonised risk-based capital (RBC) framework. The Basel I framework has been adopted in most countries around the globe, including in non-BCBS jurisdictions.
2. **Basel I provided a simple framework for the calculation of regulatory capital, initially for credit risk, and later expanding to cover market risk.** Over time, Basel I was perceived as not fully capturing risks from the activities and practices of the world’s largest and most complex banks.
3. **Basel II, introduced in 2004, added an explicit capital charge for operational risk, while also expanding the internal models-based approaches for qualifying banks to cover credit and operational risk.**² Nevertheless, the Great Financial Crisis revealed that many banks had underestimated³ their risk exposures and held inadequate capital and liquidity buffers to absorb the ensuing losses.
4. **The international response to the Great Financial Crisis, among other reforms, was the development of Basel III.** Unlike its predecessors, Basel III went beyond a sole focus on RBC, introducing new quantitative measures for liquidity risk, leverage and large exposures, in addition to significantly enhancing the RBC framework. Therefore, Basel III is sometimes referred to as the “multiple ratio” framework as numerous regulatory constraints will apply to banks within its scope.
5. **The different versions of the Basel framework are designed, in principle, for internationally active banks.** Indeed, one of the fundamental objectives of the BCBS, starting with Basel I, has been to minimise the competitive inequality of internationally active banks. Nevertheless, many authorities have applied Basel I and II, to non-internationally active banks operating in their jurisdictions. This may reflect the fact that Basel I and II dealt solely with risk-based capital. This, combined with the simplicity of Basel I and the standardised approaches introduced under Basel II, made it relatively easy for authorities to implement⁴ across a range of banks and banking systems. National authorities could thus apply a reasonably homogenous set of prudential rules within their jurisdictions and secure a certain level of international recognition for their national regulatory frameworks.⁵
6. **The intricacies of Basel III pose implementation challenges for smaller, less complex banks.** Basel III has increased the volume and complexity of new rules, encompassing not only significant changes to the numerator and denominator of the RBC regime, but also the introduction of new leverage, liquidity and large exposures rule. In many non-BCBS jurisdictions - where the banking industry remains largely focused on traditional lending activities - the added complexity is affecting the pace of implementation of the new reforms.
7. **The principle of proportionality in banking regulation – that is, tailoring rules to reflect the size, risk profile, complexity or other characteristics of banks – has re-gained relevance upon the introduction of Basel III.** A number of non-BCBS jurisdictions are trying to determine aspects of the Basel III regime that are the most applicable for their country-specific needs, while exploring ways to alleviate the regulatory burden faced by their non-internationally active banks. These considerations have a number of policy implications: First, it can impact their decision on *whether* to move from Basel I/II to Basel III; and, if so, *when* to adopt the new standards. Second, if some aspects of Basel III are adopted,

² The internal models-based approaches for market risk were introduced in 1996.

³ For example, several banks ‘gamed’ regulatory capital requirements by underestimating credit risk using their own internal models, while also taking advantage of disparate capital requirements in the banking and trading books for broadly similar risk exposures.

⁴ See earlier FSI implementation survey (2015).

⁵ See Restoy (2018).

additional policy issues arise, including *what* adjustments, if any, should be made to the new rules and to *whom* the adjustments should apply (eg to all or a subset of banks operating in their jurisdictions).

8. **There is currently no international guidance on how best to adopt global banking rules in a national context.** While the Basel standards are designed for ‘internationally active banks’, that term has intentionally never been defined by the BCBS. This provides flexibility for national authorities to determine the scope of application of relevant Basel standards. As such, national authorities need to determine how to apply the Basel standards in a manner⁶ that is proportionate to the characteristics of banks in their jurisdictions.

9. **This paper describes how jurisdictions that are not members of the BCBS⁷, have adopted various Pillar 1 requirements of the Basel framework.** A survey was undertaken in May 2018 on the implementation strategies followed in 100 non-BCBS member jurisdictions, covering five key quantitative requirements of the Basel framework. These requirements include the RBC regime, leverage rules, large exposures, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The results from the survey were supplemented by a desktop review of published laws and regulations of the surveyed countries and the authors’ own analysis.

10. **An important dimension of the study is the analysis of the approaches applied in different jurisdictions in relation to the proportionality⁸ principle.** For each of the quantitative requirements of the Basel framework, jurisdictions were asked to report on whether they apply the rules based on the applicable Basel framework or, alternatively, whether they introduce modifications or exemptions for all or a subset of banks in their respective jurisdictions. Such an approach permits characterising the proportionality strategies undertaken in different countries, while gaining insights on the nature, type and frequency of the modifications made to applicable Basel standards. In doing so, the analysis extends the previous FSI work on proportionality approaches in a set of BCBS jurisdictions.⁹

11. **This paper is structured as follows.** Section II outlines general considerations in, and the defining criteria for the application of proportionality. Section III discusses the adoption and implementation status of Pillar 1 requirements in non-BCBS jurisdictions. Section IV examines the proportionality approaches taken with respect to various quantitative prudential requirements. Section V provides concluding remarks. The annex lists the countries surveyed.

⁶ In particular, the complexity of Basel III also increases the compliance costs, which may disproportionately impact smaller banks vis-à-vis larger banks, all else equal.

⁷ The non-BCBS member jurisdictions that responded to the survey, covered countries in Europe (33), Latin America and the Caribbean (LAC - 23), Asia (18), the Middle East (11) and Africa (15). Refer to the annex for a full list of the 100 countries covered in the survey. This paper uses the words ‘countries’ and ‘jurisdictions’ interchangeably.

⁸ This paper focuses on the proportionality approaches taken with respect to locally incorporated banks. As such, proportionality approaches taken in regards to foreign bank branches are out of scope.

⁹ See Castro Carvalho et al (2017).

Section II – General framework for the application of proportionality

Application of proportionality in Basel Core Principles and prudential standards

12. **The Basel Core Principles for Effective Banking Supervision (BCPs) are the benchmark used in all jurisdictions for the development of key prudential standards and supervisory policies for banks and banking systems.** As the Core Principles are meant to be universally applicable, the concept of proportionality is embedded in them. This includes the set of principles that govern the functions and powers of the supervisory authority as well as those that outline the regulatory standards for banks. According to the BCPs, regulatory standards for banks are deemed to be proportionate if they are commensurate with the bank's risk profile¹⁰ and systemic importance.^{11, 12}

13. **In the context of prudential regulation, the concept of proportionality entails the calibration of prudential requirements to promote the safety and soundness of financial institutions while avoiding excessive regulatory burden.** This requires a deep understanding of the financial institutions operating in the relevant jurisdiction¹³, the nature and scale of their activities, the risks that they assume as well as the risks that they pose to the financial system and the wider economy. At the same time, the calibration of the requirements should avoid generating excessive compliance costs to all or a segment of institutions without a clear prudential justification.¹⁴

14. **BCBS jurisdictions normally extend the Basel framework to non-internationally active banks, but they usually tailor the requirements imposed on them.** As the Pillar 1 standards are only required for internationally active banks, there is no obligation for authorities, including BCBS member jurisdictions, to extend the full set of Basel standards to non-internationally active banks. An earlier FSI study indicates that the perimeter of banks subject to Basel III varies markedly across jurisdictions. In most cases, they employ different proportionality approaches to adjust the requirements applied to different types of non-internationally active banks.¹⁵

15. **For non-BCBS jurisdictions, proportionality is particularly important when determining how best to adapt Pillar 1 requirements to non-internationally active banks.** For the vast majority of non-BCBS jurisdictions, even the largest locally incorporated banks operating in their respective jurisdictions' may not necessarily be 'internationally active'. Therefore, non-BCBS member countries can apply proportionality in some manner to all or at least a large portion of their banking system, by adopting a modified set of applicable Basel standards or their own set of domestic standards.¹⁶ These standards can then be applied uniformly to all financial institutions or differentiated across financial entities (Graph 1).

¹⁰ The Core Principles define risk profile as the "nature and scale of risk exposures" of a bank.

¹¹ The Core Principles provide that "systemic importance is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank" in line with the Basel guidelines for global systemically important banks.

¹² Basel Committee on Banking Supervision (2012).

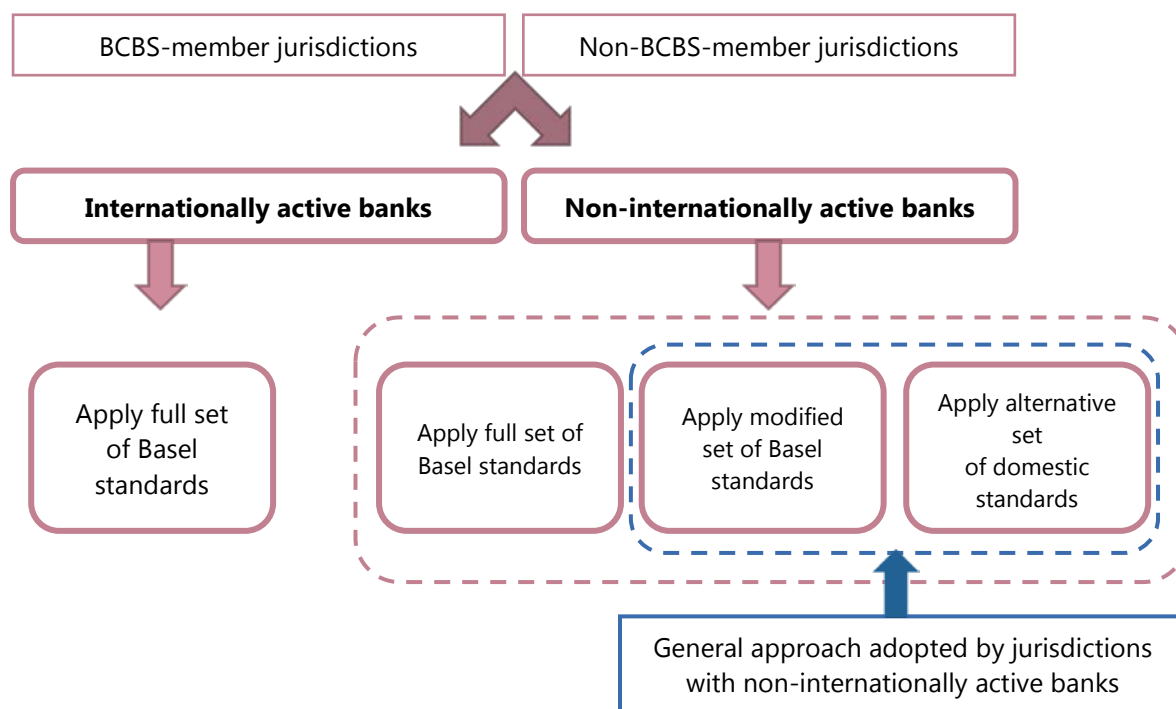
¹³ This includes a consideration of the broader environment in which banks operate, such as the development of relevant legal frameworks, accounting standards, institutional arrangements and prevailing domestic macro-economic and financial conditions.

¹⁴ It is important to note that regulatory compliance costs are relatively higher for smaller banks, all else equal. In many countries, there is also a perception that small banks are typically closer to local firms and households and are therefore better able to support their needs.

¹⁵ The first FSI study on proportionality indicates that full Basel standards are generally applied to mid-sized to large banks with balance sheets of more than EUR 20-30 billion. Some countries have larger thresholds, for example the United States and Brazil. For more details see Castro Carvalho (2017).

¹⁶ In addition, many non-BCBS jurisdictions are also the host supervisors of internationally active banks.

Graph 1: Approaches used in applying proportionality



Defining criteria for the application of proportionality

16. **For the purposes of this paper, we define proportionality as the tailoring of Basel standards, or developing alternative rules, to reflect the size, complexity, risk profile or other characteristics of individual banks and banking systems.** Proportionality thus encompasses a wide range of situations, such as applying a different set of rules to different types of bank as well as modifying certain Basel standards or applying an alternative set of domestic rules to all banks.

17. **In determining whether a jurisdiction takes a proportionate approach¹⁷ for a particular prudential standard, we compare the adoption of a given Pillar 1 requirement with the relevant Basel standard.** For example, if a country is under the Basel I RBC regime, the degree of proportionality depends whether the relevant country has adopted all of the features in Basel I. As such, if a Basel I country adopts the Basel II operational risk capital charge, it is deemed to have taken a proportionate approach, since the operational risk capital framework is technically outside Basel I.¹⁸ Similarly, if a country under the Basel III RBC regime has adopted the domestic systemically important banks (D-SIBs) framework and applicable capital buffers, it is deemed not to have taken a proportionate approach since it is merely

¹⁷ In this context, a proportionate approach is deemed to have been applied if the modifications made are more or less stringent than applicable Basel standards.

¹⁸ On the other hand, if a Basel II RBC jurisdiction elects to exempt or modify the operational risk capital charge for all or a subset of banks in their jurisdiction, a proportionate approach is deemed to have been taken.

adopting a relevant component in the adopted Basel standard.^{19, 20} Countries that have applied simplified domestic rules instead of the relevant Basel standards are also deemed to have adopted proportionality.

18. **The strategies adopted in applying proportionality in banking regulation generally fall under three broad categories: (i) a categorisation approach (CAP); (ii) a specific standard approach (SSAP); or a system-wide approach (SWAP).** The first two categories were introduced as part of a previous FSI paper on proportionality.²¹ They both result in the implementation of differentiated prudential regimes for banks in the same jurisdictions, although they use alternative approaches.

19. **Under the CAP, banks are categorised based on certain criteria (such as size, business model, etc) and a particular regulatory regime is applied to all banks within each specified category.** This approach envisages the application of consistent prudential rules for banks sharing broadly similar characteristics in a particular jurisdiction.²²

20. **The SSAP entails the definition of specific differentiation criteria for a particular standard (or set of standards).** If a bank meets specific conditions established for a particular Basel requirement (eg market risk capital requirements), that bank is either exempted from the requirement or subjected to an alternative obligation. This methodology generally involves the adoption of a simplified approach for banks meeting certain conditions that make the general requirements unnecessarily cumbersome (eg the application of the market risk framework for banks with a small trading book).

21. **This paper introduces a third approach to proportionality – the system-wide approach (SWAP) – where proportionality is applied to the banking system as a whole.** This approach is used in jurisdictions where any modifications made to the applicable Basel standard(s) are imposed on all banks in the system, regardless of size, complexity or business model. This approach is typically used when the entire financial system is considered to follow a relatively simple business model or when modifications made to a prudential standard are deemed fundamental in nature.²³ In both cases, proportionality is applied to all banks. Under the SWAP, prescribed regulations can either be more or less demanding than the international standard in terms of both stringency and complexity.

Section III – Adoption of the Basel framework

Overview

22. **All surveyed jurisdictions²⁴ have adopted some iteration of the Basel RBC framework.** This reflects the global importance of applying minimum RBC standards as a fundamental component of the prudential rule book in all surveyed jurisdictions. Table 1 shows the adoption of prudential standards in the surveyed countries.

¹⁹ If, however, the D-SIB framework is also used as the basis for differentiating prudential standards other than regulatory capital, a proportionate approach is deemed to have been taken.

²⁰ As a result, our classification of countries according to the selected regime (eg Basel I, II or III) has important implications in assessing proportionality.

²¹ See Castro Carvalho et al (2017).

²² Some supervisory authorities also use the same categorisation of banks as the starting point for their day-to-day supervision.

²³ For example, some countries may impose minimum regulatory capital requirements beyond the Basel minimums to all banks in their respective jurisdictions.

²⁴ See Annex for a list of the 100 countries surveyed.

23. **Of the 100 countries that have adopted the RBC regime, the majority are under Basel III (60 countries), although a significant number retain Basel I (30 countries) or Basel II (10 countries).** The classification²⁵ of countries according to a particular Basel risk-based capital regime (Table 2) shows the various iterations of the RBC framework adopted in major regions of the world. Notably, Europe²⁶ adheres to a uniform implementation of the Basel III RBC standards while the Middle East includes several jurisdictions that serve as international or regional financial centres, which are more inclined to adopt the Basel III RBC framework.

Adoption of prudential standards Table 1

| Prudential standard | Iteration of Basel standards | | | Domestic rule | Total |
|---------------------|------------------------------|---------------------|---------|---------------|-------|
| | Basel III | Basel II | Basel I | | |
| Risk-based capital | 60 | 10 | 30 | | 100 |
| Leverage | 2014 standard 15 | 2010 standard 1 | | 4 | 20 |
| Large exposures | 2014 standard 14 | 1991 standard 38 | | 39 | 91 |
| LCR | 54 | | | 27 | 81 |
| NSFR | 15 | | | 1 | 16 |

Implementation of the Basel risk-based capital framework Table 2

| Region | Total countries | Basel I | Basel II | Basel III |
|-----------------|-----------------|---------|----------|-----------|
| Africa | 15 | 5 | 4 | 6 |
| Americas | 23 | 16 | 1 | 6 |
| Asia | 18 | 7 | 3 | 8 |
| Europe | 33 | 1 | 1 | 31 |
| Middle East | 11 | 1 | 1 | 9 |
| Total countries | 100 | 30 | 10 | 60 |

24. **The standardised approaches to capital measurement are prevalent in the current implementation of the Basel RBC framework in all non-BCBS jurisdictions.** Table 3 shows that many countries have adopted the various standardised approaches for the credit, market and operational risk categories. The internal models approaches have been adopted by many countries, although the vast majority are European jurisdictions.

²⁵ For purposes of this paper, our classification of countries in terms of a particular Basel RBC standard, ie Basel I, Basel II or Basel III, is guided by the following criteria. Basel I countries are those that have implemented the Basel I definition of capital and the Basel I capital charge for credit risk and market risk, if applicable. Basel II countries are those that have implemented the Basel I definition of capital and at least two of the risk coverage methods from Basel II (ie standardised or model-based approaches for credit risk, market risk and operational risk). Basel III countries are those that have implemented the Basel III definition of capital, the minimum Basel III ratios for CET1, Tier 1 and total capital and at least two of the risk coverage methods from Basel II (ie credit risk, market risk, operational risk).

²⁶ Of the 33 European countries covered in our survey, there are 23 (20 EU countries and three European Economic Area countries) that follow the EU legislation.

Implementation of the Basel RBC framework – risk coverage Table 3

| Components | Total countries | Basel I | Basel II | Basel III |
|--|-----------------|---------|----------|-----------------|
| Credit risk RWA | 100 | 30 | 10 | 60 |
| Simplified standardised approach | 10 | | 2 | 8 |
| Standardised approach | 96 | 30 | 8 | 58 |
| Internal ratings-based approach | 34 | | | 34 |
| Market risk RWA | 73 | 4 | 9 | 60 |
| Standardised approach | 73 | 4 | 9 | 60 |
| Internal models | 37 | | | 37 |
| Counterparty credit risk RWA | 62 | 5 | 7 | 50 |
| Original exposure method | 10 | 3 | 3 | 4 ²⁷ |
| Current exposure method | 54 | 3 | 7 | 44 |
| Standardised method | 36 | | 2 | 34 |
| Internal model method | 27 | | | 27 |
| Standardised approach for measuring counterparty credit risk | 4 | | | 4 |
| Operational risk RWA | 71 | 4 | 9 | 58 |
| Basic indicator approach | 69 | 4 | 8 | 57 |
| Standardised approach | 51 | | 4 | 47 |
| Internal models | 31 | | | 31 |
| Total countries | 100 | 30 | 10 | 60 |

25. **Some key parts of the Basel III framework have been adopted in varying degrees by a few jurisdictions that are technically under the Basel I and II RBC regimes (Table 4).** Basel III has helped these jurisdictions to structure a sound prudential framework by benchmarking their regulatory framework to Basel III's multiple ratio regime. This has occurred either through an explicit decision to move towards Basel III, or to adopt some aspects of Basel III, even if the current prudential regime is closer to Basel I²⁸ or II.²⁹

²⁷ Some 26 European countries allow the use of the original exposure method as a proportionate approach in calculating capital requirements for counterparty credit risk for banks with small trading books.

²⁸ In regard to Basel I jurisdictions, a few countries have adopted the two quantitative liquidity requirements under Basel III, with one country each adopting the leverage ratio and the 2014 large exposures standard, respectively (Table 4). In addition, four Basel I countries have adopted the operational risk capital charge introduced under Basel II (Table 3).

²⁹ With respect to Basel II jurisdictions, three countries have adopted Basel III's D-SIB buffer (Table 10), with a few countries adopting either the 2014 large exposures standard or the leverage ratio.

Risk-based capital regime and adoption of key Pillar 1 requirements

Table 4

| Pillar 1 requirements | Basel III RBC regime | Basel II RBC regime | Basel I RBC regime | Total |
|---------------------------------|----------------------|---------------------|--------------------|------------------|
| Risk-based capital | 60 | 10 | 30 | 100 |
| Leverage ratio | 14 | 1 | 1 | 16 |
| Large exposures (2014 standard) | 11 | 2 | 1 | 14 ³⁰ |
| LCR | 51 | 0 | 3 | 54 |
| NSFR | 14 | 0 | 1 | 15 |

26. **The adoption of Basel III's liquidity standards are mixed among the surveyed jurisdictions.** Of the two quantitative liquidity rules introduced under Basel III, the LCR has been adopted by slightly more than half of the surveyed jurisdictions, while countries are proceeding far more slowly in adopting the NSFR. The NSFR - which promotes the use of stable, longer-term funding - might be more challenging to implement in countries that do not have well-developed capital markets, leaving less options for banks to source the term funding needed to comply with the standard. This may explain the slower adoption of this standard vis-à-vis the LCR.

27. **Nevertheless, a number of countries have imposed domestic quantitative liquidity rules, in most cases, well-before the advent of Basel III.**³¹ While domestic liquidity rules vary considerably across jurisdictions, almost all are designed to ensure that a minimum level of liquid assets are available to absorb potential (non-stressed) short-term funding outflows (similar to the LCR). Some 81 of the surveyed jurisdictions have imposed either the LCR or domestic "LCR-like" quantitative standards.

28. **In regards to the large exposures regime, while 91 jurisdictions have either adopted a version of applicable Basel standards or domestic rules, only 14 countries in the sample have introduced the 2014 Basel large exposures standard.** The remaining 77 jurisdictions either continue to operate with the large exposures regime that existed prior to 2014, and thus represent some variation of the 1991 standard³² (38 countries), or operate under solely domestic large exposure rules (39 countries).

29. **Despite its relative simplicity, the leverage ratio has been adopted by only 16 of the surveyed countries, with an additional four authorities imposing their own domestic leverage rules.** The leverage ratio provides an important backstop to the RBC regime, particularly in jurisdictions that permit internal models-based approaches for regulatory capital measurement. The leverage ratio is also useful for jurisdictions using the standardised approaches for capital measurement, as it can become a binding constraint on banks when the average credit risk weights under the standardised approaches fall below a certain threshold.³³

³⁰ An additional 38 countries have adopted the 1991 large exposures standard. Of this number, 33 are jurisdictions under the Basel III RBC regime, while three jurisdictions are under Basel II and two under Basel I.

³¹ Many countries have applied domestic regulation for liquidity risk before Basel III, see Wellink (2011).

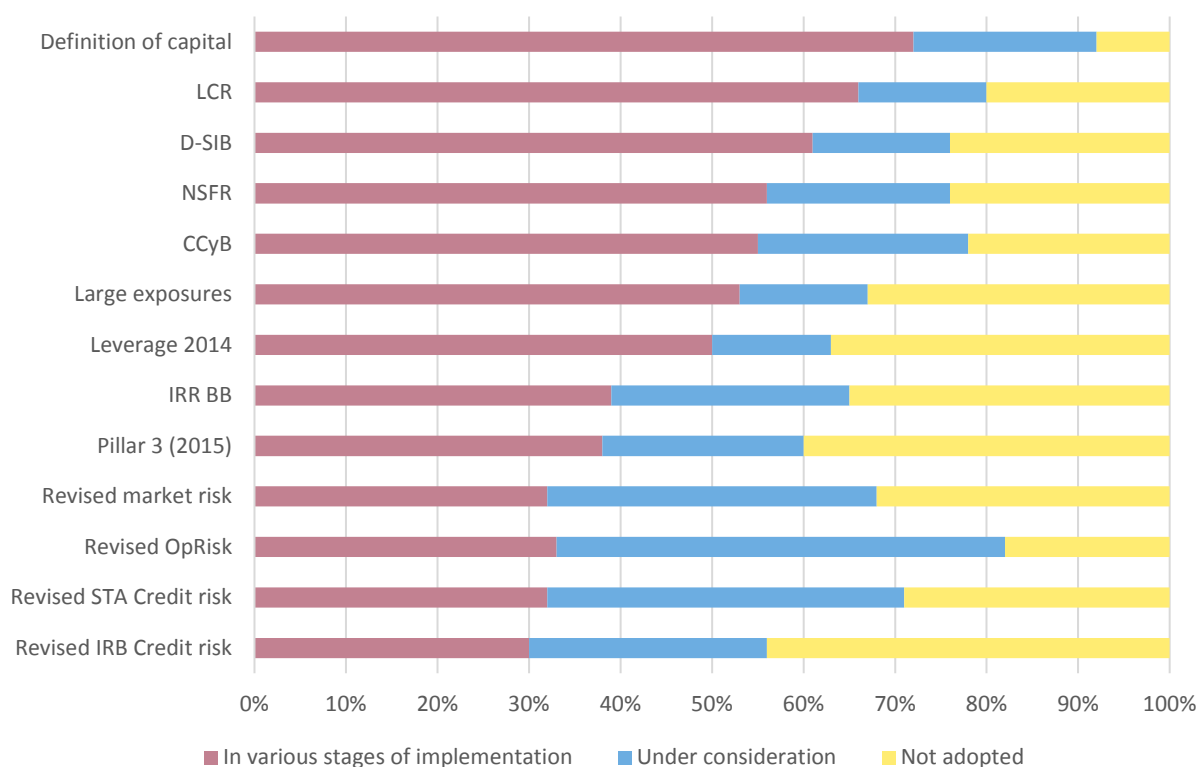
³² For purposes of this paper, all large exposure regimes in surveyed jurisdictions that broadly follow Basel standards but were introduced prior to 2014 have been classified as adopting the 1991 standard.

³³ For example, if the average credit risk-weighted assets of a bank are 37.5%, the minimum amount of capital required would equal $37.5\% \times 8\% = 3\%$; therefore, if the 3% leverage standard is adopted, it would act as a binding constraint when the average risk-weighted assets of a bank fall below 37.5%.

The journey towards Basel III adoption

30. **Most non-BCBS jurisdictions are prioritising the implementation of some core aspects of the Basel III framework.** Surveyed jurisdictions are in various stages of adopting several Basel III standards (Graph 2), based on the methodology used in previous FSI surveys on Basel standards implementation.³⁴ The implementation status and priorities of non-BCBS jurisdictions are broadly similar to the Basel III implementation priorities in BCBS member countries. Most advanced are the enhancements made to the definition of capital, including the higher minimum ratios for CET1, Tier 1 and total capital as well as related capital buffers. Closely behind follow the global standards on liquidity risk, especially the LCR, and the identification of domestic systemically important banks, and in most cases related higher loss absorbency requirements.

Graph 2:³⁵ Adoption of Basel III standards



Risk-based capital and leverage

31. **Most jurisdictions under the Basel III RBC regime have already adopted many of the components of the numerator, the denominator, the capital buffers and the relevant ratios.** The Basel III RBC framework, under our classification scheme,³⁶ has been implemented in 60 countries. About half of the Basel III RBC countries in our survey are in Europe (31), with most of them being bound by the

³⁴ See eg FSI survey (2015).

³⁵ Countercyclical capital buffer (CCyB); Interest Rate Risk in the Banking Book (IRRBB); standardised approach for credit risk (STA); internal ratings-based approach (IRB).

³⁶ For the purposes of this paper, Basel III RBC countries are those that have implemented the Basel III definition of capital, the minimum Basel III ratios for CET1, Tier I and total capital, and at least two of the risk coverage methods from Basel II (ie credit risk, market risk and operational risk).

implementation of Basel III in the European Union (EU). The EU's implementation of the Basel standards applies the prudential requirements through its "single rulebook" to a broad range of institutions.³⁷

32. **Most Basel III RBC jurisdictions have implemented the minimum capital ratios of Basel III, while some have chosen to apply higher minimum ratios.** Table 5 shows that 42 jurisdictions closely follow the Basel III minimum ratios, with only 18 countries applying higher minimum capital ratios (see Section IV, para 57 for further details).

33. **Similarly, the framework for D-SIBs has been implemented by many Basel III RBC jurisdictions.** Out of 60 Basel III RBC countries, 43 apply the D-SIB framework, which includes both the identification of D-SIBs and the higher loss-absorbing Common Equity Tier 1 (CET 1) capital. There are 28 European countries and at least 14 jurisdictions outside Europe that have implemented both the Basel III minimum ratios and the D-SIB framework.

34. **There are currently 14 jurisdictions under the Basel III RBC regime that have adopted the leverage ratio.** These are predominantly non-European countries, while the countries in the EU have adopted only a supervisory reporting requirement for the leverage ratio for the time being.

Implementation in Basel III RBC countries – overview

Table 5

| Countries under Basel III RBC standard, implementing | Global | Europe | Rest of the world |
|--|--------|--------|-------------------|
| Risk-based capital ratios (total) | 60 | 31 | 29 |
| Minimum RBC ratios only | 42 | 28 | 14 |
| RBC ratios greater than Basel III minimums | 18 | 3 | 15 |
| D-SIB framework | 43 | 28 | 15 |
| Leverage ratio | 14 | 2 | 12 |
| LCR | 51 | 28 | 23 |
| NSFR | 14 | 2 | 12 |
| Large exposure (2014) | 11 | 4 | 7 |

35. **Most jurisdictions under the Basel III RBC regime allow internal models³⁸ to be used for the calculation of risk-weighted assets for credit, market and operational risks.** Table 6 shows that 40 countries, predominantly European (25), under the Basel III RBC regime permit at least one internal modelling approach. Conversely, 20 countries under the Basel III RBC framework rely solely on the standardised approaches for measuring risk-weighted assets.

36. **Back-stopping internal model-based RBC requirements with either the leverage ratio or the capital floor is not widespread.** The EU has implemented the capital floor originally introduced under Basel II.³⁹ The Basel II capital floor is applied by 24 countries in Europe but nowhere else among the

³⁷ See Castro Carvalho (2017).

³⁸ In determining whether to introduce the internal models-based approaches to regulatory capital measurement, authorities typically consider both the capabilities of their supervisory staff and the evolution of risk management practices in the banks they supervise.

³⁹ The Basel II capital floor is set at 80% of the capital requirements under Basel I and was designed to avoid a significant drop in capital requirements after the implementation of Basel II. The capital floor was meant to be a transitional measure and is reliant

surveyed countries (Table 6). This differs from the adoption of the leverage ratio, which has been adopted in 14 Basel III RBC countries globally, nearly all of which are non-European countries. Importantly, of the 40 countries that allow the internal modelling approaches, only six have adopted the leverage ratio. Against this background, there is scope for a number of jurisdictions to improve their prudential frameworks by adopting backstops⁴⁰ especially in jurisdictions that allow the use of internal models for the calculation of risk-weighted assets.

Basel III RBC implementation – the use of internal models, leverage ratio and output floor

Table 6

| | | Global | Europe | Rest of the world |
|--|------------------------|--------|--------|-------------------|
| Countries under Basel III allowing internal models | Total countries | 40 | 25 | 15 |
| | Credit risk | 34 | 25 | 9 |
| Per risk category | Market risk | 37 | 24 | 13 |
| | Operational risk | 31 | 25 | 6 |
| | In all risk categories | 29 | 24 | 5 |
| Of which adopting the leverage ratio | | 6 | 0 | 6 |
| Of which adopting the capital floor | | 24 | 24 | 0 |

37. **Counterparty credit risk (CCR) has been adopted in most Basel III RBC countries.** There are 50 Basel III RBC jurisdictions that have adopted the CCR framework (Table 3). The adoption of simpler methods dominates, but the internal model method is also available in 24 European countries and three countries outside Europe. Not surprisingly, no country has reported the implementation of the newly introduced credit valuation adjustment (CVA) framework.⁴¹

Liquidity and large exposures

38. **The LCR has been implemented by most Basel III RBC countries, while the adoption of the NSFR is proceeding far more slowly.** Some 51 of 60 Basel III RBC jurisdictions have adopted the LCR, which represents over 90% of the surveyed non-BCBS jurisdictions (including three Basel I and II jurisdictions) that have implemented the standard. In contrast, only 14 of 60 Basel III RBC countries have adopted the NSFR (Table 5).

39. **The implementation of the 2014 large exposures standard is lagging, although many Basel III RBC countries have imposed earlier versions of the standard or their own domestic rules.** Table 5 shows that the 2014 large exposures framework has been implemented in only 11 Basel III RBC countries.

on Basel I. Basel III has significantly improved the calculation of the capital floor, now called the output floor, and significantly enhanced its relevance in back-stopping the RBC requirements calculated by internal models. The implementation date for the output floor is 2022.

⁴⁰ Both the leverage ratio and the capital floor mitigate the consequences of modelling errors and any underestimation of risk arising from the internal models-based capital requirements.

⁴¹ The CCR, particularly the CVA component, is a complex risk to assess. It is a hybrid between credit and market risks and depends on both changes in the creditworthiness of the counterparty and movements in underlying market risk factors. Since its introduction in 2010, the BCBS has substantially reduced the CCR's complexity. For more details, see FSI (2018).

Section IV – Application of proportionality in non-BCBS jurisdictions

General observations

40. **Nearly all 100 jurisdictions apply some form of proportionality, at least with respect to the adoption of the Basel RBC regime (Table 7).** In other words, jurisdictions have not typically applied a full version of any Basel RBC standard to all banks in their jurisdiction. This may reflect the fact that perhaps more than any other prudential standard, the RBC regime contains various subcomponents that may be subject to a proportionate approach, particularly for smaller, less complex banks.

41. **A significant number of countries also take a proportionate approach with respect to the implementation of the LCR and large exposures standard.** This is driven by the large number of jurisdictions that have imposed domestic rules instead of adopting applicable Basel standards on the LCR and large exposures (Table 7). The concentration of domestic rules in these two prudential standards in particular, reflects the fact that, in many surveyed jurisdictions, they pre-date the advent of the Basel III LCR and the 2014 large exposures standard.

42. **While proportionality strategies are often associated with streamlining or exempting specific aspects of the regulatory regime for smaller, less complex banks, authorities also impose more stringent standards in relation to applicable Basel requirements.** In many cases, more stringent rules are adopted in parallel with exemptions made to specific aspects of the applicable Basel standard. This approach is evident in varying degrees across all Pillar 1 requirements covered in our study.

Number of countries applying proportionality per prudential standard

Table 7

| Pillar 1 requirements | Countries adopting applicable Basel standard | Countries applying proportionality to adopted Basel standard | Adoption of domestic standards | Total number of countries applying proportionality ⁴² |
|---------------------------------|--|--|--------------------------------|--|
| Risk-based capital | 100 | 97 | | 97 |
| Leverage ratio | 16 | 9 | 4 | 13 |
| Large exposures (2014 standard) | 14 | 12 | 39 | 51 |
| LCR | 54 | 17 | 27 | 44 |
| NSFR | 15 | 5 | 1 | 6 |

43. **There is a relationship between the proportionality strategy chosen and the applicable prudential standard where tailoring is applied.** While the SWAP strategy features prominently in all five prudential standards where proportionality is applied, it is most frequently used for simple prudential rules that apply to all banks. In contrast, the SSAP, in the context of our study, is often used to prescribe threshold criteria related to the application of market risk capital rules (which is a component of the RBC regime). The CAP is used primarily to apply bifurcated rules to different groups of banks, when the underlying rules, such as the Basel III RBC regime, are deemed either overly complex or less suitable to a jurisdiction's circumstances.

⁴² The total number of countries applying proportionality is equal to the sum of the number of countries that apply proportionality to adopted Basel standards and the number of countries that prescribe their own domestic standards (instead of the applicable Basel standards).

Risk-based capital regime and proportionality strategy

Table 8

| Basel standard | Adoption | Number of countries applying proportionality | CAP | SSAP | SWAP | Mix of CAP and SWAP | Mix of SSAP and SWAP |
|----------------|----------|--|-----|------|------|---------------------|----------------------|
| Basel I | 30 | 30 | | | 29 | 1 | |
| Basel II | 10 | 10 | | | 7 | 3 | |
| Basel III | 60 | 57 | 5 | 24 | 19 | 2 | 7 |
| Total | 100 | 97 | 5 | 24 | 55 | 6 | 7 |

Proportionality approaches in Basel I and II RBC regimes

44. **The system-wide approach (SWAP) to proportionality is most commonly used in jurisdictions that have adopted the Basel I or Basel II RBC regimes (Table 8).** This reflects the simplicity of Basel I and Basel II, particularly when the latter is based on the standardised approaches to capital measurement (as is the case in the surveyed jurisdictions). Therefore, where proportionality is applied in countries under Basel I and II, the rules are generally applied to all banks.

45. **In their application of proportionality, most Basel I and II jurisdictions have imposed higher than the minimum required capital requirements, while others have gone beyond the limitations of their adopted RBC regime by incorporating certain elements of successor RBC regimes.** Of the 30 jurisdictions under Basel I, 17 countries have imposed capital requirements beyond the Basel I minimums (ranging from 9%-15%), while four countries have adopted some variation of the operational risk capital charge that was introduced under Basel II (Table 9). In regard to Basel II jurisdictions, seven of 10 countries have applied higher than the minimum Basel II capital requirements (ranging from 10%-12%), while three countries have adopted the D-SIB framework that was introduced under Basel III, as a means of imposing higher capital requirements on their systemically important banks (Table 10).

46. **At the same time, the vast majority of jurisdictions under Basel I exempt banks from calculating market risk capital requirements.** This may be an appropriate application of proportionality if banks have limited trading activity. However, banks could still be exposed to market risk if the "other comprehensive income" (OCI) category⁴³ (which is considered to be a banking book item) is used as a vehicle to replicate trading activities that should otherwise be captured in the trading book. These activities, if material, should be addressed in an appropriate manner.

47. **These practices reflect the dual nature of proportionality that is common in many Basel I and II jurisdictions.** Countries have imposed higher prudential standards (ie higher capital requirements) or introduced certain features (ie the operational risk charge in Basel I countries) that are beyond the contours of their adopted RBC regime, with the aim of enhancing the prudential framework. At the same time, they have relaxed rules in other areas (eg market risk capital requirements) where, in their view, the adoption of applicable Basel standards may not be warranted based on the risk profile or business model of banks in their jurisdictions.

⁴³ This also applies to the "available for sale" (AFS) category for jurisdictions that have not adopted IFRS 9 Financial Instruments.

Basel I jurisdictions and range of proportionality practices

Table 9

| Proportionality strategy | Number of countries | Range of approaches taken |
|--------------------------|---------------------|---|
| SWAP only | 29 | <ul style="list-style-type: none"> 16 countries require higher than the minimum Basel I CAR⁴⁴; CAR ranges from 9 to 15% 26 countries do not require banks to calculate capital charge for market risk 24 countries do not require a capital charge for CCR A few countries have a simplified measure for market risk, for example, the higher of the gross long or short foreign exchange (FX) positions is risk-weighted at 100% Four countries impose a capital charge for operational risk |
| SWAP and CAP | 1 | <ul style="list-style-type: none"> Higher total RBC capital requirements for all banks (12% CAR) Higher capital requirements for commercial banks in the first three years of operations (14.5%) and for all credit societies and savings banks Not required to calculate capital charge for CCR |

Note: The numbers may not sum to totals as countries may apply multiple modifications.

Basel II jurisdictions and range of proportionality practices

Table 10

| Proportionality strategy | Number of countries | Range of approaches taken |
|--------------------------|---------------------|---|
| SWAP only | 7 | <ul style="list-style-type: none"> Four countries require a 10% CAR for all banks, higher than the minimum Basel II requirement No capital charge for CCR Only consider FX risk in determining market risk capital requirements |
| SWAP and CAP combination | 3 | <ul style="list-style-type: none"> Three countries have adopted the D-SIB capital buffer Three countries impose higher than the minimum Basel II capital requirements for all banks; CAR ranges from 10 to 12% Deduction from Tier 1 capital amount of any exposure in excess of the large exposures limit; require all corporate exposures to be risk-weighted at 100%; and do not recognise unaudited gains from OCI as part of capital; unaudited OCI losses are deducted A few countries allow all banks to use the original exposure method to calculate CCR |

Note: The numbers may not sum to totals as countries may apply multiple modifications.

⁴⁴ Capital Adequacy Ratio (CAR) or total capital ratio of 8% under Basel I and II.

Proportionality approaches in Basel III RBC regimes

48. **Nearly all countries under the Basel III RBC regime⁴⁵ apply proportionality.** Table 8 shows that the two most common proportionality strategies adopted are either the SSAP or SWAP. Nearly all (23) of the 24 SSAP jurisdictions are European countries that exempt banks with small trading books in varying degrees from the market risk capital requirements and allow the use of simpler methods for calculating CCR (see table 13 for further details). An additional 19 countries apply a SWAP strategy, mainly by imposing higher than the required RBC ratio, modifying certain risk weights or providing exemptions from the CCR charge for all banks. Table 11 shows the full range of proportionality approaches applied for jurisdictions under the Basel III RBC regime.

49. **Several countries under the Basel III RBC regime apply multi-faceted proportionality strategies, partly in response to the additional features that have been added to the framework.⁴⁶** Several jurisdictions under the Basel III RBC regime have adopted a combined proportionality strategy (ie a mix of SSAP and SWAP, or of CAP and SWAP). For example, jurisdictions have imposed higher than the minimum capital requirements on all banks (ie SWAP), while simultaneously either allowing banks with small trading books to calculate simplified versions of specific approaches related to market risk and CCR or granting full exemptions on those approaches (SSAP). Various other permutations also exist.

⁴⁵ For the purposes of this paper and based on our classification scheme, Basel III RBC countries are those that have implemented the Basel III definition of capital, the minimum Basel III ratios for CET1, Tier I and total capital and at least two of the risk coverage methods from Basel II (ie credit risk, market risk, operational risk).

⁴⁶ For example, the Basel III RBC regime includes the numerator (definition of capital), the denominator (risk coverage for credit, market and operational risks), the applicable ratios and the capital buffers. In theory, each of these elements can be subject to different proportionality strategies and thresholds.

Basel III jurisdictions and range of proportionality practices – RBC

Table 11

| Proportionality strategy | Number of countries | Range of approaches taken |
|--------------------------|---------------------|--|
| SSAP | 24 | <ul style="list-style-type: none"> 24 countries allow for the identification of a small trading book, typically based on thresholds in terms of the absolute size of the trading book and the total assets (see details in Table 13) 23 countries allow banks with small trading books to use the original exposure method for calculating capital charge for CCR |
| SWAP | 19 | <ul style="list-style-type: none"> Nine countries implemented higher RBC capital ratios (ranging between 9 and 13%, with the majority of countries prescribing a 10% ratio) Longer phase-in periods for certain minimum RBC requirements Modifications to calculations of selected risk weights (eg stricter requirements for the calculation of credit risk weights, simplified application of, or exemptions for market risk or CCR) Some require banks to only consider FX risk in determining market risk capital requirements Islamic banks are only allowed to use the Basel I or II standardised approach for credit, market and operational risk |
| CAP | 5 | <ul style="list-style-type: none"> Five jurisdictions use various segmentation approaches and apply different capital regimes for each group of banks (see Table 12) Three of the five countries implement higher capital ratios at 10% for banks subject to Basel III RBC rules Small banks are exempted, and sometimes restricted to using only the standardised approach for market risk capital requirements Islamic banks are exempted from market risk capital requirements Two countries exempt small banks or banks with insignificant market share from calculating operational risk capital charge, one country requires small banks to comply with modified Basel II capital charge for operational risk; one country exempts Islamic banks from the operational risk capital charge |
| SWAP and CAP | 2 | <p>SWAP</p> <ul style="list-style-type: none"> Two countries impose higher capital ratios on all banks (12% and 15%) Exemption from CCR calculations Unrealised losses for OCI items deducted from CET 1, while 50% of unrealised gains included in Tier 2 <p>CAP</p> <ul style="list-style-type: none"> One country applies higher CAR to banks with foreign branches (2%) Islamic banks are exempted from Basel III RBC rules |
| SSAP and SWAP | 7 | <p>SWAP</p> <ul style="list-style-type: none"> Four countries implemented higher capital ratios between 8.5% and 13.5% for all banks Modifications to calculations of selected risk weights for all banks <p>SSAP</p> <ul style="list-style-type: none"> Several countries apply certain exemptions for banks with de minimis trading book positions (eg complete exemptions from market risk capital charge but requirement to apply a 1% risk weight to the aggregate net open short FX position; permission to include trading book positions under credit risk-weighted assets); see Table 13 for details One country allows banks with small trading books to use the original exposure method for CCR |

Note: The numbers may not sum to totals as countries may apply multiple modifications and only a few examples are cited here.

50. **Only a few countries address the increased complexity of the Basel III RBC regime by applying a different set of rules for different groups of banks (CAP only strategy).** This is the case in five jurisdictions. While the segmentation criteria differ across jurisdictions, one common outcome is to apply the Basel I RBC regime to smaller and/or specialised banks (ie development finance banks) while requiring the adoption of the Basel III RBC regime for all others. Three of these jurisdictions extend their segmentation criteria to exempt certain banks from various other quantitative Pillar 1 requirements. See Table 12 for additional details regarding the approaches taken in the five CAP-only jurisdictions.

| Basel III RBC countries that apply CAP strategies (segment banks) | | | | Table 12 |
|---|--|---|---|----------|
| Country | Segmentation criteria | RBC regime applied | Applicability of segmentation criteria to other prudential rules | |
| Country 1 | Commercial banks vs development finance and international Islamic banks | <ul style="list-style-type: none"> Commercial banks subject to Basel III RBC rules Development finance institutions subject to Basel I RBC regime, simple approaches for credit and market risk coverage, CCR not adopted International Islamic banks subject to a different regime | <ul style="list-style-type: none"> Development finance and Islamic institutions are exempt from the LCR and leverage ratio Other standards, such as NSFR and 2014 large exposures have not yet been adopted | |
| Country 2 | Universal banks vs thrift and rural banks that are not subsidiaries of universal banks | <ul style="list-style-type: none"> Universal banks subject to Basel III RBC rules Thrift and rural banks that are subsidiaries of universal banks subject to Basel I RBC regime, mainly simple approaches for credit risk and Basel II operational risk charge, market risk and CCR not adopted | <ul style="list-style-type: none"> Thrift and rural banks that are not subsidiaries of universal banks are exempt from the LCR, NSFR and leverage ratio Domestic standard prescribed for large exposures | |
| Country 3 | Banks with insignificant market share vs all other banks | <ul style="list-style-type: none"> Banks with insignificant market share subject to Basel I RBC rules (credit risk, market risk and CCR) All other banks subject to Basel III RBC rules | <ul style="list-style-type: none"> Banks with insignificant market share are exempt from the LCR and NSFR The leverage ratio has not yet been adopted, and for large exposures, domestic standards apply | |
| Country 4 | Very small banks and finance companies vs all other banks | <ul style="list-style-type: none"> Very small banks and finance companies are subject to the Basel III definition of capital but can apply Basel I risk coverage methods (credit and market risk, CCR not adopted) All other banks are subject to Basel III RBC regimes | <ul style="list-style-type: none"> Not applicable since other standards have not been adopted yet Domestic large exposures standard applied to all banks | |
| Country 5 | Credit-only micro finance institutions (Tier 4) banks vs other banks (Tiers 1–3) | <ul style="list-style-type: none"> Minimum standards of Basel III apply to all Tier 1 to Tier 3 institutions | <ul style="list-style-type: none"> Not applicable since other standards have not been adopted yet | |

51. **Two aspects of the Basel III RBC regime where proportionality has been most commonly applied are the capital requirements for market risk and CCR.** The method generally used to take a proportionate approach to both of these elements is through the identification of banks with a small trading book.

52. **The small trading book definition typically includes both the relative size of trading assets compared to total assets (generally not more than 5% of total assets) and an absolute maximum threshold.** Table 13 summarises the definition of a small trading book in 31 Basel III RBC countries, the vast majority of which are European (27 of 31). These jurisdictions provide exemptions for small trading book exposures from all or some aspects of the market risk capital charge, either through the SSAP strategy (24 countries) or through a combination of the SSAP and SWAP (seven countries).

53. **The type of exemptions granted for banks that meet the definition of a small trading book vary across the 31 jurisdictions, but all provide some relief from market risk capital requirements.** Some 27 European jurisdictions allow banks with small trading books to be fully exempt from the market risk capital charge, but nearly all (26 of 27 countries) require such trading book exposures to be included in the applicable risk weights under the standardised approach for credit risk. Of the remaining four countries, one jurisdiction fully exempts small trading book banks from the market risk capital charge, while another applies a 100% risk weight to the aggregate net open short FX position. The remaining two require the calculation of market risk capital requirements for certain trading book exposures only (see Table 13 for further details).

54. **While the exemption for small trading book banks from the market risk capital requirements appears to be an appropriate implementation of proportionality, authorities may want to consider whether similar activities are conducted within the banking book.** In particular, authorities should capture other important market risk positions such as FX risk and commodities risk in the banking book as well as any material market risk exposures that may arise from the OCI or AFS categories. This may occur if the OCI or AFS categories are used as a vehicle to perform trading-like activities that otherwise should belong in the trading book. To the extent such activities are material, authorities may consider imposing appropriate capital requirements.

Examples of definition of small trading book and proportionality approaches taken

Table 13

| Number of countries | Small trading book definition | Proportionality applied in market risk capital regime and other prudential rules |
|---------------------|---|---|
| 26 | The trading book is normally less than 5% of total assets and EUR 15 million; and the trading book never exceeds 6% of total assets and EUR 20 million. | <ul style="list-style-type: none"> • Small trading book banks exempt from market risk capital charge • Small trading book banks are subject to applicable risk weights under the credit risk framework (instead of market risk capital charge)⁴⁷ • Small trading book banks are allowed to use simpler methods for the calculation of CCR capital charge⁴⁸ |
| 1 | Volume of balance sheet and off-balance sheet operations in the trading book usually amounts to less than 3% of total assets and never exceeds 4% of the total assets. | <ul style="list-style-type: none"> • Small trading book banks are exempt from market risk capital charge • Small trading book banks are subject to applicable risk weights under the credit risk framework (instead of applicable market risk capital charge) • Small trading book banks allowed to use simpler methods for the calculation of CCR capital charge |
| 1 | The trading book business does not normally exceed 5% of the bank's total business; and USD 33 million (local currency equivalent). The trading book never exceeds 6% of the bank's total business and USD 44 million (local currency equivalent). | <ul style="list-style-type: none"> • Banks with small trading books are not required to calculate capital charge for instruments relating to interest rates and equities |
| 1 | Trading book volume must be less than 5% of the sum of total assets, liabilities and total derivatives; and no more than USD 96 million (local currency equivalent). | <ul style="list-style-type: none"> • Banks with small trading book positions are required to calculate market risk capital charge for credit derivatives and commodities risk only |
| 1 | Market risk positions less than 5% of total on and off-balance sheet assets; or market risk positions equal to or lower than USD 100 million (local currency equivalent). | <ul style="list-style-type: none"> • Banks with limited trading positions are exempt from market risk charges |
| 1 | Trading book does not normally exceed 5% of its total business. | <ul style="list-style-type: none"> • Small trading book positions are exempt from market risk capital charge but required to apply a 100% risk weight to the aggregate net open short FX position |

⁴⁷ Of the 26 jurisdictions, one country does not require small trading book banks to include such exposures in the credit risk framework, instead of the market risk capital charge.

⁴⁸ Of the 26 jurisdictions, one jurisdiction allows all banks to use simpler methods to calculate CCR.

55. **In the case of CCR, of the 50 Basel III RBC countries that have adopted the standard, 31 jurisdictions take a proportionate approach, with the most common method being the adoption of simpler measurement methodologies provided under previous Basel capital standards.** Of the 31 countries, 26 jurisdictions, all of which are European, allow banks that meet the small trading book criteria to apply the simpler CCR approaches such as the original exposure method.⁴⁹ Of the remaining five countries, four allow all banks to use simpler approaches, while one country exempts its Islamic banks from CCR capital requirements.

56. **Proportionality is rarely used in relation to the new D-SIB framework.** Almost all 43 countries adopting the D-SIB framework follow the principles outlined in the BCBS framework, aligning the identification of D-SIBs and the higher loss absorbency requirements with these principles.⁵⁰ That said, some jurisdictions have simplified the D-SIB identification methodology by using a combination of bank structure and balance sheet metric. Other jurisdictions use simple balance sheet metrics based on size (ie above a certain nominal amount or if assets exceed a specified percentage of banking system assets). The higher loss absorbency requirements for D-SIBs range from 1 to 3%, although two jurisdictions impose a D-SIB buffer of 5% or more.

57. **Numerous Basel III RBC countries have adopted more prudent criteria in some areas, while exempting, or allowing for simplified rules in other cases.** On the one hand, 18 countries impose higher minimum RBC ratios than that prescribed in Basel III, in addition to the capital buffers introduced under the standard. The respective minimum CET 1 ratio is in the 5–10% range; the Tier 1 ratio in the 6–13% range; and the total capital ratio in the 8.5–15% range. On the other hand, a number of exemptions or simplified methods have been introduced, as discussed earlier, with respect to the market risk and counterparty credit risk requirements.

Proportionality approaches in the leverage ratio

58. **Most countries implementing the leverage ratio take a proportionate approach.** This includes nine (of 16) jurisdictions that have adopted a version of the Basel leverage standards and modified some aspects (Table 14); and four jurisdictions that impose their own domestic version of the leverage standard (instead of adopting the Basel standards) on all banks in their jurisdiction. Of the nine jurisdictions that have modified the Basel leverage standard, seven are classified as Basel III RBC countries, and one each coming from Basel I and Basel II jurisdictions.

59. **The nature of modifications made by countries adopting the Basel leverage rules vary, in terms of both exemptions for smaller, less complex banks as well as the imposition of more stringent standards in number of cases.** The Basel III RBC jurisdictions tend to apply greater differentiation in adopting the leverage ratio versus the (two) Basel I and II countries, which typically impose the modifications on all banks in the system. Table 14 provides further details regarding the modifications made to leverage rules by countries that are under the Basel I, II or III RBC regimes.

⁴⁹ The original exposure method was introduced in Basel I and was meant to be discontinued with the BCBS publication of the calculation of counterparty credit risk exposure in 1995. For details see Basel Committee on Banking Supervision (1995).

⁵⁰ See BCBS (2012b) for more details.

Leverage ratio and range of proportionality approaches

Table 14

| Applicable Basel RBC regime | Countries adopting Basel leverage ratio | Countries applying proportionality to the Basel leverage ratio | Range of proportionality approaches taken |
|-----------------------------|---|--|--|
| Basel III | 14 | 7 | <p>Exemptions from the leverage requirements</p> <ul style="list-style-type: none"> • exempt development finance institutions and international Islamic banks • exempt cooperatives, non-stock savings and loans and thrift and rural banks that are not part of universal banks <p>Minimum leverage capital requirements</p> <ul style="list-style-type: none"> • Three countries impose higher leverage requirements for all banks: requirements range from 5 to 6% <p>Calculation methodology</p> <ul style="list-style-type: none"> • small trading book banks can use original exposure method to measure derivative exposures |
| Basel II | 1 | 1 | <ul style="list-style-type: none"> • 5% leverage requirement for all banks; 6% for D-SIBs |
| Basel I | 1 | 1 | <ul style="list-style-type: none"> • 6% leverage requirement for all banks |
| Total | 16 | 9 | |

Proportionality approaches in quantitative liquidity standards: LCR and NSFR

60. **Nearly one-third of all jurisdictions that have adopted the LCR apply proportionality, while other countries impose their own domestic liquidity rules.** Table 15 indicates that 17 of the 54 surveyed jurisdictions that have adopted the LCR, take a proportionate approach. An additional 27 countries have imposed domestic quantitative rules instead of adopting the LCR. In general, domestic liquidity rules require banks to hold a baseline level of liquid assets to cover potential short-term funding outflows, albeit outside of stressed market conditions (and thus may be considered as simplified, non-stressed LCR proxies).

61. **Almost all countries applying proportionality to the LCR are under the Basel III RBC regime.** Of the 17 jurisdictions that take a proportionate approach to the LCR, 15 are countries that are under the Basel III RBC regime, while the remaining two jurisdictions are under Basel I. Proportionality strategies generally include either exempting some banks from the standard or making certain modifications to the calculation methodology and applying those changes to all banks (Table 15).

62. **Of the countries that take a proportionate approach, seven jurisdictions exempt certain banks from the LCR.** Of this total, five countries impose alternative domestic liquidity rules to entities that are not subject to the LCR. These domestic rules, outlined in Table 16, require banks to meet a specified liquid asset coverage ratio in relation to short-term funding. For the remaining two countries, the exemptions focus on Islamic banks.

LCR and range of proportionality approaches

Table 15

| Applicable Basel RBC regime | Countries adopting the LCR | Countries applying proportionality to the LCR | Range of proportionality approaches taken |
|-----------------------------|----------------------------|---|---|
| Basel III | 51 | 15 | <p>Exemptions</p> <ul style="list-style-type: none"> Exempt banks with public deposits to liabilities less than 15%, unless assets more than 1% of total banking system assets; banks with operations less than 2 years required to calculate LCR Exempt Islamic banks and development finance institutions Exempt banks with insignificant market share Exempt cooperatives, non-stock savings and loans and thrift and rural banks that are not part of universal banks Exempt local banks that are part of a group subject to consolidated LCR requirements and have significant reliance on group bank inflows Exempt select banks based on nature, scale and complexity of operations (ie not internationally active, not significant to the stability of the financial system, and other criteria) <p>Liquid assets</p> <ul style="list-style-type: none"> List of instruments included in high quality liquid assets (HQLA) expanded to include debt instruments issued by foreign banks (with zero credit risk weight) and other assets <p>Inflow and outflow factors</p> <ul style="list-style-type: none"> Deposits are separated into more granular (eight) categories, with specified outflow factors – more than prescribed in the LCR No caps placed on inflows from parent bank or subsidiary of bank or another subsidiary of parent bank, subject to regulatory approval Outflow rates for retail deposits range from 7.5 to 100% (versus 3 to 10% in LCR) <p>Other</p> <ul style="list-style-type: none"> Definition of significant currency is 10% (versus 5% in LCR) |
| Basel I | 3 | 2 | <ul style="list-style-type: none"> Net cash outflow factors for account balances with the central bank at 100% (versus 40% in LCR) Net cash outflow factors for retail deposits are based on deposit account type rather than “stable” and “less stable” as prescribed in LCR |
| Total | 54 | 17 | |

Note: The numbers may not always sum to totals as countries may apply multiple modifications.

Domestic liquidity rules (LCR proxies)

Table 16

| Country approaches | Ratio | Mechanics | Limit |
|------------------------|--------------------------|---|---|
| Example 1: Americas | Liquid assets ratio | Liquid assets/short-term liabilities | 8% – local currency 20% – foreign currency |
| Example 2: Asia | Liquid assets ratio | Liquid assets/demand and time deposits | 19% – conventional banks 14% – Islamic banks |
| Example 3: Asia | Minimum liquidity ratio | Liquid assets/total qualifying liabilities | 20% |
| Example 4: Middle East | Minimum liquidity ratio | Net liquid assets/net qualifying liabilities | 25% |
| Example 5: Europe | Liquidity mismatch ratio | (Stock of liquid assets + qualifying group inflows + other inflows)/total cash outflows over next 30 days | 100% |

63. **In regard to the NSFR, one third of the jurisdictions implementing the standard apply some form of proportionality.** More specifically, five of 15 jurisdictions that have adopted the NSFR take a proportionate approach, while another country has adopted a domestic rule (instead of adopting the NSFR) that requires banks to fund their loans and advances with at least 75% of core funding (ie funding sources that are longer-term in nature).

64. **All five jurisdictions that have adopted the NSFR are under the Basel III RBC regime.** The NSFR proportionality strategies include granting certain exemptions to smaller, less complex banks or modifying the various inflow and outflow factors to better reflect country specificities and applying the modified factors to all banks. Three of the jurisdictions that exempt certain banks from the LCR have also extended their framework to exempt these banks from the NSFR as well. Table 17 outlines the proportionality approaches taken with respect to the NSFR.

65. **Jurisdictions that exempt a subset of their banks from the NSFR impose simplified quantitative liquidity standards as a substitute.** Two of these jurisdictions impose domestic liquidity rules that focus more on short-term funding risks (more akin to a simplified domestic version of a non-stressed LCR – see examples 2 and 3 in Table 16), but one jurisdiction imposes a modified NSFR for entities that are exempt from the NSFR as prescribed under Basel III. The modified NSFR simplifies the grouping of capital, liability and asset items into broader categories and allows greater calculation flexibility through the application of the available stable funding (ASF) and required stable funding (RSF) factors that better reflect banks’ local funding structures. Table 18 shows the differences between the modified NSFR and the Basel NSFR standard.

Basel III RBC countries and range of proportionality practices – NSFR

Table 17

| Applicable Basel RBC regime | Countries adopting the NSFR | Countries applying proportionality to the adopted NSFR | Range of approaches taken |
|-----------------------------|-----------------------------|--|---|
| Basel III | 14 | 5 | <p>Exemptions</p> <ul style="list-style-type: none"> • Exempt cooperatives, non-stock savings and loans and thrift and rural banks that are not part of universal banks • Exempt banks with insignificant market share • Exempt banks based on nature, scale and complexity of operations (ie not internationally active, not significant to the stability of the financial system, and other criteria) <p>Available stable funding factors</p> <ul style="list-style-type: none"> • Various ASF factors for demand, time and other deposits from non-banking financial institutions, non-financial institutions and individuals with maturity less than one year – more conservative than the BCBS NSFR standard • ASF: More conservative treatment for deposits; eg deposits above a threshold provided by a non-financial small business with a residual maturity of less than one year must be treated as deposits from non-financial corporate customers – more conservative than the BCBS NSFR standard <p>Required stable funding factors</p> <ul style="list-style-type: none"> • Various differences in RSF factors related to loans to financial institutions, non-financial institutions, and individuals – more conservative than the BCBS NSFR standard |
| Basel I | 1 | | |
| Total | 15 | 5 | |

Comparison of domestic, simplified NSFR rules versus Basel standards

Table 18

| Components | NSFR Basel standards | Modified NSFR – domestic rule |
|------------|---|--|
| ASF | <ul style="list-style-type: none"> Regulatory capital and other capital instruments with residual maturity over one year Stable non-maturity demand deposits and term deposits with residual maturity of less than one year Less stable non-maturity deposits and term deposits with residual maturity of less than one year Funding with residual maturity of less than one year provided by non-financial corporates; operational deposits; funding with residual maturities of less than one year from sovereigns, public sector entities and multilateral banks All other liabilities and equity not included in the above | <ul style="list-style-type: none"> Capital Debt securities and prescribed instruments issued Non-bank customer deposits Other types of funding |
| RSF | <ul style="list-style-type: none"> Eight categories and different RSF factors attached to each category | Two categories only: <ul style="list-style-type: none"> On-balance sheet assets Off-balance sheet assets |

Proportionality approaches in large exposure regimes

66. **More than half of the jurisdictions with a large exposure (LE) regime apply some form of proportionality.** The vast majority of these jurisdictions have imposed domestic LE rules (39 countries) instead of the applicable Basel standards, with the remaining 12 jurisdictions applying proportionality with respect to the 2014 LE standard.

67. **Most jurisdictions that take a proportionate approach to the 2014 LE standard are under the Basel III RBC regime.** This is the case in ten jurisdictions, while two jurisdictions are under Basel I and II, respectively. Table 19 provides an inventory of proportionality approaches with respect to the LE standard, categorised according to the Basel RBC regime.

68. **Jurisdictions that apply proportionality with respect to the 2014 LE standard tend to apply the modifications to all banks in the system.** The most common modification is the use of total capital as opposed to Tier 1 capital (under the Basel standard), in determining what constitutes a large exposure and for setting applicable limits. While this is less conservative than the Basel standards, a number of countries have also imposed more stringent criteria, by prescribing aggregate or cumulative LE limits, which are not required under the 2014 LE standard.

Large exposures (LE) and proportionality approaches – 2014 standard

Table 19

| Applicable Basel RBC regime | Countries adopting the 2014 LE standard | Countries applying proportionality to the 2014 LE standard | Range of approaches taken |
|-----------------------------|---|--|--|
| Basel III | 11 | 10 | <p>Limits</p> <ul style="list-style-type: none"> Higher LE limit allowed for subsidiaries of foreign banks for foreign currency exposures (50% of T1 capital vs 25% for all other banks) 40% LE limit to a group of connected counterparties for local banks and 75% for subsidiaries of foreign banks (in foreign currency) – no special limit in LE for connected counterparties Higher individual borrower limit; eg set at 40% of a bank’s eligible capital (versus 25% under the Basel standard) Lower individual limit: eg set below applicable Basel standard – ranges between 15 and 20% (as opposed to 25% under the Basel standard) Aggregate large exposures limits established – ranges between 400 and 800% of a bank’s capital base (no such requirement under the Basel standard) <p>Calculation methodology</p> <ul style="list-style-type: none"> Total capital as the base for defining a LE and for calculating the LE limit (as opposed to Tier 1 capital under the BCBS standard) Allow banks with small trading books to use original exposure method to calculate counterparty credit risk Original exposure method allowed to calculate counterparty credit risk for purposes of LE (Basel I approach) |
| Basel II | 2 | 1 | <ul style="list-style-type: none"> Original exposure method allowed to be used to calculate derivative exposures for determining LE (Basel I approach) |
| Basel I | 1 | 1 | <ul style="list-style-type: none"> 40% allowed for a borrowing group as long as no single member of group exceeds 15% of bank’s capital base Aggregate LE cannot exceed 500% of bank’s capital base (no such requirement in Basel standard) Total capital used to determine LE limit |
| Total | 14 | 12 | |

Concluding remarks

69. **The prudential standards set by the BCBS are designed for application to “internationally active banks”.** While jurisdictions have the flexibility to determine the standards to be applied to non-internationally active banks, the fundamental concepts embedded in key Basel regulatory standards have broader applicability to nearly all banks in all jurisdictions.

70. **In designing an appropriate prudential framework, jurisdictions face important trade-offs, balancing the objective to comply with international standards, while considering the specific needs of the domestic financial system.** In practice, non-BCBS jurisdictions adopt a combination of applicable Basel standards and domestic rules for non-internationally active banks in their respective jurisdictions. When applicable Basel standards are adopted, modifications are often made that involve streamlining standards in some cases, while requiring more stringent requirements in others.

71. **All 100 surveyed jurisdictions have chosen to adopt some iteration of the Basel RBC framework.** The majority of countries are under the Basel III RBC regime (60), while the remainder are under Basel II (10) and Basel I (30), respectively. Some Basel I and II countries have adopted relevant aspects of the Basel III reforms without embracing the full suite of approaches. This may indicate their intention to slowly migrate to the Basel III regime.

72. **Countries under Basel I or II generally impose higher minimum capital requirements than that prescribed in their respective frameworks.** Most Basel I or II countries require additional capital buffers to better reflect idiosyncratic risks that may be prevalent in their respective jurisdictions. In contrast, jurisdictions under the Basel III RBC regime typically do not go beyond the minimum RBC requirements. However, the Basel III RBC regime includes higher capital requirements (including buffers) that must be met with instruments with higher loss absorbency features.

73. **The current Basel III implementation status in non-BCBS countries is mixed.** In regards to the Basel III RBC regime, a majority of countries have implemented the new definition of capital, the minimum RBC ratios, and at least two of the risk coverage standards under Basel II (ie the definition of a Basel III RBC country for purposes of this paper). However, very few Basel III RBC countries that allow the use of internal models approaches for capital measurement have supplemented their RBC ratio with backstops. Besides the RBC regime, the majority of surveyed jurisdictions have adopted the LCR and a version of the large exposures standard. The leverage ratio, the NSFR and the 2014 large exposures standard are lagging behind in their implementation by non-BCBS countries.

74. **As countries shift to the more complex Basel III RBC regime, greater differentiation and more extensive proportionality strategies are applied.** Countries under Basel I and Basel II tend to apply the Basel framework uniformly to all banks, even when the rules are modified to reflect country specificities. In contrast, proportionality strategies become more multifaceted in countries under the Basel III RBC regime, due in part to a number of new features that have been introduced under the standard.

75. **Proportionality is most often applied in regards to the implementation of quantitative liquidity standards, the large exposures standard and the market risk framework.** In regards to the latter standard, the perceived complexity of the market risk framework has led many countries to either exempt all banks from the market risk capital requirements (Basel I countries) or to exempt banks with small trading books from the market risk capital charge (Basel III countries). While this appears to be an appropriate implementation of proportionality, authorities should consider whether their existing prudential frameworks can capture market risk exposures – such as FX risk, commodities risk or price risk from excessive turnover of fixed income holdings in the OCI or AFS category – that can arise in the banking book.

76. **Above all, the survey results confirm that a variety of prudential regimes are currently implemented in non-BCBS jurisdictions.** These regimes include at least three Basel versions of the RBC regime; two Basel versions of the large exposure rules; the extensive use of domestic liquidity and large exposure rules; and the tailoring of rules where Basel standards have been adopted.

77. **Non-BCBS jurisdictions may benefit from additional work by the international community on the application of proportionality.** This effort may help national authorities to tailor global regulatory standards to domestic specificities, while maintaining key prudential safeguards that are needed to foster the stability of banks and the financial system.

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Annex

Jurisdictions covered by the study

| | Jurisdiction | Region | | Jurisdiction | Region |
|----|---------------------|----------|----|-------------------------------|--------------|
| 1 | Angola | Africa | 29 | Guatemala | Americas |
| 2 | Egypt | Africa | 30 | Guyana | Americas |
| 3 | Guinea | Africa | 31 | Montserrat | Americas |
| 4 | Mauritania | Africa | 32 | Panama | Americas |
| 5 | Mauritius | Africa | 33 | Paraguay | Americas |
| 6 | Morocco | Africa | 34 | Peru | Americas |
| 7 | Mozambique | Africa | 35 | St Kitts and Nevis | Americas |
| 8 | Namibia | Africa | 36 | St Lucia | Americas |
| 9 | Nigeria | Africa | 37 | St Vincent and the Grenadines | Americas |
| 10 | Seychelles | Africa | 38 | Uruguay | Americas |
| 11 | Swaziland | Africa | 39 | Azerbaijan | Asia-Pacific |
| 12 | Tanzania | Africa | 40 | Brunei Darussalam | Asia-Pacific |
| 13 | Tunisia | Africa | 41 | Cambodia | Asia-Pacific |
| 14 | Zambia | Africa | 42 | Chinese Taipei | Asia-Pacific |
| 15 | Zimbabwe | Africa | 43 | Cook Island | Asia-Pacific |
| 16 | Anguilla | Americas | 44 | Fiji | Asia-Pacific |
| 17 | Antigua and Barbuda | Americas | 45 | Kazakhstan | Asia-Pacific |
| 18 | Bahamas, The | Americas | 46 | Laos | Asia-Pacific |
| 19 | Belize | Americas | 47 | Macao SAR | Asia-Pacific |
| 20 | Bermuda | Americas | 48 | Malaysia | Asia-Pacific |
| 21 | Bolivia | Americas | 49 | Maldives | Asia-Pacific |
| 22 | Cayman Islands | Americas | 50 | New Zealand | Asia-Pacific |
| 23 | Chile | Americas | 51 | Pakistan | Asia-Pacific |
| 24 | Colombia | Americas | 52 | Philippines | Asia-Pacific |
| 25 | Dominica | Americas | 53 | Samoa | Asia-Pacific |
| 26 | Ecuador | Americas | 54 | Solomon Islands | Asia-Pacific |
| 27 | El Salvador | Americas | 55 | Sri Lanka | Asia-Pacific |
| 28 | Grenada | Americas | 56 | Thailand | Asia-Pacific |

Regional classification – Europe and Middle East

Table 21

| Jurisdiction | | Region | Jurisdiction | | Region |
|--------------|------------------------|--------|--------------|------------|-------------|
| 57 | Albania | Europe | 79 | Malta | Europe |
| 58 | Austria | Europe | 80 | Moldova | Europe |
| 59 | Belarus | Europe | 81 | Montenegro | Europe |
| 60 | Bosnia and Herzegovina | Europe | 82 | Norway | Europe |
| 61 | Bulgaria | Europe | 83 | Poland | Europe |
| 62 | Croatia | Europe | 84 | Portugal | Europe |
| 63 | Cyprus | Europe | 85 | Romania | Europe |
| 64 | Czech Republic | Europe | 86 | Serbia | Europe |
| 65 | Denmark | Europe | 87 | Slovakia | Europe |
| 66 | Estonia | Europe | 88 | Slovenia | Europe |
| 67 | Finland | Europe | 89 | Ukraine | Europe |
| 68 | Georgia | Europe | 90 | Abu Dhabi | Middle East |
| 69 | Gibraltar | Europe | 91 | Bahrain | Middle East |
| 70 | Greece | Europe | 92 | Dubai | Middle East |
| 71 | Guernsey | Europe | 93 | Iraq | Middle East |
| 72 | Hungary | Europe | 94 | Israel | Middle East |
| 73 | Iceland | Europe | 95 | Jordan | Middle East |
| 74 | Ireland | Europe | 96 | Kuwait | Middle East |
| 75 | Latvia | Europe | 97 | Lebanon | Middle East |
| 76 | Liechtenstein | Europe | 98 | Oman | Middle East |
| 77 | Lithuania | Europe | 99 | Palestine | Middle East |
| 78 | Macedonia | Europe | 100 | Qatar | Middle East |