



SMALL COUNTRY INTERFACES WITH THE WORLD'S FINANCIAL RULE-MAKERS

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Priorities**

1 Introduction

The Central Bank of The Bahamas is pleased and honoured to be able to co-host this gathering of eminent persons from Latin America, the Caribbean, the Basel Committee on Banking Supervision (BCBS), the Financial Stability Institute (FSI), and the Bank for International Settlements (BIS).

My topic tonight is: “How Small Nations Interact with the International Financial Rule-Making Architecture”. The core elements in this architecture include:

- Multilateral agencies, among which the IMF is probably the most impactful for small countries, and the BIS the most impactful for the world’s central banks;
- Rule-making bodies, among which the Basel Committee is probably the most prominent, but including the international Association of Insurance Supervisors (IAIS), the International Organisation of Securities Commissions (IOSCO), and similar groups, with the Financial Stability Board (FSB) assuming prominence in recent years;
- The ever-growing architecture on financial crime suppression, centred on the Financial Action Task Force (FATF); and
- A range of public, quasi-public, and private groups that create, impose, and/or enforce standards in international finance, among which leading examples include the ratings agencies, SWIFT¹, ISDA², LCH³ and many others.

2 The small country experience in general

What has been the experience of small countries in dealing with these groups? In a few words: generally positive, but mixed.

From a small country perspective, the ideal engagement with an international rules-making body would feature four key elements:

- The body explicitly considers small countries when making and enforcing rules;
- The body provides, directly or through its membership, reasonable assistance to help small countries adopt and maintain the relevant rule set;
- The body’s governance arrangements allow for small country representation, and for staff from small countries to engage on working groups, task forces, secretariats, and the like; and
- When conducting compliance assessments and similar engagements, the body’s evaluation process gives small countries a fair chance to demonstrate compliance, in the context of each country’s economy and society.

¹ Society for Worldwide Interbank Financial Telecommunications.

² International Swaps and Derivatives Association.

³ LCH is a London and European based clearing house for trades in financial instruments.

My experience, both directly and through engagement in the Caribbean and elsewhere, is that most international rules-making bodies lack comprehensive policies in the above areas, but there is generally sincere goodwill expressed by these bodies. Put another way, few international rules-making bodies are set up to disadvantage small countries, but several of them can bruise us inadvertently, and we would like to see international practice improve to reduce this bruising.

The challenge in part relates to focus on rules making to affect outcomes of a globally systemic importance; outcomes which are less likely to be the case for economic events and economic actors in small countries. As such, conceding to small country concerns is often a question of quantifying and recognizing the unintended or spillover consequences of international standards; and determining how or sometimes whether to act to offset adverse externalities.

Small countries often have difficulty interfacing with the major international rule-making bodies, and it is clearly not the case that every such body should be expected to engage individually with about 200 countries. This is where regional groups shine, and among these groups, ASBA has been particularly helpful for Latin American and Caribbean small countries. We thank ASBA for their past, present, and doubtless future good work.

The FSB has also made good progress by convening non-members through its regional consultative grouping.

I can also acknowledge positive strides at the IMF and World Bank. Some of the recent sensitivity take a more micro-state view that narrows the universe to just most countries in the Caribbean, other Pacific Isles and parts of Africa. It has helped in tailoring policy prescriptions in the Fund's surveillance framework, for us, particularly around capital flow management and exchange rate policies.

Let me clarify that from my perspective, "small countries" are usually small in population, though they could be large in financial terms, with say New Zealand or thereabouts the cutoff between large and small. This is clearly a flexible definition, perhaps closer to the economic definition of small.

3 The experience with the Basel Committee

Now let's consider how the Basel Committee, with strong input from the FSI, measures up on my nominated criteria for ideal small country engagement.

3.1 *Consideration of small countries in rules making and enforcement*

First, how well does the BCBS consider small country issues when making and enforcing rules?

I commend you on two issues, and suggest a reconsideration regarding one other matter.

The first commendation flows from past years of reasonable receptivity to small country issues, albeit secondary to large country and large bank issues, at the Basel Committee. There are clearly routes through which a well-prepared small country can inject its views into the Basel processes, often via regional consultation formats.

The second commendation, and it is difficult to overstate its value, is the Basel Committee's and FSI's more recent and explicit adoption of proportionality as an accepted and important part of the framework. This allows small countries to adopt the Basel rules texts in ways that are fully compliant with the texts, but very much simpler and cheaper to supervise and comply with. To take a topical example, The Bahamas is currently consulting on a Basel III implementation that will require perhaps 10 per cent of the complexity of the full Basel rules text. Much of this simplification revolves around avoiding model-based approaches, but even the new Standardised Approaches give a great deal more freedom for small countries to adopt simpler but robust rules. Please continue with proportionality, and encourage the IMF to support this approach as they conduct FSAP reviews.

The matter I would ask you to reconsider is the increasingly fragile assertion that the Basel Committee is only making rules for large, internationally active banks. That may be the Basel position, but it is not the IMF position when it comes to FSAPs. This applies to the Basel Core Principles and the capital and liquidity frameworks. I certainly don't suggest that you move away from making rules for internationally active banks, but please try to remember, ideally not just around the margins, that a great many non-member countries will strive to adopt the Basel rules, both for international and domestic banks.

3.2 Assistance with rules adoption

The second question is, does the Basel Committee and FSI assist small countries in adopting new and almost always more challenging international rules?

Your record on this is particularly good, in our experience. That's the whole point of the FSI. We are also grateful that the Basel Committee, relative to some other international rule-making bodies, allows considerable time for consultation and for implementation of new rules. This conference is an obvious example of part of the extensive assistance given to non-member countries, as is the biennial ICBS event. So please keep up the good work.

3.3 Opportunities to engage

Third, what about governance and use of staff?

The BCBS and FSI secretariats and working groups naturally feature staff from member countries, but it is also the case that staff from non-member countries get opportunities from time to time. We would like to see this practice continue, and ideally expand. I acknowledge that there are a great many non-member countries for the Basel Committee to potentially

engage with, but on the other hand, engaging a single high quality person from such countries can have a disproportionately positive effect in transferring best practices.

I note again the ICBS, and the regional consultation groups, as indications of good practice.

3.4 Getting a fair chance to demonstrate compliance

Finally, what about a fair chance to demonstrate compliance?

In the BCBS case, RCAPs are only relevant to member countries, and small countries generally deal with Basel rules text compliance through the IMF/World Bank and FSAP processes. Our experience has been that we do get a fair chance to demonstrate compliance on the core principles, and aspects of the rules texts as they come up.

On the other hand, I must observe that small countries are often subject to regulatory and supervisory fads that emanate from the large countries that constitute the bulk of your membership. Current examples include stress testing and resolvability of domestic systemically important banks (DSIBs). On the stress testing front, North American and European banks are spending billions of dollars a year on financial stress testing. That is their business. It should not be our business. To again refer to the Bahamian example, our banking system has a Common Equity Tier 1 (CET1) ratio exceeding 30 per cent. Recession-type stresses generate reductions in that ratio, but nothing remotely large enough to approach international minimum capital levels.

But what about our obvious stress, which in common with many small countries revolves around a natural disaster? Most hurricanes which hit The Bahamas have not presented a financial system threat. But a Category 4 or 5 hurricane passing to the close north of this island could hurt us very badly. How badly? We don't know. Why don't we know? In part because it's a very complex question requiring coordination across a great many agencies plus the private sector. But also because the relevant staff are working on financial stress tests that in all honesty are more for FSAP consumption than our own use. Plus, there is a huge amount of work for a great many international agencies on a great many topics, not all of which are locally helpful.

On the DSIB resolution front: we have a minimal equity and nearly no debt capital market, and deposits handily fund loans. So why would we do total loss absorption capacity (TLAC)? And what sort of resolution plan is possible when recapitalization from markets is most unlikely? We can't afford to close a DSIB, and we have no capital markets providers to take the failure risk. This is far from unusual in small countries—so why are we putting a lot of time into Internal Capital Adequacy Assessment Processes (ICAAPs), recovery plans, resolution plans, and the like? Because that is the international expectation. It would be better to develop a super-simplified but pragmatic approach that minimizes but does not eliminate the potential for public sector bailouts of DSIBs.

4 Conclusion

To sum up: the Bahamian experience, and from what we have seen of other small country experience with the Basel Committee, has generally been positive. We are also deeply grateful for the work of the FSI, which is an extraordinarily helpful group. The same applies to the technical assistance on offer directly from Basel Committee member agencies and their associated national assistance bodies, plus the international multilateral development bodies. There are a few areas where we would like to see more consideration given to small country issues, but the bottom line is that the BCBS works for us, even though we aren't a member and are unlikely ever to become a member. We are not yet in a position to say that about all international rule-making bodies, but that is a conversation for another day.

I will conclude by thanking you personally and your agencies for your good work, and for the assistance and consideration you have shown The Bahamas and other small nations over the years, and the assistance and consideration to come in the future.