Ryozo Himino: Prophets, armed and unarmed - the roles of power and knowledge in international prudential standards

Speech by Mr Ryozo Himino, Deputy Governor of the Bank of Japan, at the GZERO Summit Japan, Tokyo, 21 October 2025.

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Introduction

Good afternoon.

More than a decade ago, in his book titled *Every Nation for Itself*, Ian Bremmer argued that the world was entering a G-Zero era, with no group of countries being able to lead on global public goods.

What I plan to do during the next 15 minutes is to test that idea in one specific area: international prudential standards, standards designed to safeguard global financial stability.

1. International Prudential Standards as Global Public Goods

Why should international prudential standards be considered global public goods?

Financial systems today are deeply interconnected, and crises spread quickly across borders. The 1997 crisis in Thailand spread to other parts of Asia and to Russia, and shook Wall Street through the failure of LTCM. In 2008, Lehman's collapse caused a global recession. In 2023, Silicon Valley Bank's failure spread stress first to U.S. regional banks and then to European markets, triggering the fall of Credit Suisse.

Each country makes its own financial system resilient for its own sake. But, just as we prefer our neighbors' houses to be fire-resistant, it is also in every country's interest for other financial systems to remain resilient. When high-quality regulations and supervision are applied around the world, the benefits are shared by all.

2. Agreement, Transposition, and Enforcement

Yet common interests do not automatically yield common rules. Because the authority to regulate rests with each jurisdiction, three steps are necessary for a standard to become effective: first, jurisdictions must agree on the standard; second, they must adopt it domestically; and third, it must be enforced on financial institutions. We need agreements, transposition, and enforcement.

3. Knowledge and Power

For these steps to succeed, both knowledge and power come into play.

Seen from the perspective of knowledge, the three steps could look as follows: Jurisdictions agree on an international standard and transpose it into their domestic framework because the standard embodies the collective wisdom of global regulators and reflects lessons from mistakes made around the world. They also see benefits in a uniform standard as it cuts compliance costs, provides a level playing field, reduces arbitrage, and creates a shared language.[1] Financial institutions would observe it because it embodies best practices and helps them demonstrate their soundness.

That would indeed be a beautiful world. But if that were all it took, then a group of brilliant academics could simply draft good rules and the job would be done.

At the opposite end of the spectrum sits the perspective that emphasizes power.

In his book *The Prince*,[2] Niccolò Machiavelli writes as follows:
It ought to be remembered that there is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things, because the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new.

He continues,
It is necessary, therefore, . . . to inquire . . . whether, to consummate their enterprise, have they to use prayers or can they use force? In the first instance they always succeed badly, and never compass anything; but when they can rely on themselves and use force, then they are rarely endangered.

Then there comes one of his famous quotes:
All armed prophets have conquered, and the unarmed ones have been destroyed.

Machiavelli continues with another reason why reforms require power:
The nature of the people is variable, and whilst it is easy to persuade them, it is difficult to fix them in that persuasion. And thus it is necessary to take such measures that, when they believe no longer, it may be possible to make them believe by force.

4. Markets, Network Externalities, and Government

In the case of international prudential standards, power takes two forms: non-governmental and governmental.

Non-governmental power includes the power of markets and the power of network externalities. Markets punish banks that fail to meet standards and jurisdictions that do not adopt standards by selling their securities or cutting off transactions. Network externalities make it costly not to use the dominant standard once many others already use it.

There are cases where knowledge, markets, and network externalities have proven to be enough to drive the three steps.

For example, the International Swaps and Derivatives Association (ISDA) is a private-sector forum without government involvement, but its Master Agreement is used by almost everybody in the wholesale derivatives market, contributing to risk reduction and market stability.

However, in many other cases, governmental power has been involved to varying degrees. I would like to discuss this in light of the history of four standards with the word "Basel" in their names: Basel I, Basel Core Principles, Basel II, and Basel III.[3]

Basel I

Let us begin with Basel I, the world's first international capital adequacy standard for banks.

The agreement stage of Basel I began in 1984 among experts at the Basel Committee on Banking Supervision. Though they rapidly formed a common base of knowledge, they failed to overcome national differences and reached an impasse after about two years.

The U.S. authorities, however, could not leave the Basel experts' stalemate unresolved. Alarmed by the Latin American debt crisis, which posed a material threat to major U.S. banks and taxpayers, the U.S. Congress demanded stronger regulation on banks. But the U.S. banking industry fought back, arguing that they would be put at a competitive disadvantage against foreign banks. Thus, Congress required both stronger regulation and international coordination.

The United States chose to enter into a common front with the United Kingdom, and twisted the arms of Japan, Germany, and others with the threat that the two would proceed alone if others would not go along. The implicit message was that those banks failing to meet the standards to be set by the two might no longer be able to operate in New York and London. The next year, the Basel Committee reached an agreement.

The transposition step also proceeded swiftly. Basel I was eventually implemented in more than one hundred countries.

The United States led the enforcement step by example. In 1991, it introduced a domestic framework called Prompt Corrective Action (PCA), in which regulators impose varying degrees of corrective action, depending on how far a bank falls below the Basel I requirements. Similar frameworks came to be adopted by countries around the globe.

Basel Core Principles

Let's move on to the Basel Core Principles.

The Basel Committee took up the project to list key features of effective banking supervision in 1996 at the request of the G7 leaders. The agreement stage was swiftly completed within a year, partly because the Committee could build on the guidance it had accumulated over the years, and partly because it had strong political backing.

The transposition and enforcement of the Core Principles is monitored by the IMF and the World Bank through the Financial Sector Assessment Program (FSAP), which was introduced in 1999 in response to the Asian Financial Crisis and at the request of G7 leaders. The results of the assessments are particularly consequential for countries that may have to rely on the IMF or the World Bank for support.

Basel II

Compared to Basel I and the Basel Core Principles, Basel II was driven more by knowledge and less by power.

The Basel Committee started the process of establishing Basel II in 1998, to align Basel I with the rapid progress in financial engineering and credit risk management. Energized by the intellectual challenge of the project, experts produced a 500-page consultative draft full of new models and formulas in 2001.

Then the process stalled. Though the Committee succeeded in publishing final documents in 2004, domestic implementation in the United States was delayed and took effect only in April 2008. By that time, the securitization bubble had already reached its peak. One of the key features of Basel II was enhanced rules on securitization, but they were not implemented in time to help alleviate the Global Financial Crisis.

Basel III

Let's now turn to Basel III.

Basel III proceeded in two phases: the original Basel III of 2010 and the Basel III endgame of 2017. The two have led contrasting lives.

Original Basel III

The original Basel III was quickly agreed and was implemented largely as agreed.

The Global Financial Crisis in 2008 brought mainstream economists into the analysis of its causes and the formulation of proposals to prevent a recurrence. At the same time, the recession, the mass unemployment, the use of taxpayers' money, and the public anger around the world forced political leaders into decisive joint action.

In 2008, two months after the collapse of Lehman Brothers, the G20 leaders convened their first meeting. In 2009, they delivered a comprehensive plan for reforms. Responding to their request, the Basel Committee had already agreed on the first package of the new regulatory framework, Basel III, by 2010. Jurisdictions started domestic implementation largely in line with the agreed timeline.

Basel III endgame

The process for the Basel III endgame, which finalized the subsequent series of reforms, has been more painful. The international agreement phase took much longer, and the Basel Committee finally reached a compromise almost a decade after the Global Financial Crisis.

The transposition stage proved even harder. G20 leaders repeatedly affirmed their commitment to full, timely, and consistent implementation, but implementation deadlines were extended time and again. Even today, eight years after the agreement, the transposition has not happened in the United States. U.S. regulators are said to be working to repropose the domestic endgame rules by the end of 2025 or early 2026. The United Kingdom has not implemented it either, and the European Union has left a key element unimplemented.

The original Basel III was implemented in time for the Covid-19 shock and helped the global financial system survive it, but the Basel III endgame was not.

5. How Should We Proceed from Here?

How should we proceed from here?

Global financial regulators are not prophets, but they sometimes identify key vulnerabilities in the financial system and try to prevent them from causing the next crisis.

In the episodes of Basel II and Basel III endgame, the regulators somewhat resembled prophets unarmed. In other cases, they could have been compared to prophets armed. 1988 Basel I was backed by the power of G2 when the United States was the only superpower. The 1997 Basel Core Principles were directed by the G7, which was clearly dominant at the time. The original Basel III of 2010 was sponsored by the new-born G20, which was much more united than today.

The world today, however, is a different place.

Still, we need to continue to modernize international prudential standards to keep up with the new and emerging realities. Today, half of the assets in the global financial system are held by non-bank financial institutions, including money market funds, other open-ended funds, and hedge funds, all of which fall outside the remit of Basel III. Stablecoins might emerge as a key player in the global payment system, partially replacing the role of bank deposits. Regulators are doing a lot in these spheres, but much more needs to be done.

Then how can we effectively mobilize knowledge and power in the changing global landscape to continue to innovate international prudential standards?

I confess that I do not know the answer. Still, let me put forward three things which may be worth trying.

First, we might want to face more squarely the question of power. In some cases, we may be able to rely on the power of markets and network externalities. In other cases, key jurisdictions may be willing to take the lead. For example, American banks have by far the strongest dollar deposit bases, which gives them a significant competitive advantage in the international banking market. It could therefore be in the interest of the United States to take the lead in developing common standards, preventing market fragmentation and expanding the level playing field.

Second, when we set our schedule, we may want to take into account that political momentum has an expiration date. The original Basel III of 2010 was agreed upon right after the crisis and was implemented quickly. By contrast, the 2017 Basel III endgame was published 10 years after the crisis and has not yet been implemented eight years after the agreement.

Third, we may want to maximize the power of knowledge and persuasion. In the international agreement stage, the quality of consensus matters as much as the quality of standards. Have members engaged enough with their domestic stakeholders before joining the international consensus? Do members have a sense of ownership in the agreement? The aim of the agreement stage should not be confined to putting documents on websites.

The same applies to the domestic transposition stage. National authorities should show why implementing the standards is in the best interest of the country, rather than shortcutting domestic persuasion by justification based solely on international commitments.

These three, however, may not be enough. Even in the past, there was no fixed formula that solved all problems. Today, there may be more need to tailor our approach to the demands of the task and the circumstances, and to be agile in seizing the opportunities that arise.

Conclusion

Let me conclude. Power gives knowledge its effectiveness, and knowledge gives power its legitimacy. Knowledge and power should remain in tension, but they must also reinforce each other in our efforts to secure global public goods.

Lastly, I would like to emphasize that the views I expressed today are my own and not necessarily those of the Bank of Japan.

Thank you.

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[1] Ryozo Himino, "Basel II-towards a new common language," *BIS Quarterly Review*, September 2004, https://papers.ssrn.com/sol3/Delivery.cfm?abstractid=1967506.

[2] Translated by W. K. Marriott.

[3] For the history of Basel I and the Basel Core Principles, see Charles Goodhart, *The Basel Committee on Banking Supervision: A History of the Early Years 1974-1997,* 2011. In Chapter 15, he discusses the roles of power and knowledge. For the history up to Basel II, see Ryozo Himino, *Kenshou BIS Kisei to Nihon (The Basel Accord and Japan, a Review), second edition,* 2005.