The state of global financial regulation

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1. Introduction

Thank you for this opportunity to provide an update on the Basel Committee's work to finalise the global regulatory framework, as well as its longer-term agenda. I note that I started with similar words on this occasion last year, adding that our goal was to complete the framework by the year's end. As you know, that didn't quite happen – but I can nevertheless repeat myself, to the effect that we are now close to finalising these reforms, which will provide clarity and certainty to supervisors and market participants alike.

2. Global policy agenda is virtually complete

A. Net Stable Funding Ratio

As we speak, a few of the post-crisis reforms remain to be completed, but the Basel Committee made good progress at its meeting last week. Let me give you a brief overview of the latest developments. As announced in a press release last Friday, the Committee has discussed the Net Stable Funding Ratio (NSFR) standard and agreed to allow national discretion for the NSFR's treatment of derivative liabilities.[1] At national discretion, the required stable funding (RSF) treatment for derivative liabilities can be reduced from 20% to no lower than 5%. We will continue to work on this issue and will consult if a change to this treatment is proposed. But the existing proposal should facilitate the implementation of the NSFR, which is due to begin on 1 January 2018, given that most jurisdictions have already published their final or draft rules.

1 Press release, "Implementation of net stable funding ratio and treatment of derivative liabilities", 6 October 2017.

B. Step-in risk

We've also made good progress on step-in risk – the risk that a bank will provide financial support to, say, an off-balance sheet entity, beyond its contractual obligations, if that entity gets into difficulties. Building on the consultation started in December 2015, final guidelines have been approved, and should be published later this month. Step-in risk will not attract a minimum capital requirement, but it will be subject to additional reporting to supervisors. The guidelines are another step in mitigating potential spillover effects from the shadow banking system to banks. And, as in the case of the NSFR measures, the Committee will monitor implementation in member jurisdictions.

C. Basel III revisions, including the capital output floor

With thanks to a Basel Committee member who is also a personal friend, I'd like to use the metaphor of running a marathon to describe where we stand in finalising the post-crisis reforms.

Pace yourself and remember the long-term goal

When running a marathon, it's important to pace yourself and keep sight of the big picture. Keeping track of your pace is important, but it is the long-term goal that should be your main motivation. For the Basel Committee, the long-term goal is resilient banks, which underpin safe and stable banking systems. I am acutely aware that we have recently marked a decade since the Great Financial Crisis began, and yet we are still working to finalise some of the reforms that respond to that crisis. This is a long time, but it's important to get it right. Despite this lengthy process, I hear from time to time that we are moving too quickly! But the Committee cannot arrive at the right decisions without consulting with the public and properly assessing what the economic effects of reform will be – using what we call quantitative impact studies. Like proper nutrition and rigorous training for a marathon, these are two preliminaries that cannot be dispensed with.

The wall

Many marathon runners hit a so-called wall. This happens late in the race, typically at around the 20th mile in the 26.2-mile marathon. When runners hit the wall, they feel a seemingly insurmountable wave of fatigue and doubt whether they have the energy or even the will to continue. I think it is safe to say that all of us, both industry and regulators, have experienced something like this. The list of reforms may seem very long, and banks, for their part, have made significant progress to correct deficiencies laid bare by the crisis. The only way to deal with hitting the wall is to endure it and simply push on to the finish line.

The finish

Once you've pushed through the pain and fatigue, you sense that the finish line beckons. Last year, at our meeting in Santiago, Chile, the Basel Committee had already hit the wall and then regained its stride, but we were still a few hundred metres from the finish line. I think of it as a steep, uphill finish. In the past few months, we have laboured to get up and over this last hill, otherwise known as the capital output floor.

Those last few meters

Now, I think we're almost there. In those last few metres of a marathon, with the finish line in sight, it's fairly clear what the result will be, although the final decision is up to our governing body, the Group of Central Bank Governors and Heads of Supervision.

As with the conclusion to many of the Basel Committee policy development processes, many might express unhappiness with the result, and sometimes for opposite reasons. They will believe either that the final standard is too stringent, or that it is not stringent enough. But, as in running a marathon, even if one is not thrilled with the final result, there is satisfaction knowing that the race has ended and one has done the best that could be expected. I often hear that "no deal is better than a bad deal". I disagree. No deal means that we have not finished the job and that we have failed to lay the groundwork for more resilient banks and a more stable banking system. That we have missed an opportunity to restore the credibility of risk-weighted capital ratios.

Thus, if we stop now, we will not have satisfactorily addressed the thorny issue of unwarranted variability in risk-weighted assets (RWA). Indeed, we see that RWA compression continues in some cases, even though risks have not really been scaled back. Also, all the other revisions to the *global* regulatory framework the Committee has worked on and agreed during the past two years would be discarded. These include updating the standardised approaches for credit and operational risks and adding restrictions to the use of internal ratings-based approaches. The floor is only one element among many that comprise this package of reforms. I stress "global" because these revisions are real improvements to the framework used by the vast majority of banks around the world.

Post-marathon

Finishing a marathon is a major effort, just as reforming the global regulatory framework has been. Once finished, it is ill advised to attempt another race until one has sufficiently recovered and recuperated. Once the Basel Committee gets to the finish line, there is likely to be a period during which no further major policy initiatives will be undertaken. A raucous post-race celebration is unlikely; instead, we'll take the chance to catch our collective breath. Does this mean that we will stop training and stop worrying about our fitness level? Certainly not. As a marathon runner keeps training, so we regulators should also be alert to any new emerging risks in the banking system. There is no room for complacency. History tells us that there will always be another crisis, albeit in some different guise. We need to keep striving to reduce the probability of that crisis and to mitigate its impact when – not if – it occurs.

3. Next steps

A. Impact

The next step is to assess what we have done and determine whether the result accords with our expectations. What is the impact of individual standards? How do the standards work in combination? What is the broader, macro impact of the revised framework? These questions need to be answered in cold, hard facts – that is, with data and analysis. What incentives will arise from the new standards? How are banks adapting to the new rules and what are the behavioural changes? How are banks optimising their balance sheet and are there already signs of attempts to circumvent the rules? We have seen some early indications of regulatory arbitrage, and this is something we are watching carefully.

B. Supervision

We need to keep our focus on improving supervision. Better, more effective and forward-looking supervision is a never-ending quest. A combination of effective supervision and robust standards is absolutely necessary to enhance the safety and soundness of the banking system.

C. Implementation

I have spoken before of the “implementation imperative”.[2] Basel Committee member jurisdictions have agreed on the importance of implementing the Basel global standards in full, in all jurisdictions. This is something on which we must continue to focus. For many, recollections of the crisis have faded, but for others, the lessons of the crisis are seared into memory. Full, timely and consistent implementation of Basel Committee standards is critical to improving the resilience of the global banking system, promoting public confidence in prudential ratios and encouraging a predictable and transparent regulatory environment for internationally active banks. Such implementation is also critical to ensuring global standards continue to be adopted. This is why we will keep on closely monitoring implementation. Next week, as it happens, we will publish our 13th progress report on the adoption of the Basel regulatory framework along with the final four assessment reports on implementation of the LCR.

4. Conclusion

We – all of us – have been running the Basel III marathon for quite a while. There is considerable fatigue, but we are close to the finish line. To quit the race now would negate all of our hard work these past few years and would do a disservice to the global regulatory framework and banking systems around the world.

Thank you all for your attention and your stamina.

[2] W Coen, "Global adoption of the Basel framework: enhancing financial stability across countries", speech at the 9th Islamic Financial Services Board Public Lecture on Financial Policy and Stability, Kuala Lumpur, Malaysia, 5 April 2017; W Coen, “Regulatory equivalence and the global regulatory system”, speech at the International Financial Services Forum, London, 25 May 2017.