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Moving towards a more selective and effective international banking regulation

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In the IMF's recent annual meetings the question of international banking regulation standards has once again come up, following the prolongation of discussions on the finalisation of Basel III. There is a certain feeling that the international standards are increasingly complex, needlessly wordy and unevenly implemented, while uncertainty regarding their impact is growing. Intended to ensure a level playing field among international banks, this wave of increasingly detailed standards has also coincided with the increasing fragmentation of the financial sector, which, among other things, translates into a withdrawal of the international banks from some markets, partly due to the effects of the financial crisis but also due to increasingly local regulation. The exception to this trend is retail banks with a decentralised model - such as the Spanish banks in Latin America - which have proven to be more resilient to the financial crisis and better adapted to a world of financial fragmentation.

It is worth remembering that ever since the Basel Concordat of 1975, international banking regulation standards have been based on certain minimum requirements in order to prevent countries from gaining a competitive advantage through more lax regulation. Countries that adopt them are free to establish more demanding regulations. This approach works in a deregulated world, such as the world which predominated between the 1970s and the 2000s, but it is less effective when countries appear to compete to be stricter in some aspects of the regulation, as has occurred since the financial crisis that began a decade ago. The adoption of the standards is voluntary and compliance with them is based on moral persuasion, peer pressure and market discipline.

The paradox of a set of international standards that are increasingly detailed, but the implementation of which is ever more unequal, is partly explained by the fact that countries exercise their right to be more demanding in some aspects, but also because they appeal to national particularities to be laxer in other aspects. The deviations exist in both directions.

The United States only applies the international agreements to a handful of systemic banks, while small entities are subject to rather less demanding regulation. The Trump Administration has initiated an in-depth review of banking regulation, with a view to move towards some “deregulation”, which openly questions some of the agreements that have been reached. This has made it difficult to conclude the Basel III negotiations, faced with the doubts surrounding the American authorities’ commitment to what was previously agreed.

Europe is marked as non-compliant in the Basel Committee’s review exercises (generally for rather trivial reasons), despite its implementation being highly detailed and extensive. There are even substantial differences in implementation between European countries themselves, as we have recently seen in some cases of banking crisis resolution.

There is also a problem of democratic legitimacy in some of the bodies that set the international standards, such as the Basel Committee. It is a self-elected board with a limited number of members (the G20 countries, with one or two others added), yet it issues standards which, in practice, are universally applicable. The more detailed the regulations are, the easier it is for them to conflict with the national parliaments' ability to regulate, exacerbating this problem of legitimacy.

One possible solution would be to establish more general international standards, but with a stricter degree of compliance. The proliferation of committees, subcommittees and work groups - which end up taking on a life of their own - has led to the Basel standards acquiring a level of detail that is perhaps undesired and unnecessary. The Basel Concordat is 6 pages long; Basel III comes to 3,414 pages, and it is still not completed. Another regulation based on principles should be accompanied by firmer compliance mechanisms. This issue is not easy to resolve, but inspiration can be sought in the field of international trade, where the World Trade Organization has a certain ability to impose penalties. A more important role can be given to the International Monetary Fund, whose universal membership grants it greater legitimacy… although its governance is evidently suboptimal.