The Limits of Globalizing Basel: Why regulators around the world are responding differently to Basel banking standards

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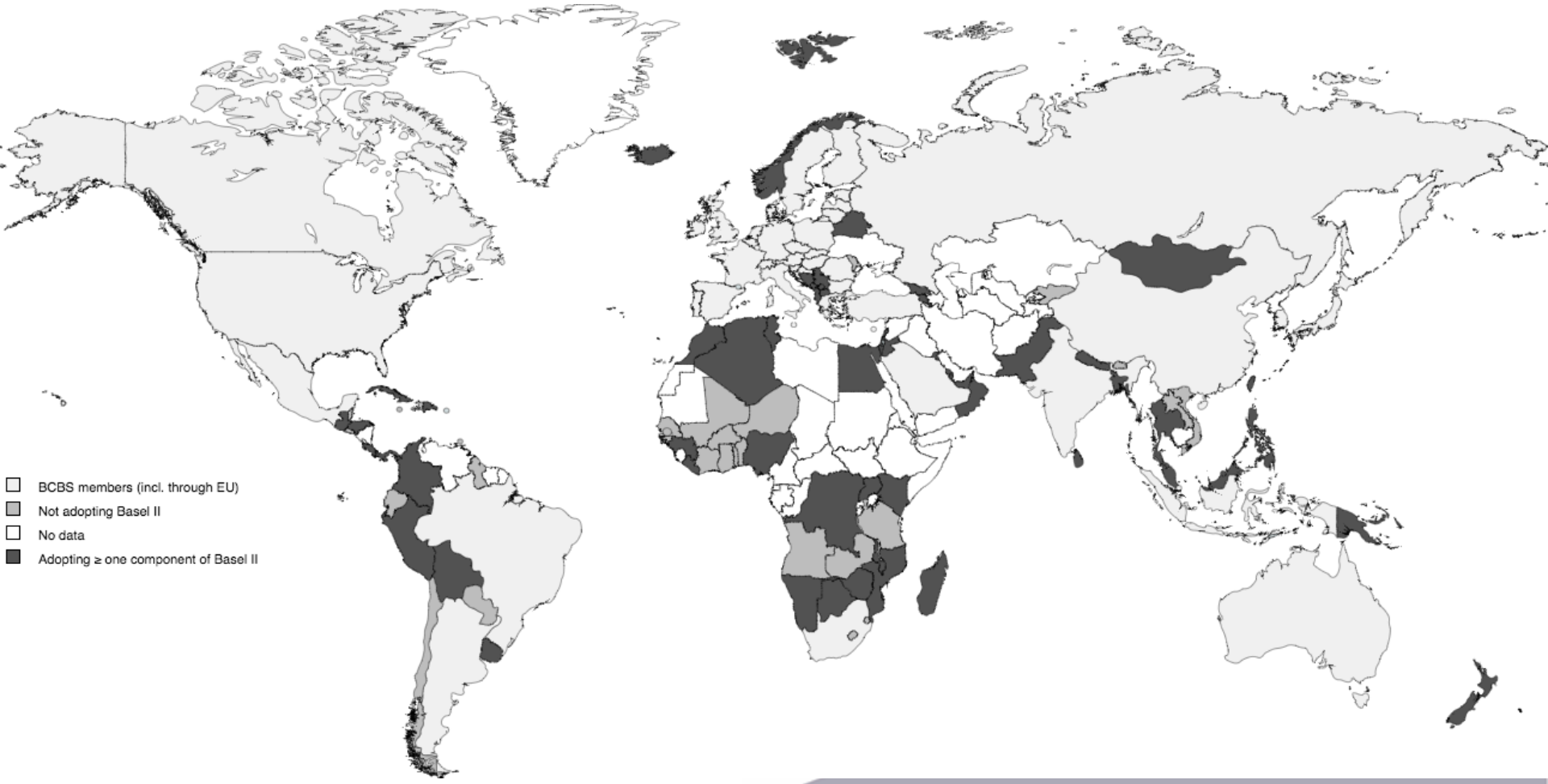
Outline

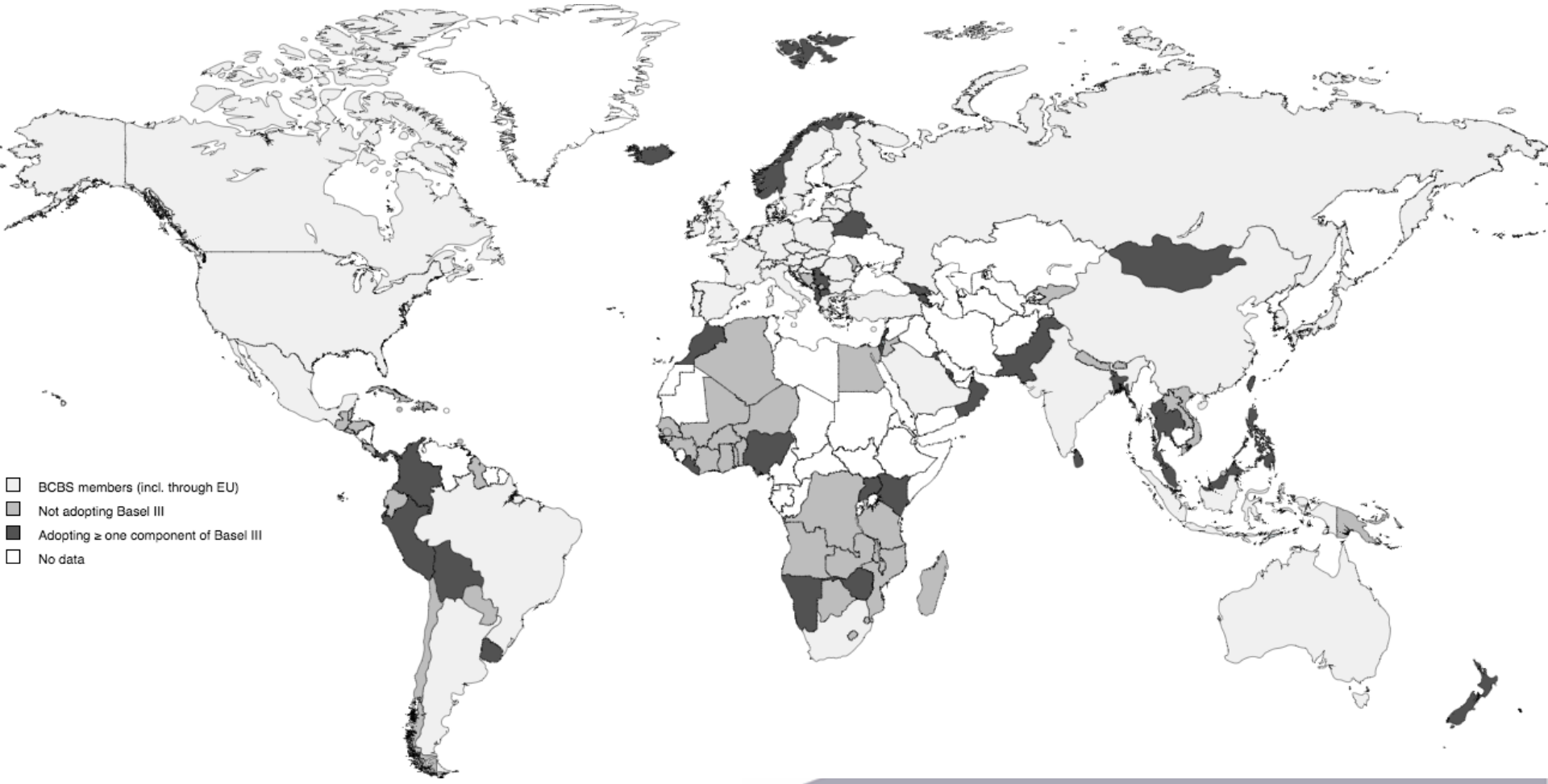
1. How are 'standard-taking' regulators responding to Basel standards?
   - FSI data from 100 jurisdictions outside of BCBS
2. Two explanations for variation in responses:
   - 'Goodness of Fit'
   - Internationalization of the banking sector
3. Do our explanations withstand empirical scrutiny?
   - Regression analysis

1. How are ‘standard-taking’ regulators responding to Basel standards?

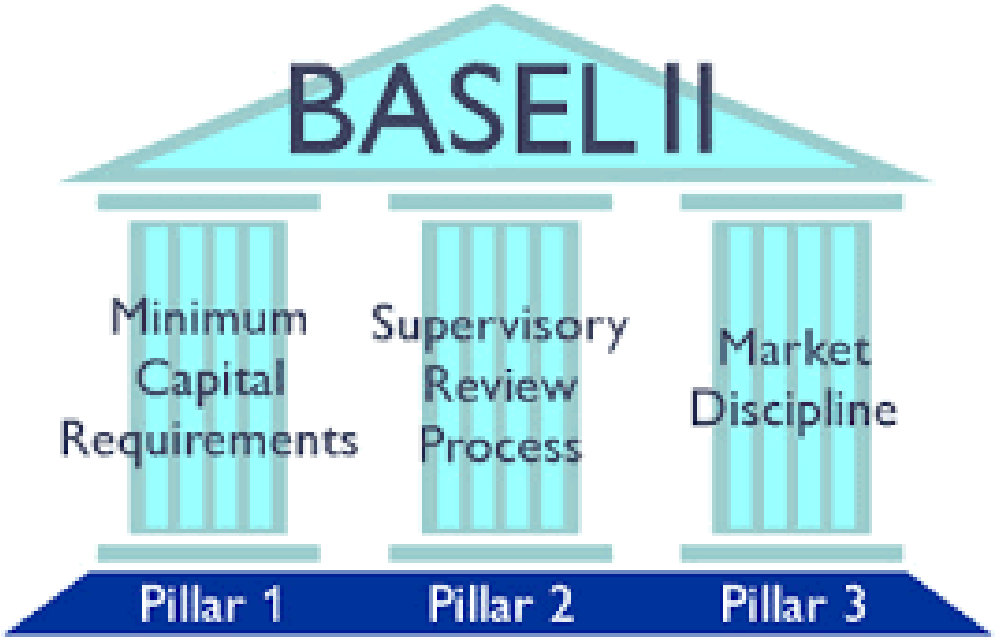
Basel II Adoption (non-members)



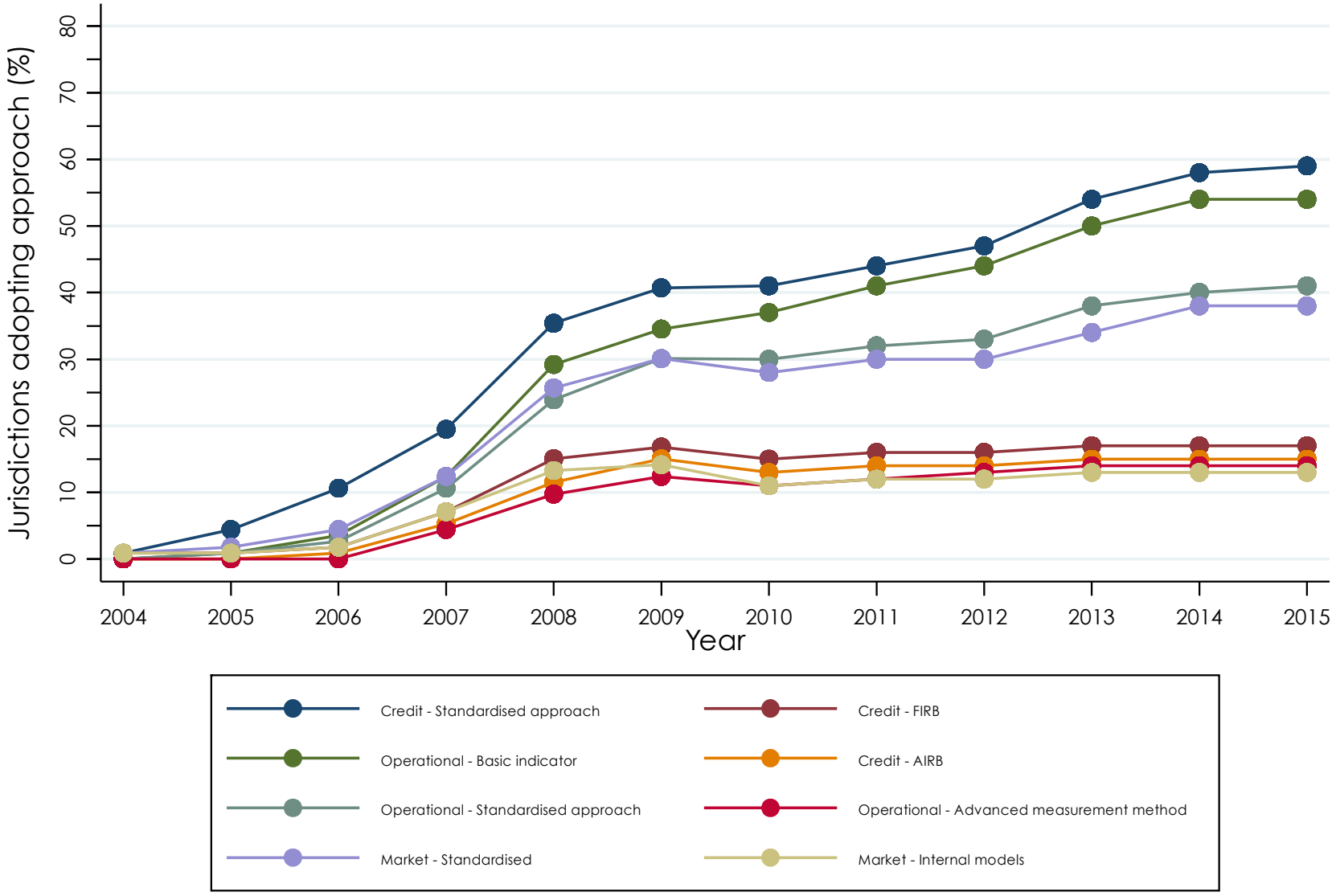
Basel III Adoption (non-members)

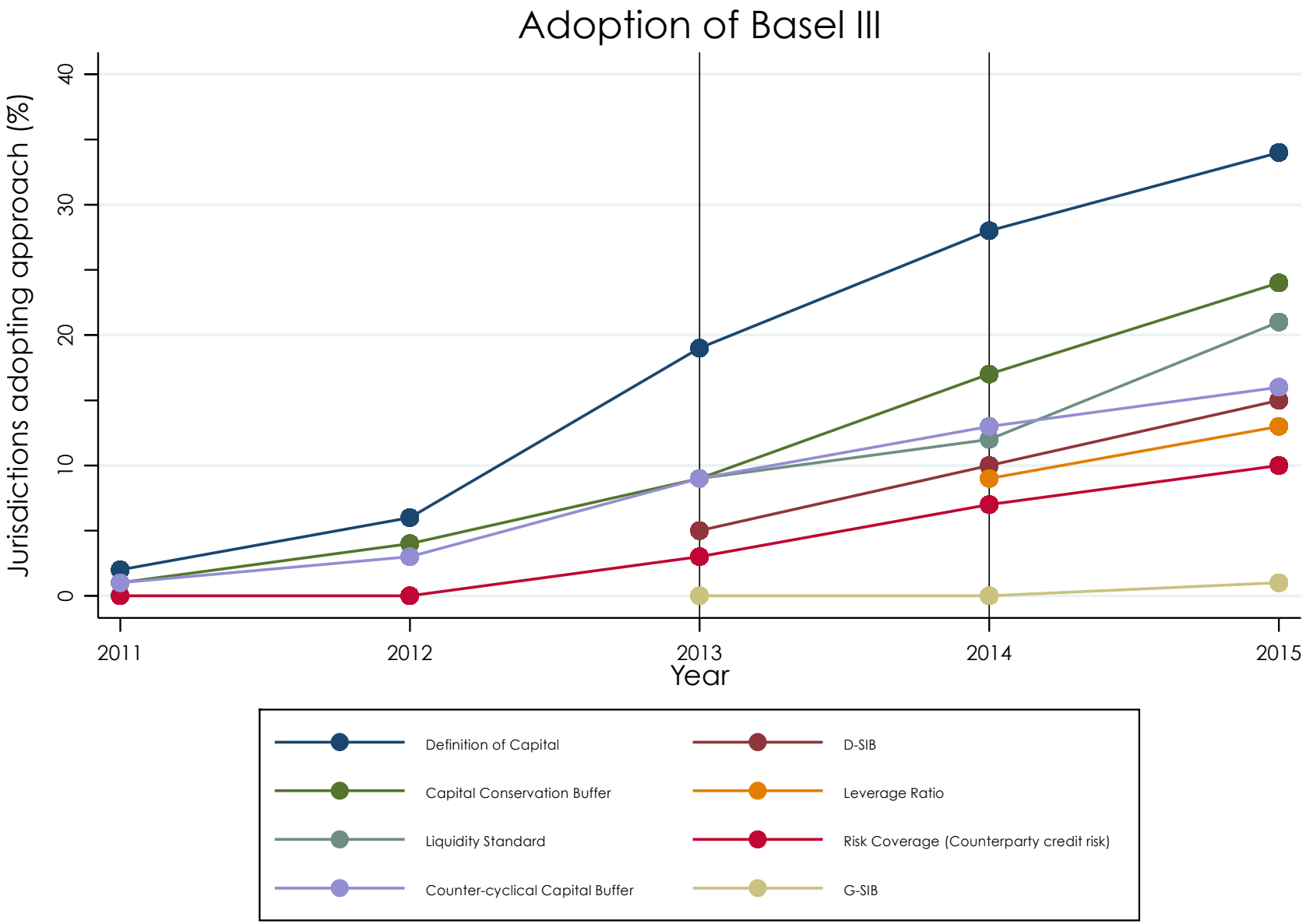


Variation within Basel II



Adoption of Basel II Pillar I Minimum Capital Requirements




Adoption of Basel III
Jurisdictions adopting approach (%)
0
10
20
30
40
2011
2012
2013
2014
2015
Year
Definition of Capital
Capital Conservation Buffer
Liquidity Standard
Counter-cyclical Capital Buffer
D-SIB
Leverage Ratio
Risk Coverage (Counterparty credit risk)
G-SIB

2. Explaining variation in responses

Goodness of Fit

- Basel designed for sophisticated financial markets & well-resourced regulators

- Basel II:
  - Standardized vs Internal models
  - Pillar 3 market discipline

- Basel III:
  - Definitions of capital, capital cons. buffer, leverage ratio
  - Countercyclical buffer, liquidity standard

Basel Adoption by Income (as at 2015)

	Basel II Adoption	Basel III Adoption
Low income	11 (79%)	5 (36%)
Lower-middle income	15 (56%)	10 (37%)
Upper-middle income	22 (81%)	13 (48%)
High-income	23 (77%)	13 (42%)

Internationalization of Banking Sector

	Compliance Costs	Regulatory capital	Transactions costs	Market entry costs	Cost of international capital
Foreign Banks	↑	↓ (BII) ↑ (BIII)	↓	NA	↓
Domestic banks operating abroad	↑	↓ (BII) ↑ (BIII)	↓	↓	↓
Domestic banks raising capital abroad	↑	↓(BII) ↑ (BIII)	NA	NA	↓
Small domestic banks	↑↑	↑	NA	NA	NA

2 Hypotheses to Probe

Goodness of Fit:

H1: Expect levels of BII and BIII adoption increase with financial sector depth / sophistication and regulatory capacity

Internationalization of banking sector:

H2: Expect levels of BII and BIII adoption (including internal models) to increase with level of banking sector internationalization

3. Do our explanations withstand empirical scrutiny?

Data

- Data on Basel Adoption (DV):
  - Index of Basel II adoption, 0-10 components
  - Among BII adopters, binary variable: model-based or not
  - Index of Basel III, adoption, 0-8 components

- "Goodness of fit":
  - Financial sector depth (for robustness: GDP per capita)
  - Private credit bureau coverage
  - Number of supervisors

- Banking sector internationalization
  - Foreign bank presence (for robustness: Foreign bank assets)
  - Banks abroad

- Controls:
  - IMF program
  - Financial crises

Results: Basel II

	(1) Index of Basel II adoption 2007	(2) Index of Basel II adoption 2010	(3) Index of Basel II adoption 2015	(4) Index of Basel II adoption 2015 (covariates averaged 2004-2014)
Financial sector depth	0.014	0.050***	0.023	0.037**
	(0.012)	(0.015)	(0.015)	(0.017)
Number of supervisors	0.000	0.003	0.005	0.004
	(0.003)	(0.005)	(0.004)	(0.004)
Private credit bureau	0.016	-0.004	0.007	0.007
	(0.011)	(0.013)	(0.014)	(0.015)
Foreign bank presence	-0.018	-0.001	-0.006	-0.010
	(0.015)	(0.020)	(0.020)	(0.020)
Banks abroad	-0.132	0.231	0.107	0.147
	(0.083)	(0.187)	(0.122)	(0.186)
IMF program	0.058	0.051	0.620	0.778
	(0.713)	(0.870)	(0.878)	(0.976)
Constant	0.907	-0.347	1.749	1.497
	(1.041)	(1.649)	(1.598)	(1.809)
Observations	55	48	52	56
R-squared	0.148	0.383	0.197	0.206

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Results: Basel II

	(1) Adoption model-based components 2007	(2) Adoption model-based components 2010	(3) Adoption model-based components 2015	(4) Adoption model-based components 2015 (covariates averaged 2004-2014)
Financial sector depth	2.485	0.040	0.020*	0.024*
	(0.000)	(0.028)	(0.011)	(0.012)
Number of supervisors	1.821	0.021	0.004*	0.005*
	(0.000)	(0.013)	(0.002)	(0.003)
Private credit bureau	4.492	-0.004	0.008	0.010
	(0.000)	(0.014)	(0.008)	(0.008)
Foreign bank presence	-1.216	0.070**	0.007	0.012
	(0.000)	(0.035)	(0.012)	(0.011)
Banks abroad	46.972	0.159	0.021	0.053
	(0.000)	(0.194)	(0.065)	(0.100)
IMF program	11.880	0.067	0.328	0.700
	(0.000)	(1.042)	(0.515)	(0.628)
Constant	-587.303	-8.363**	-3.022***	-3.780***
	(0.000)	(3.696)	(1.151)	(1.409)
Observations	12	27	40	44
Pseudo R2	1	0.542	0.245	0.246

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Results: Basel III

	(1) Basel III adoption 2015	(2) Basel III adoption 2015
Basel II adoption	1.355**	1.526***
	(0.505)	(0.529)
Financial sector depth	0.011	
	(0.007)	
GDP per capita (thousands)		0.087***
		(0.024)
Number of supervisors	0.003*	0.004*
	(0.002)	(0.002)
Private credit bureau	0.000	0.002
	(0.007)	(0.007)
Foreign bank presence	0.003	0.001
	(0.010)	(0.010)
Banks abroad	0.010	-0.030
	(0.059)	(0.061)
IMF program	0.131	0.194
	(0.422)	(0.446)
Constant	-0.857	-0.737
	(0.848)	(0.822)
Observations	52	54
R-squared	0.313	0.433

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Conclusion

- Disaggregation shows Basel is not really 'global'
- Two explanations for variation in adoption
  - Goodness of fit, but not sufficient
  - Internationalization of the banking sector
- Regulators face strong market-based incentives to adopt, even if Basel is a 'poor fit'
- Need to rethink the global standard-setting process -> more inclusive?

Thank You