BANK FOR INTERNATIONAL SETTLEMENTS

Reflections of a Basel Committee Chairman

Keynote address by Mr Stefan Ingves, Chairman of the Basel Committee and Governor of Sveriges Riksbank, at the 19th International Conference of Banking Supervisors, Santiago, 30 November 2016.

Introduction

Good morning, and welcome to the 19th International Conference of Banking Supervisors (ICBS).

I would like to begin by thanking the Superintendency of Banks and Financial Institutions of Chile, and in particular its Superintendent, Eric Parrado,for hosting the 2016 ICBS. Your hospitality and outstanding organisation of this year's event is greatly appreciated by the international regulatory community. It is a pleasure to be in Santiago this week.

This will be my final ICBS as Chairman of the Basel Committee. I therefore want to spend most of my time today reflecting on how the Committee works - thereby taking a look at the Committee's operations, its Secretariat and its Chairman. After almost six years as Basel Committee Chairman, I thought it would be a good opportunity to share such insights.

I know that many of you are keenly interested in knowing the outcome of the Committee's deliberations over the past two days. Perhaps some of you may even be more interested in the outcome of the Committee meeting than my own reflections! In the second part of my remarks, I will provide you with a brief update on the Committee's progress towards finalising the Basel III reforms. Of course, what I am able to say today in this regard is somewhat limited, as the Basel III reforms are ultimately subject to endorsement by the Group of Governors and Heads of Supervision, which should meet in January.

Section 1 - Reflections on the workings of the Basel Committee

Let me start with some thoughts on the workings of the Basel Committee.

In September 2013, the BIS hosted a Symposium to mark 25 years of the Basel I Capital Accord. Two of the distinguished speakers at that event included Paul Volcker and Peter Cooke. Both men were instrumental in shaping the Basel Committee, as well as in designing the first global bank capital adequacy standard. In my remarks today, I want to recall some of the reflections from that Symposium, and also share with you some of my own thoughts.

In reflecting on the work of the Basel Committee, I want to focus on four challenges that the Committee faces. I am not talking about challenges related to strengthening banking practices or improving the effectiveness of supervision. Rather, the challenges, as Paul Volcker and Peter Cooke recalled, relate to:

1. The ability to **reach consensus** across multiple jurisdictions facing many different issues and constraints;
2. How best to **communicate and engage** with the wide range of stakeholders that have an interest in the Committee's work;
3. Finding the appropriate balance in terms of **representation** - how many seats should there be at the Committee table? How should they be distributed globally and how should decisions be made?; and
4. Understanding **the limits of international standard setting.**

Overall, the challenges the Committee faces today are no different and no more difficult than those faced by Paul Volcker, Peter Cooke, and others when Basel I was agreed in 1988.

Forging agreements

One thing that the founders of the Basel Committee clearly understood was the need to compromise. As Peter Cooke eloquently put it at the Symposium I referred to earlier:

"In order to achieve something, everyone must be willing to give up a little."

It is in this spirit of compromise that agreements are ultimately forged. Every member of the Committee should take some credit for reaching agreements (although none might want to take total responsibility).

It is important to note that no single country or region gets everything it wants from the negotiations. If left to their own devices, everyone would write the final rules differently. But as we know, the financial system is global in nature and highly interlinked across jurisdictions and regions. So there is a collective understanding that the benefits of compromise (and giving up a little) which results in a global standard far outweigh the costs of divergence.

Let me say a few words about compromises. At times there is a view that a compromise should always take the form of a "middle ground" between two positions. For example, if one side of the debate wants a 15% risk weight, while the other side wants a 5% risk weight, one might be tempted to conclude that a 10% risk weight is the best outcome.

I think this is a somewhat simplistic view. To paraphrase the American poet James Russell Lowell, such an approach would "make a good umbrella, but a poor roof". Always placing equal weight on each position would likely lead to sub-optimal outcomes.

Rather, any compromise reached by the Committee should be based on the validity and strength of each position to further the Committee's objective of enhancing global financial stability. Our challenge in reaching compromises is to achieve sensible outcomes.

Communication and engagement

Spreading the Committee's word across the wider supervisory community and the broader public is, of course, critical. Much of the responsibility here rests with the Chairman and Secretariat. The most significant challenge is how to communicate progress and direction, while the process is ongoing, but before agreements have been formally signed off.

Speaking on behalf of 27 jurisdictions and 45 member organisations (or 54 including Basel Committee observers) in such circumstances is challenging. There is typically a fairly narrow window in which one can provide the public with broad direction but without committing to a particular policy position. In some sense, this is no different to the challenges associated with monetary policy communication, or public policy communication in general. A complicating factor here is the international dimension and the often complex, technical nature of the subject matter.

Faced with these constraints, the Chairman's communication - including speeches such as this one - are sometimes as much about internal communication as they are about communicating with external stakeholders. In some cases, a reference in a speech may be the only public communication that the Committee has made on a topic, and such statements can become the de facto Committee position. If the Chairman or Secretary General stray too far away from the central Committee position on such issues, other members will not be shy in pointing that out.

While communicating the Committee's progress in developing global standards is a difficult but essential part of our work, the engagement between the regulators and the regulated is no less important. The former US President Ronald Reagan once said that:

"The nine most terrifying words in the English language are: I'm from the government and I'm here to help."

In recent times, the Committee has received many offers from the industry to help us finalise post-crisis reforms. So much so that the nine most terrifying words for some of us have become:

"I'm from the industry and I'm here to help."

Having said that, I fully understand that the Committee cannot, and does not, operate in a vacuum. Constructive input from the industry is highly valued, even though the interests of the regulators and regulated will not always align.

But the Committee should, and does, reach out to a wider range of stakeholders. In that regard, the views of academics, analysts, market participants, the public sector and the general public also play an important role in shaping the Committee's work. This is reflected most notably in the extensive consultation process followed by the Committee.

There is no escaping the broader political and economic issues that shape international policymaking. However, standard setting for global banks should not be viewed as a trade negotiation. The Committee's organisational structure and the independence of its Secretariat help in this regard, as both are a step removed from national economic and political considerations. This facilitates policymaking and helps ensure that the focus is more prudential and long-term. Otherwise, it might be shaped purely by short-term economic and political factors, which may not be consistent with designing long-term policies to promote financial stability.

While this may open up the Committee to questions of international legitimacy, I believe such concerns are more than offset by the independence and transparency of the process. Moreover, while the Committee agrees to certain standards, it has no legal enforcement power. It relies on the commitment of the jurisdictions at the table to implement what has been agreed. In 2012, the Committee established the Regulatory Consistency Assessment Programme (RCAP) to further promote timely and consistent implementation of its standards and to improve transparency. Even in this area, while the Committee has influence through disclosure, it has no legal enforcement power.

To illustrate, this year the Committee will finish its first round of assessments of the implementation of the risk-based capital standard. All member jurisdictions were assessed and over 1000 deviations were identified. The large majority of the deviations were rectified during these assessments, which has significantly improved the consistency of the regulatory implementation across member jurisdictions.

Representation

Closely related to the issue of communication and engagement is the issue of Committee membership. For all the hotly debated issues that have come across the Committee's table over the past 40 years, nothing raises more interest and discussion than the topic of seats at the table.

The Committee was conceived as a G10 construct. Following its expansion in 2009, and more recently in 2014, the Committee is now a far more inclusive and, in my view, global standard setter.

While the composition of the Committee will continue to be an issue that surfaces from time to time, the Committee has made great strides in expanding its engagement with the global supervisory community. The Committee, for example, regularly receives updates from the Basel Consultative Group, a body that includes 16 non-Basel Committee member jurisdictions. Moreover, the Committee's documentation is shared with a large number of other jurisdictions well before final decisions are reached or made public. This week's conference, and a number of regional groups, were promoted for these very reasons. That is, to disseminate the Committee's message and to interact more broadly with the international supervisory community.

Looking ahead, I think there may be further scope to consider how best to balance the global representation of the Basel Committee with the number of actual members and the ability to reach agreements in a timely manner. Could we further increase the global representation of the Committee while consolidating the number of seats around the table? Is the regional balance of members adequate, or is there scope for further enhancements? These are just some questions which will no doubt have to be considered at some point in the future.

Broad-brush versus detailed standards

As I noted earlier, the task of global policymaking is a difficult one due to a variety of factors. Our goal is to develop a global standard but we have to take account of a wide range of perspectives, such as regional, national and often state and local considerations. All can have a bearing on the final outcome.

Recognising these differences, the Basel I Accord was developed with a broad brush. It was never intended to capture every risk that a bank faced. On the balance between comparability, simplicity and risk sensitivity, it clearly favoured comparability and simplicity. Basel II shifted the balance decidedly in the direction of risk sensitivity and its associated complexity. In effect, it also allowed for much greater national discretion, both at the bank and bank supervisor levels. The current Basel III proposals attempt to restore this balance by taking greater account of comparability and simplicity, while still retaining a fundamentally risk-sensitive framework. More generally, perhaps the key innovation in Basel III is that there is no longer a reliance on a single measure of bank safety. Few credit analysts would ever rely on a single measure of a firm's creditworthiness. It follows that, as regulators, we should also avoid placing all our trust in one measure of bank soundness.

Underlying these broad shifts in the regulatory framework is the general question of international standardisation. Basel I's broad-brush approach left much that was not standardised to the discretion of national supervisors. By its nature, the earlier framework allowed for national discretion under the surface of the broad risk weight categories. Basel II and Basel III - by taking a more detailed approach - expanded the scope of international standardisation. In addition, areas of flexibility, through national discretion, became more transparent. My point here is simply to note that the goal of international standard setters is not to standardise the measurement of every risk for every firm. There are limits to the benefits of international standards, and these should be understood when designing and implementing the standards.

In this regard, the Committee is always guided by two general principles.

First, the standards that the Committee develops are global **minimum** standards. Jurisdictions that adopt higher standards are considered to be compliant with the Basel framework.

Second, the standards are designed for **internationally active banks**. Nevertheless, in many cases, the suite of approaches provided by the Basel framework will be applicable to most banks around the world. This is reflected in the widespread application of the Basel rules to banks across the world.

Section 2 - Finalising post-crisis reforms

Let me now turn to the issue of the finalisation of the Committee's post-crisis reforms. As you know, the Committee has spent the past two days working towards an agreement to finalise these post-crisis reforms. We have made very good progress and the contours of an agreement are now clear. At a high level this includes:

- A revised standardised approach to credit risk. This will be more risk-sensitive than the current standardised approach and more consistent with the internal model-based approaches. It will also be neutral in terms of its capital impact;
- The revised framework will largely retain the use of internal models but with the safeguards provided by input floors and revisions to the foundation IRB approach;
- A revised standardised approach for operational risk will replace the four existing approaches, including the Advanced Measurement Approach, which is based on banks' internal models. I expect this will also be capital-neutral overall, but there will no doubt be increases and decreases in operational risk capital requirements for certain banks;
- A leverage ratio surcharge for global systemically important banks will be introduced to complement the risk-based G-SIB surcharge;

- Finally, I expect an aggregate output floor will be part of our package of reforms. It will be based on the standardised approaches and the final calibration of the floor is subject to endorsement by the GHOS.

- It is important to note that a lengthy implementation and phase-in period is likely to be part of this package. This would allow for banks to migrate to the new framework in an orderly and manageable fashion.

Let me say a few final thoughts about the impact of these reforms, and specifically on (i) the goal of reducing excessive risk-weighted asset (RWA) variability; and (ii) "focusing on not significantly increasing overall capital requirements", which is probably a contender for the most quoted regulatory sentence of the year.

- I am confident that the changes that the Committee has agreed move in that direction. But it should be clear that, to reduce RWA variability, changes in capital requirements are needed. This means that capital requirements may go down for some banks and go up for others. At the global, aggregate level, the impact is not significant, but it may well be significant for some banks.

- I also want to clarify what I have in mind when I use the term "impact". The Committee has considered the impact of its proposals on both minimum capital requirements and banks' actual capital ratios. I expect that the aggregate capital shortfalls relative to minimum requirements will be small and relatively concentrated. The impact on capital ratios will be more diverse across banks and across jurisdictions. The net effect of these changes will be that published risk-based capital ratios will be far more robust and comparable across banks.

- For those of you that were expecting more details of the Committee's discussions over the past two days, I refer you to my earlier remarks in this speech about the challenges of communication. And, taking advantage of being in Chile, I quote the brilliant Chilean poet, politician and Nobel laureate Pablo Neruda: "a word is one wing of silence".

- Finally let me conclude with a very simple message. It is time to get the job done, to move forward, and focus more on supervision and implementation. While the Committee will continue to develop standards as and when needed, the time to finalise Basel III has come.

Thank you. I wish you all an enjoyable and productive conference.