Strong together: the benefits of international cooperation

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Introduction

Good evening, everyone. Let me thank Claudia Buch and José Manuel Campa for inviting me to speak tonight. I would also like to congratulate all of those involved in the European Banking Authority and the ECB's Single Supervisory Mechanism, past and present, for being a model for supervisory and policy cooperation for over a decade.

As I represent an institution whose mission is to support central banks in their pursuit of monetary and financial stability through international cooperation, the theme of this year's conference, "Addressing supervisory challenges through cooperation", is one that resonates with me.

The Bank for International Settlements (BIS) has placed international cooperation at the centre of its efforts for over 90 years. It is part of who we are. To us, and I'm sure to most people in this room, the benefits of cooperation are self-evident.

But this attitude is not universally shared. In many forums, those advocating to weaken national implementation of regulatory standards are undermining global cooperation efforts to foster a safe and sound banking system. So, it is critical that we proactively make the case for cooperation in the interests of financial stability.

Against this backdrop, I would like to spend my time this evening reflecting on some of the most significant benefits of cooperation, before discussing some of the challenges that lie ahead.

The benefits of international cooperation

Jurisdictions globally face common challenges, which require common solutions. The importance of global cooperation in this respect has long been recognised. The growth of international trade in the 20th century hastened the growth of international banking and finance. This, in turn, necessitated the development of international standards to govern these activities and to reduce the risks associated with them.

As financial markets and banking systems have become increasingly global, so too has the importance of international standards. They provide a common language and signalling device for market participants. In doing so, they improve efficiency by reducing regulatory fragmentation and associated compliance costs. This facilitates cross-border banking activities and a more integrated international financial system, helping to support global prosperity.

It is also possible that without commonly agreed international standards, competition among regulators could lead to lower requirements.[1] One should not overemphasise this point – many jurisdictions set their standards above the global minimum, reflecting the intrinsic benefits of a sound regulatory environment. Nonetheless, it could still be the case that individual regulators may not internalise the positive spillovers of banking regulation, or they have the incentive to lower requirements for domestic banks to provide them with a competitive advantage, at least in the short term. Global cooperation prevents a "race to the bottom".

The Basel Process and the Basel III reforms

Through the Basel Process, the BIS acts as a forum for cooperation among policymakers. The internationally agreed standards developed by the BIS committees are perhaps the most visible examples of this cooperation. In fact, the best known committee, the Basel Committee on Banking Supervision (BCBS), this year celebrates 50 years of global supervisory cooperation.

And yet, despite its efforts to promote banking and financial system stability, the Committee's flagship standard – the Basel III Framework – has received some criticism lately. The appropriate level of bank capital requirements, in particular, has attracted a robust and often quite public debate, reflecting differing views among supervisors and industry about where to draw the line to ensure both institutional soundness and financial stability. As implementation efforts have been delayed and, in some cases, diverged from the agreed minimum standards, some have even questioned whether all jurisdictions will fully implement the reforms.

In this regard it is worth emphasising that Governors and Heads of Supervision of all BCBS member jurisdictions have repeatedly stated their support for full and consistent implementation of Basel III as soon as possible.[2]

I fully endorse this view. And let me address head on those who have called into question the Basel Framework and years of international cooperation. The Basel III reforms have been an enormous success, and global cooperation is critical to safeguard the global banking system. The

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[1] See G Dell'Ariccia and R Marquez, "Competition among regulators and credit market integration", *Journal of Financial Economics*, vol 79, no 2, February 2006, pp 401–30.

[2] See BIS, "Governors and Heads of Supervision reiterate commitment to Basel III implementation and provide update on cryptoasset standard", press release, 13 May 2024.

reforms have delivered a clear improvement in banks' resilience in terms of both their solvency and liquidity.[3] And they will be implemented in full.

Compliance with common international standards provides valuable information and engenders trust in markets globally. One of the enduring lessons from both the Great Financial Crisis and more recent stress episodes in particular banking systems was that without reliable and trustworthy metrics for assessing the strength of financial institutions, investors will indiscriminately withdraw funds in a crisis and in turn the confidence of depositors can be shaken. Therefore, the value of these common metrics – to society, market participants and the banking industry – should not be underestimated.

Beyond the quantifiable measures of resilience, the Basel Framework also provides a common international language and acts as an important signalling device. Having common metrics allows market participants to measure, for example, banks' credit, market and liquidity risks in a comparable way. Consider the example of last year's banking turmoil. Without commonly understood metrics for risk-based capital and liquidity, how would supervisors and market participants have assessed the strength of individual institutions?

Crafting international standards is a complex task. While all efforts are made to reach broad-based consensus, there will inevitably be some frictions from national interests that do not always align. Therefore, we have deliberately adopted a "soft law" approach that aims to develop minimum standards. While not directly legally binding, the "soft law" nature of the Basel Framework provides a good balance between technical expertise, speed, flexibility and political accountability.

This last factor – political accountability – is critically important. The Basel Committee sets global standards. But it is for individual jurisdictions to implement them.

Each jurisdiction implements the Basel III standards in its own way. And each can choose to go beyond the minimum standards to account for the specific risks to their banking systems as well as their own risk tolerance. This flexibility is not a weakness in the framework's design, but rather serves as an underlying strength.

Importantly, cooperation is not limited to developing global standards. The "softer" elements of cooperation can be just as powerful and important, including the social capital and trust built among central banks and supervisory authorities. Neither Basel III nor prudential supervision more broadly aims to achieve a zero-failure regime. There will be crises in the future, so it is essential that supervisors continue to maintain and refine their approach to supervisory cooperation.

The Basel Process has worked well to provide a solid foundation for global financial stability. By raising the overall levels of capital and liquidity in the banking system, it enhances banks' resilience, supports confidence and limits contagion. As "regulatory fatigue" and "short memories" weaken incentives to act, last year's banking turmoil serves as a reminder of the urgency of

[3] See BCBS, *Evaluation of the impact and efficacy of the Basel III reforms*, December 2022.

completing the task. So let me reiterate the importance of the Basel III reforms being fully implemented in all major jurisdictions.

Challenges ahead

Let me now turn to future challenges.

In banking and finance, the need for ongoing cooperation has only increased over time. Banking activities remain inherently cross-border, with the largest global banks operating across multiple jurisdictions. For example, the cross-jurisdictional claims of global systemically important banks have increased by 59% since 2013, to over €25 trillion, and have also increased as a proportion of total exposures.[4]

Now, perhaps more than ever, when the challenges facing the global financial system are increasingly cross-border and cross-sectoral, there is a need for international cooperation. New and emerging risks, such as those arising from digitalisation, climate-related financial risks and non-bank financial intermediation, require enhanced cooperation with a broad range of stakeholders.

Consider the example of the ongoing digitalisation of finance. This development may amplify traditional financial risks – for example, liquidity stress may become more acute due to the speed at which deposits can be withdrawn, while the use of automated models may exacerbate procyclicality. In addition, it is also likely to introduce risks and challenges that have not traditionally been within the remit of banking supervisors. For example, heightened cyber risks and sophisticated digital fraud, concentration risks associated with a reliance on critical third parties, the ethics of using artificial intelligence (AI) models, and the appropriate use and governance of personal data. So, while cooperation with other financial sector authorities, such as securities and conduct regulators will be needed, it is also likely that cooperative efforts will need to extend further to also include competition, privacy and security authorities.[5]

As the demands on supervisors grow, it is important to ask whether they are appropriately resourced and who should pay the bill. It is critical that supervisory authorities have sufficient funding and operational independence. They need to be able to attract and retain the right human capital and to make the necessary investments in technology to equip their staff with the tools they need. Funding models, including the use of industry levies, may need to be revisited to ensure that supervisors can continue to fulfil their mandates.

Recent advances in AI warrant particular attention. It is essential that supervisors keep abreast of banks' uses of this technology. And supervisors should seek to identify ways in which it can

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[4] Based on end-2022 data. Over the same period, total exposures for global systemically important banks increased by 55% (BCBS, G-SIB Framework: Denominators); see also M Libertucci et al, "G-SIB denominators and scores dynamics: a ten-year assessment", *BCBS Working Papers*, no 41, March 2024.

[5] See P Hernandez de Cos, "Building on 50 years of global cooperation", speech at the 23rd International Conference of Banking Supervisors, Basel, 24 April 2024.

augment their own supervisory capabilities. Working with AI, however, requires skills that will be in short supply in most supervisory agencies. It is important that authorities can afford to hire and upskill staff in areas such as data science, model development and model validation to keep pace with the latest technological developments.

While digitalisation-related developments may present new risks, they may also help central banks and supervisors to address some key challenges. Here is an area that is ripe for international cooperation. There is significant value in fostering greater cross-border collaboration to build supervisory capacity and to develop tools to address these challenges. Working together to develop new toolkits would allow supervisors to learn from others' experiences and to reap economies of scale and other efficiencies through pooling and sharing resources. The BIS Innovation Hub provides a model of cooperation that could be further utilised by authorities. The various joint projects provide an opportunity to cooperate not only with regulatory and supervisory peers but also with industry participants, using technology to work towards addressing some of the most pressing challenges.

Conclusion

Let me conclude with the reminder that financial stability is a public good, the maintenance of which requires effective international cooperation. After all, past crises have taught us that financial instability that emerges in one jurisdiction can quickly spread to others. In the financial sector, the "soft law" model we have developed for regulatory and supervisory cooperation has worked well.

Given that many of the challenges we have are global in nature, they will invariably call for global solutions. The BIS will continue to promote cooperation among central banks and financial supervisory authorities to foster global financial stability. I look forward to many more years of strong partnership with the European Banking Authority and the ECB's Single Supervisory Mechanism in this endeavour.