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The Basel Committee on Banking Supervision in the Post-crisis International Governance of Banking Regulation

Continuity Despite Weakness

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6.1 INTRODUCTION

The regulatory regime applicable to the banking sector consists of multiple sets of principles, rules, and standards: international, regional, and national law; hard law and soft law; public law, private law, and private rules; political and technical decisions. Although to varying degrees, each component of that regime plays a part in the setting of goals to be pursued and standards of conduct to be followed. As the components or/and their combination change so does the regime as a whole and thus its functioning. The regulatory regime applicable to the banking sector can therefore be thought of as an ecosystem characterized by diversity and interdependence.

But is the ecosystem of banking regulation also characterized by resilience – another essential characteristic of ecosystems? What drives the evolution of that regime and what explains its resilience, particularly in the face of a crisis, such as the financial crisis of 2007–2008?

The remainder of this chapter is organized as follows: first, we introduce the Basel Committee on Banking Supervision and the standards its members develop. Second, we survey the failures of the Basel regime leading to the global financial crisis of 2007–2008 and some possible explanations thereof. Then, we discuss the reasons why the fundamental features of the regime are still in place even after its evident inadequacies and why the reforms adopted in the wake of the crisis are a way to safeguard the resilience of such features.

6.2 THE BASEL COMMITTEE OF BANKING SUPERVISION (BCBS) AND THE REGULATORY REGIME FOR BANKING

The cross-border trade of goods and services, foreign investment, and finance as well as other activities central to the functioning of the global economy are each

https://doi.org/10.1017/9781009329408.009 Published online by Cambridge University Press

governed by distinct legal and regulatory regimes. All those regimes carry out the same three basic regulatory functions, that is, rule or standard-setting, monitoring, and enforcement. However, the way in which these functions are discharged differs a great deal. While the regimes in trade and in foreign investment mainly rely on binding international law, the most important components of the regulatory regime in banking are international soft law and national law.[1] The structure of the international financial architecture is characterized by what has been called "Transnational Regulatory Networks,"[2] or "loose network of soft-law standard setters,"[3] or "International regulatory forums."[4] The ecosystem that has the Basel Committee of Banking Supervision (BCBS or Basel Committee) at its epicenter is emblematic of the regulatory regime in banking.

The BCBS is the most important international standard-setting body in the field of financial regulation. Its remit concerns banking regulation and particularly prudential requirements of internationally active banks.

Established in 1974 by the central bank governors of the G10 group of countries, it currently has forty-five members from twenty-eight jurisdictions, consisting of central banks and authorities with formal responsibility for the supervision of banking business. Therefore, it is composed not of governmental representatives but of officials from domestic technocratic authorities; however, representatives from political institutions such as the European Commission sit as observers, a status that in practice is equivalent to proper membership. The internal organizational structure of the Basel Committee comprises the Committee (the ultimate decision-making body), Groups, Working Groups, and Task Forces, the chairman and the secretariat. The Committee can be analyzed against the three regulatory functions of standard-setting, monitoring, and enforcement.

The Basel Committee's main objective is financial stability. Its Charter states that its "mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability" (Section 1).[5] A minimum harmonization of national or regional banking laws and regulation protects fair competition and particularly prevents banks that are subject to adequate prudential requirements from being at a competitive disadvantage relative to banks coming instead from more permissive jurisdictions. In this way, a related objective is being pursued by the BCBS, that is, to prevent a dangerous and unfair inter-jurisdictional competition in laxity in the field of banking.

1 R. Lastra, Do We Need A World Financial Organization? (2014) 17 *Journal of International Economic Law* 787; C. Brummer, Why Soft Law Dominates International Finance – and Not Trade (2010) 13 *Journal of International Economic Law*, 623.

2 E. Avgouleas, *Governance of Global Financial Markets: The Law, the Economics, the Politics* (2012) 2; A.-M. Slaughter, *A New World Order* (2004).

3 Lastra, *supra* note 1, at 795.

4 See, for example, N. Moloney, Institutional Design: The International Architecture, in *The Oxford Handbook of Financial regulation* (N. Moloney et al. eds., 2015), 129, at 145.

5 Basel Committee Charter, www.bis.org/bcbs/charter.htm.

The BCBS has become a synonym for powerful international sources of informal law. The principles and standards that are adopted by the Committee are widely implemented at the domestic level, not only in its members' legal systems but also in third-country jurisdictions. Informality is a feature characterizing the very nature of such an entity, as well as its decision-making processes and the legal nature of the standards it adopts. Its Charter is not an international treaty. The BCBS is not an international organization, nor does it possess any legal personality; agreements reached internally by its members do not formally constitute a source of law. As explicitly stated in its Charter, "The BCBS does not possess any formal supranational authority. Its decisions do not have legal force. Rather, the BCBS relies on its members' commitments, as described in Section 5, to achieve its mandate." The BCBS represents an international forum for the "negotiation" and development of principles and standards aimed at protecting a sound international financial system.

The BCBS is part of a wider system, composed of international and national principles/rules/standards and actors (BCBS-system). The BCBS' standards, as essential as they are, constitute only a segment of a composite legal regime, in which further important and complementary roles are played inter alia by the Group of 20 (G20)[6], the Financial Stability Board (FSB),[7] and national authorities. The G20, the FSB, and the BCBS are all sources of decisions meant to be implemented by domestic regulators in their own legal system.[8] In line with the organizing principle of specialization and division of labor, each plays a different role in the regulation of banking markets.[9] Collectively, they provide some of the legislative, executive, and technical components of financial regulation that find their way into domestic jurisdictions and applied to financial institutions by domestic regulators. The G20 "specializes" in taking meta political decisions, while the FSB focuses on proposing

[6] The G20 is a forum for discussion of financial and economic issues between a mix of the world's largest advanced and emerging economies, representing about two-thirds of the world's population, 85 percent of global gross domestic product, and over 75 percent of global trade. The G20 started in 1999 as a meeting of finance ministers and central bank governors in the aftermath of the Asian financial crisis. Since 2008, the G20 Leaders' Summit is held annually, comprising prime minister/heads of state, finance ministers, and central bankers. Such summits have played a key role in responding to the global financial crisis.

[7] The FSB was established in 2009 when the G20 London Summit took the decision to transform the Financial Stability Forum into a body with an enhanced institutional role with regard to safeguarding the stability of the international financial system. The statutory objective of FSB is to coordinate multi-sectorial regulatory activities of domestic regulators directly and through international networks of regulators (e.g., IOSCO and BCBS). Compared with the G20, the FSB has more of an executive role. As requested by the G20, the FSB also develops general principles and standards on specific topics.

[8] D. Zaring, The Emerging Post-crisis Paradigm for International Financial Regulation, in *Comparative Law and Regulation. Understanding the Global Regulatory Process* (D. Zaring and F. Bignami eds., 2016), 497, at 502.

[9] M. Ortino, The Governance of Global Banking in the Face of Complexity 2019 *Journal of International Economic Law* 1.

and implementing these decisions by coordinating technical decision markers, and, finally, the BCBS works to articulate prudential banking regulatory and supervisory standards. In 1988, the Committee adopted the Capital Accord, also known as "Basel I," which underwent a radical revision in 2004, known as "Basel II." Finally, in response to the 2007–2008 global financial crisis, the Basel Committee members approved a comprehensive package of reforms collectively known as "Basel III." These reforms have sought to address problems in the banking system exposed by the global financial crisis, including unsustainable levels of leverage, insufficient high-quality loss-absorbing capital, excessive variability of banks' modeled risk-weighted assets, a mispricing of liquidity risk, and the buildup of system-wide risks.

Since its creation, there has been a progressive expansion of the BCBS' mandate, of its membership as well as of its capacity to influence the content of domestic banking regulation and supervision. This trend has continued even after the global financial crisis, which as it is well known was triggered in the banking sector. Interestingly, in the wake of the crisis, there has been a further increase in the BCBS' powers and scope of influence, notwithstanding the fact that its standards not only were not able to prevent the crisis but in fact contributed to its outbreak and spread. The Basel Committee was in fact part of the problem, not part of the solution. According to Rodrik, the BCBS

> has produced largely inadequate agreements. The first set of recommendations (Basel I) encouraged risky short-term borrowing and may have played a role in precipitating the Asian financial crisis. The second (Basel II) relied on credit rating agencies and banks' own models to generate risk weights for capital requirements, and is now widely viewed as inappropriate in light of the recent financial crisis. By neglecting the fact that the risks created by an individual bank's actions depend on the liquidity of the system as a whole, the Basel Committee's standards have, if anything, magnified systemic risks.[10]

6.3 THE WEAKNESSES OF THE BCBS

The failings of the BCBS system can be found in all of its basic regulatory functions: standard-setting, monitoring, and enforcement. They are interconnected weaknesses that feed into one another.

With respect to standards setting, there is a partial conflict between the goal formally attributed to them by the BCBS, that is, international financial stability, and the goals that individual members in the Committee may ascribe to them, that is, the protection and competitiveness of their own national banking sector. The compromises that often follow from this conflict detract from the realization of the statutory purpose of the Committee.

[10] D. Rodrik, *The Globalization Paradox: Why Global Markets, States, and Democracy Can't Coexist* (2011), at 224.

https://doi.org/10.1017/9781009329408.009 Published online by Cambridge University Press

Further, the substantive content of the standards adopted by the Committee has been found wanting, in at least three respects. First, the conduct prescribed for the banks by the standards tends to be insufficiently rigorous for the stability of the financial system. The inadequate technical quality of the Basel standards is exemplified by the excessively low capital requirements and the reliance on self-regulation in the form of banks' own risk assessment determinations. In this respect, Basel II mirrored the inadequacies of national banking regulation and supervisory practices, particularly in the United States, in the years leading to the crisis.

The inadequacy of Basel standards in their specific prescriptions and level of harmonization have various causes, including insufficient understanding of financial markets, regulatory capture, and national interests. The financial crisis revealed gaps in the policymakers' understanding of the functioning and effects of financial markets and of financial and technological innovation, especially in terms of risks to the general well-being.[11] This gap – which private interests have taken advantage of – has given rise to flawed economic theories and misconceptions, which in turn have produced ineffective banking regulation, both at the international and at the national level. Lastra points out that before the crisis widespread was "the belief . . . that financial markets are best left to their own devices."[12] The substantive regulatory flaws in the Basel standards stemmed, in large part, from the failure of the Anglo-American legal and theoretical framework in the field of financial regulation, which constituted until 2007 the reference model for the definition of the international standards regime.

Furthermore – stressing the "capture" explanation for the failings of Basel – Rodrik states that "if the regulations were written by economists and finance experts, they would be far more stringent."[13] The "over-reliance on private sector input"[14] evident in the Basel standards – and deemed as one of the reasons of their failure – is probably the product of both gaps in the policymaker's understanding of the functioning and effects of financial markets and of financial and technological innovation and regulatory capture. Furthermore, the wide range of national preferences and interests that confront each other at the Basel negotiation table tends to

[11] Avgouleas, *supra* note 2, at 3–4, who describes the financial revolution as a knowledge revolution. The complexity of banking and of banking institutions has reached such a level that a proper level of understanding is not only missing in banking supervisory authorities but even within the private side of the sector. According to R. P. Buckley, The Changing Nature of Banking and Why It Matters, *Reconceptualising Global Finance and Its Regulation* (R. P. Buckley et al. eds., 2016) 11, at 25: "It is apparent from multiple discussions with bankers that while each may well understand their own role well, very few bankers, and only those at the very highest levels of the bank, actually understand the bank's entire business."

[12] Lastra, *supra* note 1, at 797.

[13] D. Rodrik, *Straight Talk on Trade: Ideas for a Sane World Economy* (2018), at 129. On regulatory capture in international banking regulation, see K. Alexander, *Principles of Banking Regulation* (2019), at 73–77.

[14] Avgouleas, *supra* note 2, at 2.

result in poor regulatory compromises, consisting in weak and ineffective standards.[15]

Second, because of ongoing conflicting national interests, the level of harmonization reached in the Basel agreements is usually not high enough to prevent the negative effects of a regulatory competition or the "race-to-the-bottom" problem. Particularly when the standards affect politically sensitive domains, they tend to be weaker.

Third, when a substantial degree of harmonization is achieved, the standards are often not adequate to the needs of many countries, particularly the less developed ones. This is because they are conceived to suit, in the first place, the more advanced economic and banking systems of the real rule-making members in the BCBS.

Some of these failings have a common institutional underlying factor: the Basel Committee's decision-making structure and process. The BCBS' governance structure failed to produce effective regulations and supervisory standards; first, because it lacked transparency, accountability, and legitimacy, thus enabling, among other things, special interest group pressure from major banks and international finance associations to have disproportionate influence on the regulators that were members of the Committee, stirring the process in their favor and to the detriment of an adequate regulatory outcome.[16] And second, because the countries and the banking industry that developed the standards did not consult countries that were not members of the Committee (mainly developing and emerging market economies).

The Basel system has proven to be inadequate also with respect to enforcement. In fact, many commentators, be they academics or regulators, seem to hold the belief that the single biggest institutional failing of the BCBS is not its standard-making structure and process but on the enforcement side. According to this view, Basel standards were not effective in preventing the 2007–2008 financial crisis because they were poorly implemented at the domestic level, in the sense that implementation, and as a result enforcement, was lacking or varied across jurisdictions. Agreed standards were not (fully) adopted in some jurisdictions or were not uniformly implemented or enforced across national legal systems, to the detriment of international financial stability and the level playing field. Therefore, what attracts a great part of the commentary on the Basel institutional system is its failure to properly carry out the enforcement function. For example, according to Lastra, the global banking system requires legal and institutional changes especially at the surveillance and enforcement stages, rather than in the law-making function.

[15] D. Howarth and L. Quaglia, The Comparative Political Economy of Basel III in Europe (2016) 35 *Policy and Society* 205, at 212, examining how the preferences of European regulators on Basel III explain "the disagreements that emerged in Basel and ultimately the weakness of the reforms eventually agreed by the BCBS, despite the severity of the international financial crisis."

[16] Alexander, *supra* note 13, at 73–74.

https://doi.org/10.1017/9781009329408.009 Published online by Cambridge University Press

While formal international standard-setters like the Basel Committee are "adept" at the regulatory function and thus "can continue with their rule-making role," what is really missing is an effective enforcement of these standards.[17]

The reasons for inadequate implementation and enforcement are various and to a certain extent link back to the function of standard-setting. First, the non-binding nature of Basel standards means that any deviation from them is, from a strictly legal point of view, formally costless for national jurisdictions. This makes it easier for domestic interests – be they public and/or private, general or special – when it is time to implement or enforce these standards, to prevail over conflicting international commitments and the goal of international financial stability. Second, as already mentioned, Basel standards, to the extent that their regulatory content is determined by the most influential members of the Committee, may not be adequate for the other jurisdictions and their specific economic and financial system. This is particularly the case of nonmember countries from less economically advanced part of the world, which are not even represented in the Basel negotiations. These other countries are likely to proceed at best with a lukewarm implementation, also because a full implementation can be disproportionately costly.[18]

6.4 THE RESILIENCE OF THE BCBS

6.4.1 *Exogenous Factors Accounting for Resilience*

The most characteristic component of the BCBS regime, that is, the soft-law nature of its standards and the related informality of the standard-setting body, is unlikely to be replaced anytime soon. According to Arner, "outside of the EU, there continues to be very limited interest in moving from soft law to hard law approach to international financial regulation."[19] What explains the continued resilience of the BCBS and its standards?

At least four exogenous factors can explain this resilience. First, a certain degree of institutional inertia or path dependency certainly contribute to the continued relevance of the BCBS and its standards.[20] A radical transformation of the regulatory approach, like the switch from an informal network of national regulators to a proper hard-law organization or agreement would be, conceptually and practically, more difficult to put in place than incremental revisions of the status quo. This is particularly true in a regulatory space as complex as international banking, which

[17] Lastra, *supra* note 1, at 800–801.

[18] C. Monticelli, *Reforming Global Economic Governance: An Unsettled Order* (2019), at 163.

[19] D. Arner, The Politics of International Financial Law, in *The Changing Landscape of Global Financial Governance and the Role of Soft Law* (F. Weiss and A. J. Kammel eds., 2015), 81, at 89.

[20] P.-H. Verdier, The Political Economy of International Financial Regulation (2013) 88 *Indiana Law Journal* 1405.

https://doi.org/10.1017/9781009329408.009 Published online by Cambridge University Press

does not simply or mostly provide for liberalization measures (like the trade and the foreign investment regimes) but instead entails the harmonization of national regulation of financial institutions and activities. The latter task becomes even more difficult to carry out if the political conditions at the international level are missing, as when international multilateralism is receding and replaced by a stronger unilateral or bilateral approach to international relations.

Second, soft law provides a series of practical and legal advantages that make it a very useful – and thus resilient –instrument of setting standards in the field of banking, domestically and internationally. Generally, soft law represents a sort of regulatory compromise between conflicting needs. It is still law but without the obligation to comply with many substantive and procedural legal requirements that are attached to hard law. It carries out the same principal regulatory function as hard law, namely, standard-setting, but generally with more flexibility, speed, and technical expertise and much less formality. This is why soft law is extensively relied upon, especially by specialized agencies, in the field of financial services. The latter is characterized by technical complexities and by the speed of financial and technological innovation and market developments. For its flexibility and malleability, soft law is particularly suitable to cope with the infinite variations of regulated financial activities and institutions.

The same underlying reasons explain the use by the BCBS of soft law as opposed to binding international legal acts. Soft law standards represent the useful compromise to solve the tension between, on one side, the BCBS members' lack of legal authority and legitimacy to impose international hard law prescriptions and, on the other side, the need for cross-border regulatory and supervisory consistency. Similarly, BCBS' soft law standards and principles are meant to solve the tension between an international regulation sufficiently ambitious and universal in its applicability and appropriately transparent to be assessable by market participants and national authorities,[21] with the need for some degree of flexibility in their implementation and enforcement so as to be compatible with different legal and economic systems.[22]

The third factor behind the resilience of soft law in international banking regulation is the protection of certain interests by and in major countries, which makes the latter ambivalent about stepping up international cooperation. Such interests want to gain from international coordination by promoting some degree of inter-state commitment, while avoiding the costs associated with proper hard law agreements. In its standard-setting function, the Basel regime is shaped in a way as to simultaneously increase the advantages and reduce the disadvantages of international coordination in the banking field as much as possible. On the one hand, by providing some degree of conduct harmonization across global financial markets

[21] Monticelli, *supra* note 18, at 148.

[22] C. Brummer, *Soft Law in the Global Financial System: Rule-Making in the 21st Century* (2015).

through common standards and the relative behavior-changing mechanisms, the regime narrows down the margin for regulatory race to the bottom and reduces the sources of international financial instability. On the other hand, the absence of formal binding obligations and dispute resolution systems simplifies the efforts to adjust – if, when, and to the extent necessary – the national implementation and enforcement of international standards according to conflicting (public or private) domestic interests. Verdier[23] has highlighted three domestic actors that are keen on leveraging the characteristics of the Basel regime to further their own interests, even if it is to the detriment of internationally agreed policy goals: developed jurisdictions (such as the United States, the United Kingdom, and the EU), their financial industries, and their specialized financial regulators. According to this account, the pursuit of their own interests by these three forces has greatly contributed to the decades-long resilience of an international regulatory approach based on non-binding standards and on delegated and somewhat discretionary implementation and enforcement. Thus, soft law will remain the dominant legal form in international banking regulation until for those actors its benefits exceed the costs or until other actors and interests prevail.

Finally, the fourth exogenous factor, strengthening the resilience of the Basel regime, has to do with political international credibility. National implementation of what is agreed in the BCBS has also an important international political dimension. Since 1974, the BCBS standards, once adopted by its members by consensus, have been endorsed by the Group of Central Bank Governors and Heads of Supervision (originally of the G10). However, since 2008, the G20 has started holding summits at the level of heads of state or government; and in that composition in November 2010 (G20 Seoul Summit), it endorsed the Basel III agreement.

Therefore, through its highest-profile political composition, the G20 has brought to the international economic governance of financial markets a higher level of political and institutional commitment. The latter in turn can bring a higher degree of legitimacy and authority to international legal standards. More specifically, while remaining soft law, the BCBS standards can become a little "harder" because of the official commitment by the highest-level political institutions to their implementation at the domestic level. The mechanism increasing the standards' compliance pull is not strictly legal but political: it is a question of international credibility. If and to the extent that international political commitments are not followed through by a country's domestic institutions, damaging consequences can follow in terms of reduced international credibility, and thus of future negotiation strengths, of that country and of its internationally active representatives and organs (starting from the very central bank and supervisory authorities that sit in the BCBS).

[23] Verdier, *supra* note 20.

6.4.2 *Endogenous Factors Accounting for Resilience*

After having highlighted the most important exogenous drivers of the resilience of the Basel regime, it is important to turn to the endogenous factors.

The fact that international financial regulation is still based on soft law standards does not mean that the reforms that have been introduced within the Committee after the start of the crisis have left such component unchanged. Rather, the reforms can be viewed as an attempt to reconcile the almost inevitability – at least for now – of having to rely on soft law standards with the need to reduce the weaknesses of this very type of regulatory approach. In other words, the changes brought to some parts of the international regime of banking are meant to make up at least partially for the continued reliance on an informal standard-setting body and nonbinding legal standards, so as to have the advantages of soft law while reducing its drawbacks as much as possible. At least to some extent, these changes contribute to the resilience of the regime, in an attempt to avoid more radical reforms.

In this regard, two important endogenous factors in the resilience of the Basel regime will be highlighted below:[24] the membership enlargement of the BCBS and the BCBS internal mechanism of peer assessment (of the two, the latter will be examined in more detail). These reforms can be seen as means to improve especially the implementation and enforcement of BCBS standards, notwithstanding their continued soft-law nature. In some way, the objective of such reforms is to make the BCBS standards less soft, not in a formal sense but de facto, that is, to facilitate, or apply pressure for, a higher degree of compliance, even in the absence of a legally binding obligation.

6.4.2.1 Extended Membership

The first reform, which could improve the implementation of BCBS standards, is the broadening of the Basel Committee's membership. The expansion was decided

[24] To be sure, these are not the only relevant reforms enacted at the international level. As regards the functions of standard-setting, for instance, as already mentioned, in 2009 there was the establishment of the Financial Stability Board (replacing the Financial Stability Forum), which, as a mix of political and technocratic support of the G20, has been given the task of agenda setting and coordinating the work of international standard-setting bodies (including the BCBS). Instead, as regards the function of monitoring, the surveillance of compliance has been strengthened: the IMF and the FSB have made Financial Sector Assessment Program (FSAP) a regular part of their members' obligation as well as imposing publication of their results (International Monetary Fund, Press Release, IMF Expanding Surveillance to Require Mandatory Financial Stability Assessments of Countries with Systemically Important Financial Sectors [September 27, 2010], www.imf.org/en/News/Articles/2015/09/14/01/49/pr10357). Additionally, in 2009, the FSB set up a series of peer review mechanisms to monitor the progress made by its members in implementing FSAP regulatory and supervisory recommendations (for a description and a list of relevant documents: www.fsb.org/work-of-the-fsb/implementation-monitoring/peer_reviews/).

and took place in 2009, carrying forward the call from G20 leaders for major standard-setting bodies, including the FSB and the BCBS, to review their membership.[25] By involving additional countries and making them part of the standard-setting process, two beneficial effects can arise, at least in principle. Due to the involvement and representation of additional jurisdictions, the standard-making process – and the resulting standards – might be seen as more legitimate. Furthermore, in this way, also less influential countries' financial and economic needs and specificities are more likely to be taken into account and incorporated in the final agreements. Consequently, the final BCBS standards can be more easily accepted, and thus more consistently implemented, by a wider network of countries. However, whether and to what extent these effects are effectively going to materialize is another matter.

6.4.2.2 The BCBS' Peer Assessment Program

The second reform that can increase the compliance pull of BCBS standards is the Regulatory Consistency Assessment Program (RCAP) established within the Basel Committee in 2012 for monitoring and evaluating the adoption and implementation by its members of its agreed standards. The program can work in synergy not only with the political credibility-based implementation mechanism mentioned above but also with other functionally equivalent mechanisms normally associated with nonbinding international financial law. As explained below, these mechanisms are based on market discipline and on the possible regulatory reaction and retaliation by foreign financial banking regulatory and supervisory authorities to deviations from Basel agreements.

The RCAP consists of two distinct but interlinked parts: the monitoring of timeliness and the assessment of consistency. The first part monitors the timely adoption of Basel standards. It takes place every semester and is based on the data provided by each member. The second part assesses the consistency and completeness of domestic implementing measures, highlighting possible deviations from agreed standards.

The second part results in a "report card" given to each individual member regarding compliance with the commitments undertaken within the Committee. The report card contains two evaluations. Each assessed jurisdiction receives a grade concerning the key components of a specific legal framework (e.g., risk-based capital framework) and a grade on the framework as a whole. The best grade that members can obtain is "compliant," where all the minimum requirements have been observed; the second highest rating is "largely compliant," where only the main

[25] See www.bis.org/press/p090313.htm. Nout Wellink, chairman of the Basel Committee, stated that "this expansion in membership will enhance the Committee's ability to carry out its core mission, which is to strengthen regulatory practices and standards worldwide."

https://doi.org/10.1017/9781009329408.009 Published online by Cambridge University Press

standards have been met; negative judgments of "'materially non-compliant" follow, when fundamental provisions are not met or differences have been found between international standards and domestic legislation capable of seriously affecting financial stability or conditions of equal competition at international level; and of "non-compliant," when the applicable Basel requirements have not been adopted or differences have been found that could seriously affect financial stability or international competitive parity.

The assessment part of the RCAP has two strands: jurisdictional peer reviews and thematic assessments of regulatory outcomes. While the first concerns the assessment of domestic legal regimes, the other concerns banks, in the sense that in addition to evaluating the correspondence between the standards and the legal regimes adopted by the individual jurisdictions, the application of the same standards by individual banks (sampled) is also assessed to determine whether, how much, and how this application diverges across banks and countries.

The part of the RCAP that most interests the present analysis is jurisdictional assessment, due to its relevance as a monitoring mechanism that is aimed at promoting consistent domestic adoption and implementation of the Basel standards. The objectives, the object, the parameters, and the evaluation procedures are illustrated in a guide prepared by the Committee: the Handbook for Jurisdictional Assessments.[26] The guide explains the complete assessment program and describes the RCAP questionnaires, which member jurisdictions complete ahead of the assessment and update regularly.

The evaluation of individual legal regimes aims to promote the full and correct implementation of the Basel standards by the members of the Committee. To this end, the RCAP identifies domestic rules and requirements applied to international banks that are not in line with the letter or spirit of the relevant Basel standards. The assessment relates to domestic regulations aimed at regulating the aspects covered by Basel standards, while a broader analysis on the functioning of the regulatory framework and the effectiveness of supervision is not carried out.

The evaluation process is divided into several phases and involves various institutional actors. After a preparatory and preliminary phase, there is the evaluation phase focused on the work of the Evaluation Group (the Assessment Team) set up ad hoc for the preparation of a draft report; then there is the revision phase in which a different Group – the Review Team – reexamines the draft report and then transmits it together with its observations to other bodies (the Peer Review Board [PRB] and the Supervision and Implementation Group [SIG]) "hierarchically" superordinate, for approval and possible sending to the Committee for discussion and final approval.

[26] BCBS, Regulatory Consistency Assessment Programme (RCAP). Handbook for jurisdictional assessments, March 2018, www.bis.org/bcbs/publ/d434.htm.

The pressure to comply with Basel standards exerted on members through the RCAP stems from the cumulative negative consequences that the publication of negative assessments can produce. Despite the euphemistic tones used in explaining the objectives of the RCAP – according to which its assessments "help member jurisdictions to undertake the reforms needed to make them more aligned with Basel standards"[27] – the implicit purpose is to increase the costs for those jurisdictions that decide to deviate from Basel standards. The main costs are of three types. First, there are reputational and credibility costs at the political level (G20 and FSB) and at the technocratic level (among the participants to the Basel Committee), which can negatively impact the strength of a member's future negotiation position. Second, there are market costs stemming from market discipline, if and to the extent to which national deviations from internationally agreed standards are perceived by market participants as a sign of weakness of the corresponding domestic banking system. And third, there are regulatory costs which derive from the additional legal requirements imposed across jurisdictions on internationally active banks whose country of origin deviate from Basel standards. Foreign regulators and banking supervisory authorities can deem those banks as a greater source of financial instability and/or can retaliate seeing such deviations as undermining the sought-after level playing field in the global banking market.

These deterrent effects are potentially the stronger the more authoritative the evaluation process and its final assessment – in addition to the substantive content of standards – is perceived. To this end, although these are in any case peer reviews, and therefore not carried out by an impartial third party, the RCAP is based on a procedure with various elements aimed at reasonably ensuring a "fair" evaluation.

The RCAP procedure does not end with the assessment but essentially provides for continuous control by the Committee on the subsequent progress made by the competent domestic authorities to correctly implement the Basel standards. Among other things, at least one year after the non-positive evaluation, the assessed jurisdictions must draw up a report indicating the legislative and regulatory amendments adopted or proposed to correct the nonfulfillment and gaps highlighted by the evaluation approved by the Committee. In addition, subsequent RCAP assessments may also include in the examination those elements of the domestic regime that in the previous assessment had been reported as being corrected. So, in essence, the RCAP monitoring mechanism exerts ongoing pressure on members. This pressure is further strengthened by the involvement of the more strictly political actors of international cooperation in economic and financial matters: for accountability, the BCBS periodically reports to the G20 and the FSB, in addition to other external stakeholders, on progress achieved in the implementation of the agreements concluded within the Basel Committee.

[27] Ibid., at 3.

Only time will tell if, even in the absence of any enforcement authority, this new monitoring mechanism will actually work in fostering "more consistent implementation through peer pressure and public identification of noncompliant jurisdictions."[28]

6.5 CONCLUSION

The fundamental question addressed by this chapter was what explains the resilience of the Basel Committee and its standards, particularly in the aftermath of the crisis. The Committee has been criticized much in the same way as private standard-setters and the delegation of rule-making powers to private bodies have.[29] In the European Union (EU), for example, the reliance on private standard-setters to achieve legal harmonization across Member States has been questioned for lack of legitimacy and accountability. Concerns have been expressed that their decision-making is not sufficiently transparent, prompting the risk of capture by the industry to be regulated and thus to the exclusion of other stakeholders' voice and interests.[30]

However, still in relation to EU law, these legitimacy concerns have not determined any real change of course on the part of EU policymakers, the reason probably being that the standard-setting process is deemed to be actually working.[31] In other words, the acceptance of such "non-democratic" bodies, processes, and networks may be based on their effectiveness on the ground and thus on output legitimacy. This sets these private standard-setters apart from the Basel Committee, whose standards have instead failed to concretely achieve their objectives, depriving such international regulatory approach of much of its output legitimacy.

This chapter has highlighted some of the reasons behind paradigm continuity in the post-crisis international governance of financial regulation, still dominated by an approach based on informal networks of national regulators. The decision, taken at the political (G20) and at technocratic (Committee) level, has been to favor incremental changes of the existing institutional structure and workings rather than a system overhaul. The chosen strategy is therefore to keep on relying on the Basel Committee and on nonbinding international standards, while introducing some institutional reforms to the way the BCBS system works in order to address at least some of its most problematic issues. In particular, important changes have been adopted with a view to making standard-setting more legitimate and receptive to a

28 N. Véron, *The G20 Financial Reform Agenda after Five Years* (2014), 1, at 6.

29 Alexander, supra note 13; M. Borowicz, The Internal Ratings-Based and Advanced Measurement Approaches for Regulatory Capital under the "Basel regime," in *The Governance and Regulation of International Finance* (G. Miller and F. Cafaggi eds., 2013), 167–208.

30 Ibid.

31 C. Barnard, *The Substantive Law of the EU* (2019), 597.

https://doi.org/10.1017/9781009329408.009 Published online by Cambridge University Press

wider range of national interests and specificities, and standards implementation more widespread and fuller across jurisdictions.

However, fundamental problems with the BCBS system have not been addressed (limited legitimacy, regulatory capture, disproportionate influence of some jurisdictions on the standard making process, lack of involvement of an adequately wide range of stakeholders also beyond the financial sector, lack of international dispute-settlement mechanisms, diversity of financial and economic systems across jurisdictions, etc.). The fact that not even a crisis as disruptive as the 2007–2008 global financial crisis was able to trigger enough political will and technical ingenuity to overcome the actual governance model – toward a more formal international law approach or, in the opposite direction, an increased nationalization/diversification of the prudential regulation of international banking[32] – is testament to the resilience of the factors – including path dependence, practicality, and the diversity of national regulatory preferences reflecting public and private interests – behind such model.

[32] Rodrik, *supra* note 13.