The political economy of post-crisis regulatory response: why does compliance with Basel vary?

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Growing international coordination of post-crisis regulatory response

- Contrast with regulatory unilateralism in 1930s
- Core Basel problem: agreeing minimum international standards, with growing focus on implementation
- “Over-compliance” (OC) seen as unlikely & unsustainable

But regulatory OC is common *and* persistent (Basel CARs)

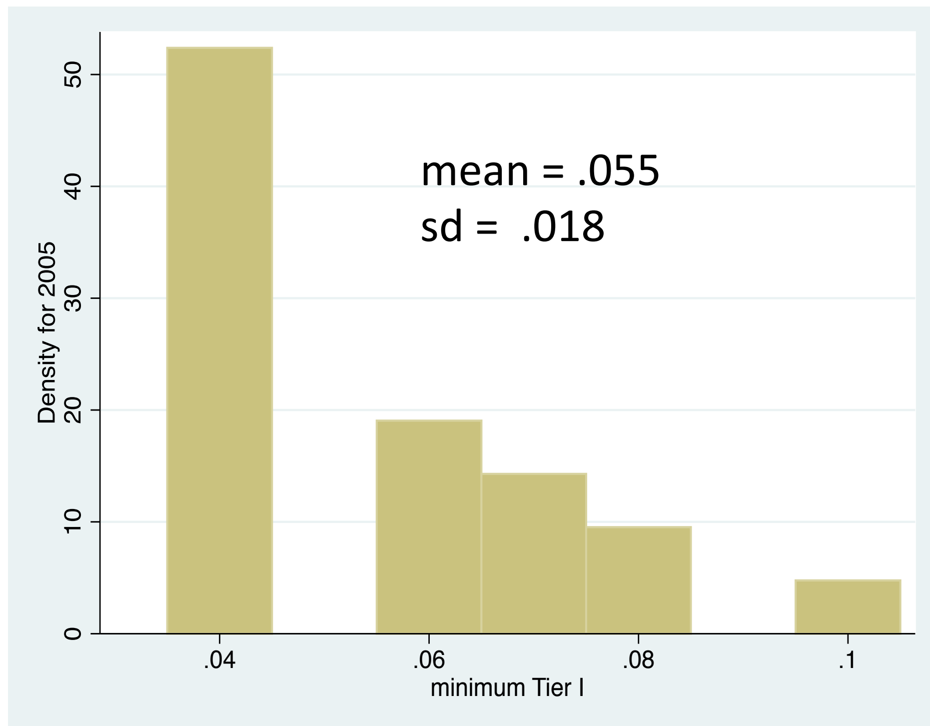
year	Count of minimum compliers (min. total CARs)	Count of overcompliers (min. total CARs)	Total countries	**% Overcompliers (min. total CARs)**	**MEMO: % Overcompliers (min. Tier 1 CARs)**
1999	66	32	98	**33%**	**17%**
2000	66	32	98	**33%**	**17%**
2001	71	52	123	**42%**	**14%**
2002	71	52	123	**42%**	**11%**
2003	71	52	123	**42%**	**4%**
2004	72	52	124	**42%**	**4%**
2005	79	53	132	**40%**	**4%**
2006	79	53	132	**40%**	**8%**
2007	79	53	132	**40%**	**8%**
2008	79	53	132	**40%**	**10%**
2009	79	53	132	**40%**	**10%**
2010	79	53	132	**40%**	**10%**

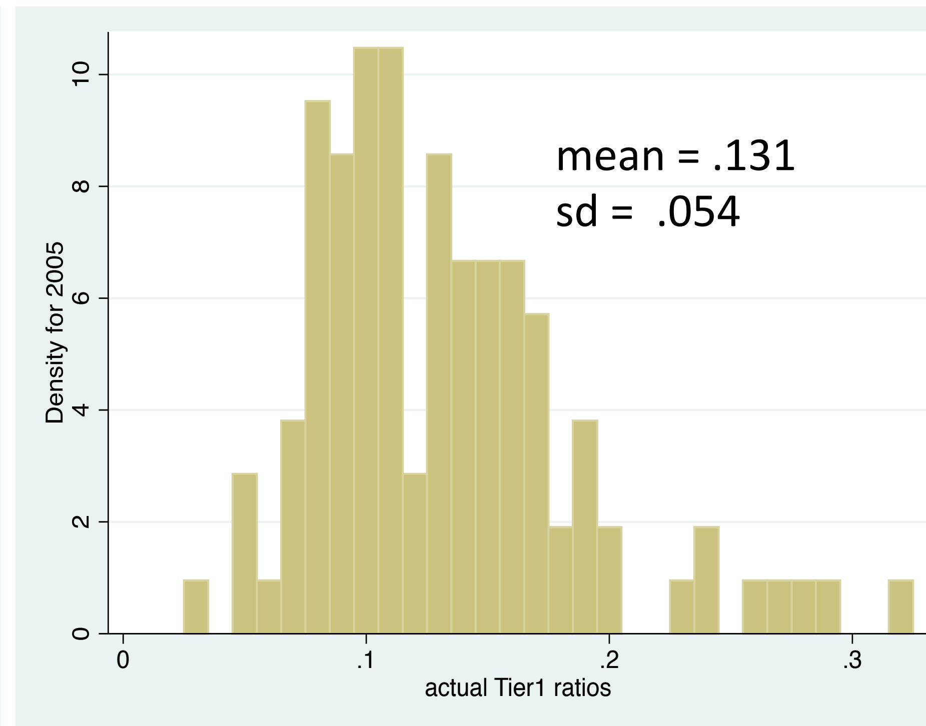
Source: IMF, World Bank, national regulators.

Levels of OC have been substantial (2005)

Minimum regulatory Tier 1 ratios, 2005

De facto average Tier 1 ratios, 2005





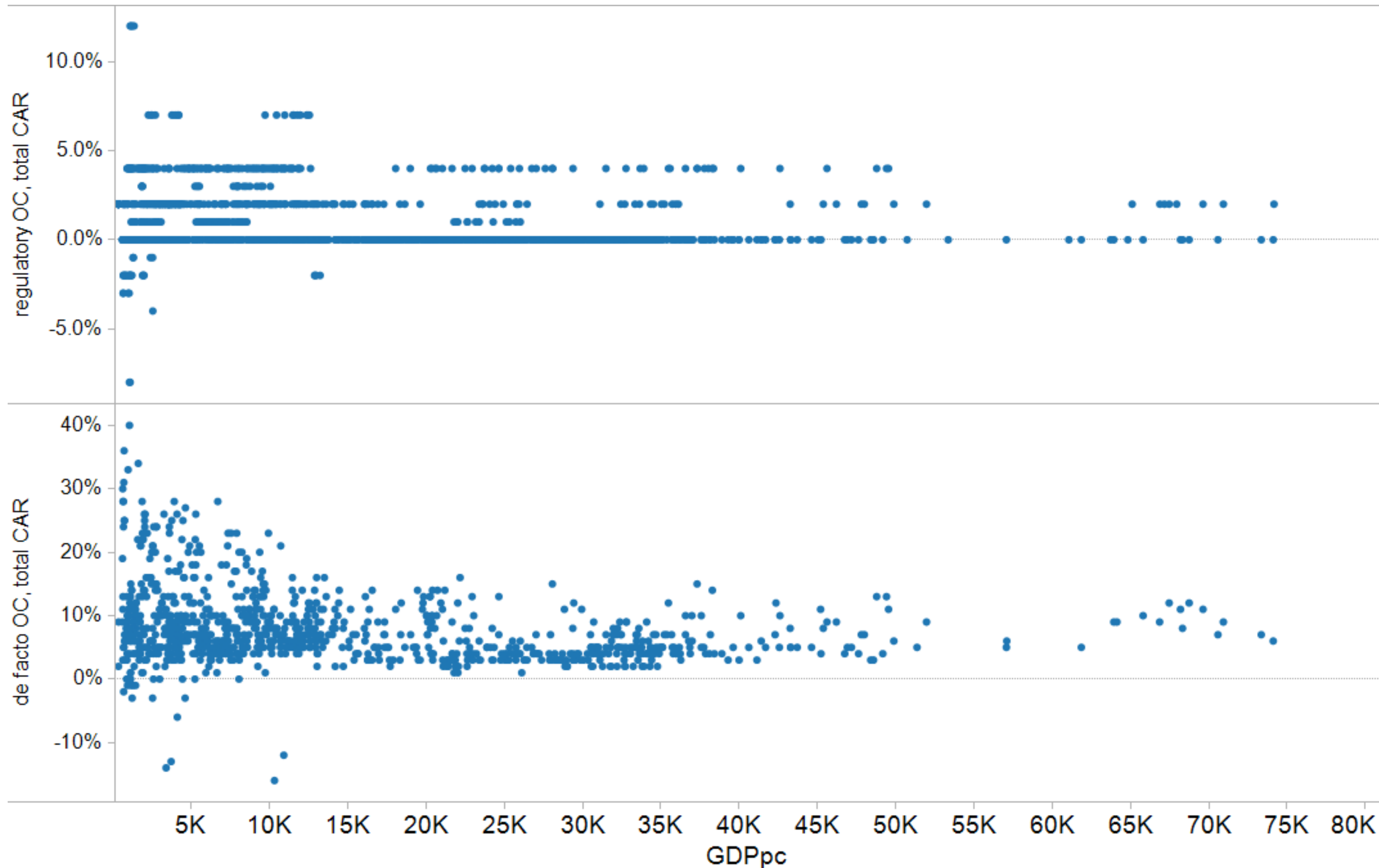
N.b. minimum Tier 1 ratios were 4%.

This is surprising

- Assumption of strong RTB in equity capital
  - Key UK-US motivation for minimum standards in Basel I (key targets: Japanese, European banks)
  - Domestic political bargains based on raising bank capital only to similar level of main competitors (Kapstein, Simmons, Singer)
- Financial sector enjoys growing political leverage, even after 2008 (Johnson, Hacker & Pierson)
- Would expect more under-compliance (cheating) than we seem to see
- But since Basel III, we see more OC announcements (US, UK, Sweden, Austria, China, India, etc)

“Mock OC” – headline OC with compensation?

Regulatory & de facto OC, by income per capita



- E.g. Mongolian regulators: OC as compensation for weak governance

When will states prefer safer banks?

- In circumstances of low state fiscal capacity (banks may prefer more capital too)
- With TBTF banks & high financialization (but banks may be in a stronger position to resist)
- When governments/agencies prefer more stringent regulation than they can achieve in Basel
- Much depends on institutional strength/autonomy

Bank interests & lobbying incentives

- Implicit funding subsidies, oligopoly pricing for large banks might offset headline OC in higher rule of law jurisdictions
  - But why give these up?; large banks still lobby against OC in US, UK, etc
- Financial structure
  - Capital markets vs. bank-based systems (Henning: finance-industry coordination in latter)
  - Some market segments may benefit from OC? (e.g. wealth management?)

Strength of anti-bank political coalitions

- Public anger after crises & demands for more stringent regulation
  - But why go *beyond* Basel?
  - Might expect populist/symbolic regulatory responses than more technical, onerous forms of OC
- Political institutions can channel or block such activism
  - Party organization & discipline
  - Citizens' referenda

The "Swiss finish"

- 10% CET1 capital ratio, 19% total CAR for UBS & CS on a group & national subsidiary basis
  - Looks costly, though Swiss Bankers Association is generally "positive" about this approach – why?
- Costs of OC limited in various ways
  - Keeps 3% Basel III leverage ratio: could UBS & CS "manage" RWAs? (SNB disclosure requirement since 2012, but less stringent than US)
  - Wealth management business benefits from OC? (but why no support for a higher leverage rule?)
  - Smallest banks exempted from OC
- Direct democracy seems unimportant
  - No financial sector referenda; Swiss industry & govt have effectively opposed populist measures to restrict bonuses

The United States – emerging OC?

- No capital OC, but in 2013 Regulators propose 5% leverage rule for BHCs & more stringent liquidity rules than Basel
  - 2012 Collins Amendment: A-IRB banks must also meet 100% of standardized floors for RWAs
  - Major banks strongly oppose; potentially more constraining than Swiss finish
- Regulatory politics of divide & rule
  - Focus OC on the big 8 & make concessions to small banks, garnering strong small bank support
  - Traditional anti-big bank politics reinforced by Tea Party constraint on Republicans (Brown-Vitter May 2013)
  - Role of “the whale”

China – retreating OC

- Modest OC proposed in 2011 (extra 0.5% CET1 capital, 1.5% for 5 majors) by end-2013, & a 4% leverage ratio
  - But uncertainties given governance weaknesses in financial sector, LGFP lending
  - Slowing economy prompted relaxation of implementation to 2019 despite already high CET1 levels
- What drove the initial strategy?
  - Use of Basel standards as internal reform tool
  - International aspect: "good citizen", and giving no excuses to US & EU
  - Latter less important now implementation is less uncertain

Implications

- OC, like other forms of Basel implementation, is adapted to domestic political circumstances
  - Can be more symbolic than real, with adjustment for bank & industry interests
- But moves to modest extra stringency in US suggests "capture" there is incomplete
- Indicates rising dissatisfaction with Basel outcomes in key countries, dilution of a focal point for post-crisis regulatory convergence