As the postcrisis regulatory framework was crafted, there has been a substantial trend toward the use of the Basel Committee on Banking Supervision (BCBS), Financial Stability Board, and other international standard-setting bodies as principal instruments of policy development. While this increasing internationalization of U.S. bank regulation is often taken for granted, the growing reliance on international standard-setting bodies, together with the opacity and lack of governance regarding how key decisions are made by those bodies, poses serious risks to the integrity and quality of U.S. bank regulation.

The objective here is to describe the nature of the recent trend toward internationalized bank regulation, identify significant problems that the trend poses to U.S. bank regulatory policy, and suggest a number of reforms that might address these problems and enhance the integrity and quality of international standard-setting.

**The Evolution of International Standard-Setting in Bank Regulation**

The development of bank regulation through international organizations is not a recent phenomenon. The BCBS was founded in the 1970s as a forum for establishing supervisory best practices, and in the 1980s took up the additional work of establishing an international capital adequacy framework, beginning with the 1988 Basel Capital Accord. This initial remit of the BCBS – supervisory techniques and capital standards – was based on a judgment that the potential advantages of international standard-setting outweighed the potential disadvantages in each area of focus. Though it’s easy to take the BCBS’s work in this area today as a given, it is important to remember that the validity of this judgment is not self-evident. A sustained reliance on international standard-setting as the basis for national regulation is an extraordinary thing, and it’s rarely seen in U.S. regulation of other industries. As Figure 1 summarizes, both the potential advantages and disadvantages of international standard-setting can be considerable.
With respect to the BCBS’s traditional activities – supervisory practices and capital adequacy standards – the general consensus has been that the advantages of international standards outweigh their potential disadvantages. By contrast, there has been little careful analysis of the relative merits of internationalized standards in the many areas into which the BCBS and similar international organizations have expanded in recent years. As Figures 2 and 3 depict, the expansion of the BCBS’s mission has been remarkable, encompassing a major increase in the scale and scope of its standards and activities. It now covers matters relating to bank liquidity and funding, bank corporate governance, derivatives margin, insolvency and bank resolution, lending limits, “interconnectedness” and systemic risk, deposit insurance, internal and external audit, accounting opening procedures, anti-money laundering, consumer finance – and the list goes on.
Rethinking the Internationalization of U.S. Bank Regulation

PROBLEMS AND SOLUTIONS

In the BCBS’s new areas of activity, the case for internationalized policy development is not particularly clear. For many, the traditional benefits of internationalization – eliminating competitive inequality or global regulatory arbitrage, or facilitating cross-border operations – seem limited. And particularly for the more detailed and technical standards that have emerged in recent years, the potential downside of internationalization – less accountability and transparency, and only limited scope for dealing with country-specific circumstances – seem pronounced. As just one example, consider bank corporate governance, an area of increasing BCBS focus. On the one hand, differences across jurisdictions in the structure and operation of boards and managerial bodies seem very unlikely to give rise to competitive inequality or opportunities for regulatory arbitrage. And on the other, the very different legal regimes and corporate law traditions in each jurisdiction that form the framework for these governance mechanisms are difficult to accommodate meaningfully in a uniform global set of standards.

The point in highlighting this trend is not to debate the relative merits of international standard-setting in each of the areas in which the BCBS and other international organizations have been active since the financial crisis. Rather, it’s to draw attention to the fact that, largely speaking, this debate simply has not occurred. This is a policymaking mistake, and it poses four problems for bank regulation that are troubling and significant. While the focus herein is primarily on the BCBS, many of these problems arise equally in the context of the activity of the Financial Stability Board and other similar international organizations.

The first problem with this trend toward internationalized standards is the fact that the BCBS and other international organizations aren’t merely think tanks at which ideas are discussed, but rather de facto regulators. The BCBS in particular is enormously influential on national regulatory outcomes. On this point, U.S. regulators frequently emphasize that they’re not legally bound to implement any particular BCBS standard. But that assertion appears to conflict with the BCBS’s own governing charter, which states that members are “committed … to implement and apply BCBS standards in their domestic jurisdiction.”

And it does not comport with recent history and practice, where BCBS and other international standards have been routinely implemented by U.S. regulators. This should not come as a surprise, given the recent BCBS emphasis on “naming and shaming” countries that do not fully implement its standards, which is the core function of its recently instituted Regulatory Consistency Assessment Programme. The result is an environment in which U.S. regulators may effectively be just as beholden to the decisions of Basel as they are to the decisions of Congress. Indeed, when it comes to U.S. implementation, it often seems that the only open question is the extent to which U.S. regulators will enact rules that go beyond the BCBS standard in stringency – often referred to by the misnomer “gold-plating” – which they frequently do.

This environment is in real tension with the basic procedural safeguards embodied in the U.S. Administrative Procedure Act and the rule of law more generally. It should

FIGURE 1: ASSESSING THE DESIRABILITY OF INTERNATIONAL STANDARDS

<table>
<thead>
<tr>
<th>POTENTIAL ADVANTAGES</th>
<th>POTENTIAL DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level international playing field</td>
<td>Inherent imprecision of one-size-fits-all approaches</td>
</tr>
<tr>
<td>Elimination of cross-border opportunities for regulatory arbitrage</td>
<td>Obstacles to addressing idiosyncratic national features or preferences in uniform rules</td>
</tr>
<tr>
<td>Improved quality of supervision and regulation across jurisdictions</td>
<td>Distant and less transparent decision-making, and related obstacles to public input</td>
</tr>
<tr>
<td>Efficiency in cross-border operations</td>
<td>Absence of national procedural and accountability protections (e.g., national administrative law)</td>
</tr>
</tbody>
</table>
A sustained reliance on international standard-setting as the basis for national regulation is an extraordinary thing, and it’s rarely seen in U.S. regulation of other industries.

public administrative process relating to that standard has commenced in the United States.

A second problem is the nature of governance and decision-making at the BCBS and other international standard-setters. To be fair, recent leadership at the BCBS has made strides in enhancing transparency by ensuring that all proposals go through a standard notice and comment period at the BCBS level. Nevertheless, these improvements, however, once that process is complete, no public record or other details are made available.
regarding how decisions were actually reached by the BCBS, including relevant votes, or what positions the U.S. regulators or other members took as questions were decided. Indeed, the only information available regarding how decisions are made is an oblique statement in the BCBS’s charter that notes they are “taken by consensus among its members,” whatever that might mean. Also problematic is the role of the Group of Central Bank Governors and Heads of Supervision (GHOS), which acts as the oversight body of the BCBS and sets its agenda, steers its work, endorses key decisions, approves new members, amends the BCBS charter, and selects the BCBS chair. Yet other than a brief paragraph in the BCBS charter that describes the GHOS’s powers and members, there is no public document anywhere that describes its organization, procedures, or decisions. It is hard to reconcile the incredible influence and power that BCBS choices have on U.S. and other national regulatory outcomes with the very limited information available on its governance, procedures, and decisions.

A third problem is the increasing evidence that the new science of international bank regulation is being invented by a remarkably small universe of policy experts. On this point, Boston University professor Cornel Ban has done fascinating work that analyzes, in the context of the international policy debate over shadow banking, the striking extent to which influence over international standard-setting organizations is limited to a small, highly interconnected network of experts, a large number of whom are themselves employees of those organizations or their members. It’s hard to reconcile the detail, importance, and influence of more recent international standards with the echo chamber environment in which they are produced.

A fourth problem is that the principal disadvantage of internationalized standard-setting – the inability to reconcile uniform global standards to the specific circumstances of the United States (or other nations) – is significant and growing in importance. When it comes to the structure of financial markets and services, differences between the United States and other BCBS members are pronounced. The United States has the deepest and most liquid capital markets in the world, and it relies much more heavily on capital markets to finance its economy than other BCBS members – which means that the consequences of the capital regime for trading activities in the United States are uniquely high. It has a national mortgage system that is largely funded via government-sponsored enterprises and the capital markets (rather than, say, via covered bond markets that are prevalent in Europe), so its banks’ balance sheets are meaningfully different from those of other BCBS members. It has a substantially less concentrated banking sector and has made substantially more rapid progress in ending “too big

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**FIGURE 3: EVOLUTION OF BCBS RELEASES BY TOPIC AND PERIOD (1975-2015)**

![Graph showing the evolution of BCBS releases by topic and period from 1975 to 2015. The graph highlights the number of releases over time, with different colors representing various topics such as Capital, Supervisory, Liquidity, AML, Accounting, Financial Stability, Stress Testing, Insolvency, Derivatives Margin, Bank Governance, Lending Limits & Exposure, Auditing, Compensation, Deposit Insurance, and Consumer Finance.](image-url)
to fail” than many other BCBS members, making for a very different context and analysis when considering the design of macroprudential regulation, a key area of international focus. It has an older and more robust deposit system and “stickier” deposit markets than other members – which presents a very different risk profile in the context of the BCBS’s new work to establish quantitative standards for liquidity regulation. These are merely illustrative examples, and the list could go on. The key point is the substantial and growing extent to which an international approach to standard-setting may entail leaving significant U.S.-specific considerations behind.

No responsibility for the trends or problems described here lies at the feet of these international organizations or their staffs. Their activities are directed and overseen by their membership, and so it is their members – U.S. and foreign regulators alike – that are in a position to ensure that both the processes and outcomes of international standard-setting are appropriate. To this end, there is a range of concrete steps the U.S. and other members of these groups might consider to strengthen the integrity and quality of international standard-setting. Here are five suggestions that would make for a good start:

1) **A MUCH MORE DELIBERATE PROCESS TO CONSIDER THE THRESHOLD QUESTION OF WHETHER AN INTERNATIONAL STANDARD IS APPROPRIATE.** International standard-setters might, for example, undertake for each potential standard a careful analysis of whether an international standard is actually worthwhile, and articulate and present that analysis for public comment.

2) **ENHANCED TRANSPARENCY FROM INTERNATIONAL ORGANIZATIONS ABOUT THEIR OPERATIONS AND DECISIONS, AKIN TO WHAT IS REQUIRED OF OUR U.S. BANKING AGENCIES.** This might include public standard-setting dockets, meeting notices and agendas, actual vote results, and perhaps even open and public meetings at which more significant matters are to be decided. This kind of transparency and accountability would enhance public confidence in the fairness of key decisions.

The international development of regulatory standards can be useful and beneficial when done properly and discriminatingly. But just because international standard-setting may sometimes be the best solution, that doesn’t mean that it’s always the best solution.

3) **ENHANCED TRANSPARENCY REGARDING THE POSITIONS THAT U.S. AGENCIES TAKE IN INTERNATIONAL FORUMS, AS WELL AS MEANINGFUL OPPORTUNITY FOR U.S. STAKEHOLDERS TO CONSIDER AND PROVIDE INPUT BEFORE THOSE POSITIONS ARE FORMALLY PRESENTED ABROAD.** This idea isn’t actually new at all – there is ample precedent from the U.S. agencies’ history that might be followed.

4) **A DEMONSTRABLE WILTINGNESS AMONG THE U.S. AGENCIES TO DEVIATE FROM INTERNATIONAL STANDARDS WHERE EITHER U.S.-SPECIFIC CIRCUMSTANCES OR A DIFFERENT U.S. POLICY VIEW WARRANT DOING SO.** That deviation should run both ways, such that U.S. rules are not simply made tougher than the international standard when appropriate, but also sometimes cut part or all of an international standard when it doesn’t make sense for U.S. institutions or markets. It’s hard to imagine how doing so could have any result other than an improvement in the quality of U.S. regulatory outcomes.

5) **MANDATORY PERIODIC REVIEW AND REAFFIRMATION OF SIGNIFICANT INTERNATIONAL STANDARDS** This could include a binding commitment by international organizations to review significant standards on a periodic basis to assess their continuing appropriateness, together with a requirement that those standards effectively be periodically “reauthorized” (e.g., through a mandatory sunset provision) to ensure that organizational dysfunctions
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BANKING PERSPECTIVE

don't obstruct needed change. Such a process would ensure that standards are refined over time to reflect lessons learned in national implementation and help overcome the inherent challenges associated with getting the diverse, multinational constituencies of each organization to revisit highly negotiated outcomes.

Reforms along these or similar lines would seem only to enhance the quality and integrity of international standard-setters' work, and could go a long way toward ensuring that the development of U.S. bank regulation is internationalized only where doing so is truly likely to produce better and more appropriate regulatory outcomes.

The international development of regulatory standards can be useful and beneficial when done properly and discriminately. But just because international standard-setting may sometimes be the best solution, that doesn't mean that it's always the best solution. It is high time that both the process and substance of international standard-setting received renewed scrutiny that is directed at ensuring that it remains fit for its expanding purpose.

ENDNOTES

1 The BCBS was formed in 1974 for the purpose of establishing supervisory guidelines and best practices that were consistent across key jurisdictions, with the express goal of closing gaps in the international supervisory framework, such that no international bank could escape supervision. In its early years, the BCBS primarily focused on improving the quality of supervision globally through enhanced information sharing among national supervisors, refining supervisory techniques, and setting minimum standards for supervision. See BCBS, “History of the Basel Committee” (October 1, 2015), available at http://www.bis.org/bcbs/history.htm.

2 The BCBS’s stated objectives in this endeavor were “to strengthen the stability of the international banking system and to remove a source of competitive inequality arising from differences in national capital requirements.” Ibid. Although the BCBS made a few limited forays into other areas, its primary focus in the 1990s and early 2000s was the periodic adjustment of its capital framework and continuation of its work on supervisory matters.

3 Both figures present the same data, but the first highlights the increase in scope, while the second emphasizes the increase in scale. They are based on the BCBS’s own compilation of every BCBS release since its creation in 1974, and simply chart these releases over time, roughly categorized by broad topic and adjusted to remove clearly nonsubstantive items (e.g., status reports to other organizations).


5 The BCBS’s RCAP program was established in 2012 to monitor implementation of BCBS standards in each member jurisdiction and, in particular, to assess (and report publicly) the extent to each member’s “domestic regulations are aligned with the minimum Basel requirements agreed by [BCBS].” See BCBS, “Implementation of Basel standards – Regulatory Consistency Assessment Programme, available,” at http://www.bis.org/bcbs/implementation.htm.

6 See 68 Fed. Reg. 45900 (August 4, 2003) (proposed rule) at 45900, 45901 (“setting forth for industry comment” the U.S. banking agencies’ views on the BCBS Basel II proposal and noting not only that public comments would be used “to assist the Agencies in reaching a determination on a number of issues related to how the New Accord would be proposed to be implemented in the United States,” but also that “in light of the public comments submitted … the Agencies [would] seek appropriate modifications to the New Accord.” The Federal Reserve’s final Basel I rules provide a detailed account of the similar process by which the U.S. banking agencies sought public comment in the United States on the BCBS’s initial Basel I proposal and used that input to inform the negotiation and finalization of the standard. See 54 Fed. Reg. 4186 (January 27, 1989) (final rule) at 4186-87.

7 Although the BCBS comment process has improved, it continues to fall short of the kind of procedural safeguards provided by U.S. law.

8 These details are not merely academic. Take, for example, the question of U.S. influence over BCBS decisions. The United States is one of 28 nations represented on the committee (~3.5%) and has four of the 45 institutions represented (~9%). By comparison, of the total assets of all BCBS-member banks reported in Bank for International Settlements statistics, U.S. banks account for approximately 19%. See Bank for International Settlements, “Summary of consolidated statistics, by nationality of reporting bank” (September 13, 2015), available at https://www.bis.org/statistics/b1.pdf.


When your technology advances the future of finance, that’s invested.

Launched Digital Pulse, turning Big Data into Big Insights

First investments company member of Cloud Foundry Foundation

Built tech-driven solutions for Tri-Party Repo Risk Reduction

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