

Banking regulation and the benefits of international cooperation – views from a banking supervisor*



By Joachim Wuermeling
Deutsche Bundesbank

Keywords: BCBS, global standards, international regulation, digital innovation, BigTech regulation, harmonisation, digital regulation.

- *In banking supervision, we have global and harmonised standards by the Basel Committee on Banking Supervision. The Basel standards are probably among the most effective global standards, as they are implemented and applied all over the world. Banking supervision therefore is a good example of international regulation and harmonisation, and could be regarded as a blueprint for other areas.*
- *There is a clear case for international digital innovation standards. Digital innovation is global by nature. BigTech companies can't be properly regulated at the national level. Regulatory arbitrage is a common feature in the world of today.*
- *Cross-border regulation of digital innovation is in its infancy, but a start has been made. Harmonisation within the EU is a good example. However, getting a grip on the risks of digital innovation will be difficult and complex.*

* [Speech](#) held by Professor Joachim Wuermeling, Member of the Executive Board of the Deutsche Bundesbank, at the Global Industry Club on 10 March 2021.

Globalization has increased the interconnectedness of our world and our economies. This has increased the importance of international cooperation and fair worldwide rules. In banking supervision, we already have global and harmonised standards. The global standard-setter for the prudential regulation of banks is the Basel Committee on Banking Supervision, or BCBS.

In fact, in my opinion, the Basel standards are probably among the most effective global standards, as they are implemented and applied all over the world. As I see it, banking supervision is a good example of international regulation and harmonisation, and could indeed be regarded as a blueprint for other areas such as digital innovation.

First, I would like to present the BCBS and how international cooperation works there. Second, I will discuss the pros and cons of international regulation from my perspective at the Deutsche Bundesbank. Third, I will try to imagine how international standards for digital innovation could be set up and what they might look like.

1. BCBS – a blueprint for international regulation?

In 1974, the infamous Herstatt Bank in Cologne had accumulated losses of DEM 470 million, compared with capital of only DEM 44 million.

This caused serious disturbances in international currency and banking markets. As part of the lessons learned, the central bank governors of the Group of Ten countries established the Basel Committee on Banking Supervision, the BCBS.

The aim was to enhance financial stability by improving the quality of banking supervision worldwide.

Today, the BCBS comprises a network of supervisors from 28 jurisdictions.

The Committee makes sure that (i) no banking establishment escapes supervision, and (ii) that supervision is adequate and consistent across member jurisdictions.

One of the main tasks of the Committee is the development of international minimum standards for banking regulation and supervision. These are intended to reduce the opportunity for regulatory arbitrage. And in the process, they reduce the likelihood of a regulatory race to the bottom.

Naturally, decision-making at the BCBS is not always easy. With the involvement of many people representing various interests from different jurisdictions and financial systems, finding compromises is hard. We have to reach a consensus. More than 20 working groups and subgroups have been set up to hammer out details. The book of standards today comprises over 1,600 pages.

International cooperation is a marathon, not a sprint. That is why the BCBS, just like many other international institutions, sometimes seems like a slow tanker and not a racing boat. But this does not diminish its value.

The work of the BCBS is not limited to agreeing on standards.

Standards can only work as intended if they are implemented into the national law of every member state.

The BCBS publications do not have a formal legal character. But even though the standards are only non-binding agreements, they are typically implemented in more than 100 countries – far beyond the official membership of 28 jurisdictions.

The Committee monitors the implementation of its standards. In addition, it reviews the consistency and completeness of implementation across member countries. We in the Eurosystem and at the Deutsche Bundesbank are committed to the goal of fully compliant implementation.

All in all: the Basel standards are a huge success. The current crisis due to the pandemic is good proof of this.

2. Pros and cons of international regulation

I like to think of the BCBS as an example of the value of international cooperation. Thanks to its work, banking regulation has a fairly successful track record of international cooperation – and this brings me to my second point: the pros and cons for supervised entities, supervisors and the financial system as a whole.

For supervised entities, the Basel minimum standards create a reasonably level playing field between all competitors worldwide. Because they are implemented differently from one country to the next, the playing field might not be perceived as being fully level. But it is at least much more even than it would be without the BCBS. Arbitrage is significantly suppressed.

A second benefit is that for entities operating internationally, the rules are more consistent across the countries in which they conduct business. Thus, the rules are more easily understood and implemented.

For supervisors, the benefits are quite obvious.

By working together, we help establish good regulation. The Basel standards are drafted by experts from all around the globe. If every member state were to start designing their own regulation from scratch, I am sure that basically none of them would match the quality of the Committee's work.

And in this case, what is good from the supervisors' view is also good for the financial system as a whole.

Safeguarding financial stability is not something we can do at the national level alone if the entities we supervise are acting internationally.

But I also acknowledge potential downsides. International standards follow a one-size-fits-all approach. Some rules are not fit for purpose in every jurisdiction. National specificities may not be addressed.

The standards are intended for banks that operate internationally. In Germany, however, small and medium-sized banks make up more than two-thirds of the market share. Thus, a proportionate approach to applying these rules is key.

Having discussed the fundamentals of international cooperation in banking regulation, I would now like to widen my focus. In banking, just like in many other industries, we see a lot of benefits stemming from new technologies.

I will make three points in this regard:

1. There is a clear case for international digital innovation standards.

Digital innovation is global by nature. Thus, there is the danger of regulatory arbitrage.

Digital innovation needs scaling up. Otherwise, the huge investments will not pay off. Divergence in the legal environment is costly and could ultimately hamper innovation and progress, maybe even of humanity, if you will.

BigTech companies can't be properly regulated at the national level. Google and Amazon are perfect examples of this; and the issue only becomes more complicated when BigTech companies enter the arena of financial services. The regulatory issues associated with Libra Association's Diem-project serve as just one example. Regulators across the globe are struggling to get a grip on BigTech companies – be it in the EU, the United States, Australia or even China.

2. Cross-border regulation of digital innovation is in its infancy, but a start has been made.

Harmonisation within the EU is a good example. Take the General Data Protection Requirements, or GDPR – whether or not you are a fan – or the EU's new Digital Operational Resilience Act (DORA) – a legislative initiative which also addresses material ICT Third Party risks for banks.

For the Libra Association's Diem project, the Swiss regulator FINMA set up a college of supervisors from all over the globe. This is a good example of international cooperation in regulating digital innovation.

3. Getting a grip on the risks of digital innovation will be difficult and complex. It will take continuous work and international cooperation.

In tech, the big issue is of course: can regulation ever keep pace with digital innovation?

We can see that legislators are trying to accompany the digital transformation in a forward-looking manner, by providing legal certainty for innovative developments and by appropriately addressing risks.

To do this, it is necessary to keep abreast of current developments, to actively seek out dialogue, and to accept that regulation has to evolve regularly. Regulators need to be agile and proactive in order to swiftly implement the lessons learned from crises. That is true at a national and international level.

That is no easy task for international cooperation, I am afraid. Harmonisation should be our common goal. Perhaps even a G7 or G20 mandated body could be an option to establish such standards and risk management; we could call it a "Basel Committee on Digital Innovation - BCDI". ■

About the author

Dr Joachim Wuermeling has been a member of the Deutsche Bundesbank's Executive Board since November 2016. His remit covers banking supervision, risk control and information technology. He is a member of the ECB Supervisory Board and represents Deutsche Bundesbank in the Basel Committee for Banking Supervision (BCBS) as well as the German Financial Stability Committee (AFS).

His previous positions include serving as Member of the European Parliament, State Secretary at the Federal Ministry for Economic Affairs and Technology, member of the Executive Board of the German Insurance Association, and Chairman of the Association of Sparda-Banken.



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SUERF Secretariat
c/o OeNB
Otto-Wagner-Platz 3
A-1090 Vienna, Austria
Phone: +43-1-40420-7206
www.suerf.org • suerf@oenb.at