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Basel III is coming

[Internationally Active Banks Are Meeting Initial Basel III Standards – Forbes Oct 04, 2018]
[Basel III in Developing Countries—a Difficult Relationship – International Banker Jan 28, 2019]
[Basel Committee seeks feedback on streamlined version of Basel III – Central Banking Apr 09 , 2019]
[The Case Against A One-Size-Fits-All Approach To Ensuring Global Financial Stability - EM Views Apr 29,2019]

Basel 3 is arriving, there is no doubt on that, but is it a perfect fit for all? Is it a simple plug and play for all banks, for all countries? And how are banks shaping up to meet the new demands on them?

Basel accords originated after the 2008 GFC, which originated in the financial systems of advanced economies. Policymakers would like to ensure that measures derived to protect economies and institutions should be applied everywhere to prevent another credit crunch. One issue is how the Basel III can be adapted by emerging economies and their financial institutions without unintended, and potentially harmful, consequences.

Image via Flickr-Patrik Tschudin

Obviously, banks from developing nations would not be expected to be as robust or as able to on board all measures as easily and under the same timeframe as developed nations financial institutions. There is also a need to be aware of regional differences when implementing global financial stability measures in different regions. Different economies use different macro-prudential tools. Advance economies often use LTV limits as opposed to FX limits used in developing nations. While Basel III is calibrated primarily for advanced countries, the result of appearing less risky and therefore attract capital investment, means it appeals to many emerging market countries as well.

A task force convened by the Center for Global Development determined that 3 main principles should underline this process: (1) Any adoption of Basel III should be proportional to the capacity and needs of a developing country's financial system and tailored to these economies. (2) As Basel III is implemented across the globe by regulators, great care should be taken to minimize negative spillover effects in terms of credit availability for developing countries. (3) Regulations should not result in a zero-sum game between financial development and financial stability. The result is financial stability and a prevention of any shocks that might have a knock-on effect internationally.

A concern is that the stringent measures of Basel III has already pushed global banks to consolidate and reduce their global footprints. This may result in a scaling back of lending activity and a negative effect on economic growth, and the countries most affected would be the developing nations.

Whilst global trade is already under threat from Mr. Trump's policies, the concern is Basel III could also significantly undermine cross-border trade financing, by forcing banks to hold more capital to cover the loans. Provisions such as the leverage rule, risk weighting requirements and liquidity rules will make it an even more expensive endeavor and compound what is already a low-margin business.

By tailoring measures, it may be possible to remove or diminish any new roadblocks to lending to those developing nations. Developing economies want to adopt Basel III because they see it as in their long-term interest, but the one-size-fits-all approach of the new standards poses new risks and challenges.

The common goal to avoid another global financial crisis should not mean ignoring any possible negative impact to weaker fledgling economies Basel III would have, which would harm the development of these economies and nations, and harm global economic growth and a fairer distribution of economic wealth.

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