The Daily Dish

The Basel III Endgame: Administrators Assemble

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Basel is Switzerland's third-most populous city, near the country's northern border on the river Rhine. Known as the cultural capital of Switzerland, the city crams in over 40 museums in addition to the humanistic University of Basel, a harbor for political refugees including Nietzsche and Jung. It is also famous for its pastries and fondue.

Sadly, and less deliciously, Basel is also the home of the Basel Accords, an international standardized approach to banking regulation – in particular, bank capital requirements – since the 1980s. Since 2009, all members of the G20 major economies, and some others, have been voluntary participants in the Basel Committee on Banking Supervision. While the committee has no legal power to enforce its recommendations, most countries tend to do so.

The third iteration of the Basel Accords, Basel III, was developed in response to the financial crisis of 2007–2008 and focused on increasing minimum capital requirements and decreasing bank leverage. It has taken literally decades for committee member countries to introduce domestic legislation implementing Basel III in domestic law, and in 2017, regulators met to agree on a final version of Basel III described portentously as the Basel III "endgame."

Today the Federal Reserve and the Federal Deposit Insurance Corporation boards will meet to consider "proposed rules to implement the Basel III endgame agreement for large banks and adjustments to the surcharge for US GSIBs" (global systemically important banks). Finally, U.S. banks will learn how the government intends to incorporate BASEL III into U.S. banking law. While little is known at this stage about the banking regulator's proposal, the new regulation is believed to apply to all banks exceeding $100 billion in assets and cover credit, market, and operational risks.

The question is, why? Banks today are in a vastly different place from 2017, let alone 2007. The banking industry has much improved risk practices and are extremely well capitalized, leading to the failure of not one of the banks tested in the 2023 Fed stress tests. The Basel endgame was only supposed to make technical changes to the Accords, not create a new set of capital requirements that former Fed Vice Chair for Supervision Randy Quarles has said could lead to capital hikes of 20 percent at some large banks.

Note that incorporation of the Basel III endgame is separate entirely from the Fed's upcoming "holistic review" of bank capital requirements, previewed in a speech by current Fed Vice Chair for Supervision Michael Barr, in which Barr recommended that bank capital requirements should be more onerous, apply to more banks, and rely less on a bank's own estimation of risk. What both developments have in common (other than a punitive approach to bank capital requirements) is an utter disregard for cost. Raising capital requirements would create barriers to growth for U.S. businesses, especially small businesses. This approach is even less defensible when banks have shown that existing capital requirements meet the Fed's current standards.

A reflexive approach to bank capital requirements that increasingly renders the basic business of banking uneconomic and regulatory requirements that stifle new banking entrants is not the European import

Washington needs. But we could always use more pastries.