AN INSTITUTIONAL ANALYSIS OF BANK REGULATION

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Abstract: *This article focuses on the institutional content and impact of the new Basel Capital Accord, commonly known as Basel III. These rules were enacted in response to the recent developments in global financial markets and to introduce some substantial changes into established regulatory approaches. We use the method of "process tracing" of the neo-proceduralist school to assess whether Basel III is a victim of regulatory capture or not. We find that Basel III met a number of procedural requirements and is not a victim of regulatory capture. On the other hand, we point to the fact that there remain numerous open issues that could undermine the as yet unfinished outcome and cause Basel III to join its predecessors in their fate.*

Keywords: *Banking, Basel II, Basel III, Institutions, Neo-proceduralism, Banking regulation*

JEL Classification : *G21, G28.*

Introduction

Banking regulation has been blamed to have a share on the 2007-2009 global crisis. Banks failed to maintain sufficient capital buffers to absorb the losses and to prevent them from running risky operations that are incompatible with financial stability and the privileged role of banks as routers and transformers of capital flows in the economy [18]. In this paper, one of the most important regulatory reforms adopted lately is discussed. The third version of Basel Capital Accords, commonly known as Basel III ([1], [2], [3] and [4]), is presented and analyzed from the institutional point of view. This reform proposal, drafted and adopted in record time, introduces some revolutionary changes into banking regulation. Its impact is, however, far from clear - especially liquidity proposals are subject to a lot of critique and uncertainty both on the part of the industry and national supervisors.

Using the method of process-tracing, we examine Basel III enactment process and find that it is not a victim of regulatory capture, as opposed to its predecessor. On the other hand, we find that new rules will likely be watered down due to the lengthy transitional period and the fact that a significant portion of provisions are subject to supervisory review process over the years. This contributes to our final assertion that although a step in the direction, Basel III will fail to meet its objectives due to reasons outlined herein.

The paper is organized as follows. In the second part, we present the paper by Lall [14] that serves as the departing point for our analysis. We believe that understanding the institutional context of the environment in which regulation is drafted and adopted, together with implications for the behaviour of market participants, is of utmost importance. To this end, we try to extend the Lall´s work until present time. We find that Basel III represents a significant improvement in terms of regulatory capture,

compared to Basel II. After that, we discuss in Section 3 some challenges faced by the Basel Committee on Banking Supervision that could further undermine regulatory efforts. Section 4 concludes the paper.

1 Analysis of Basel II

In his seminal paper [14], Lall argues that the primary cause of the failure of Basel II lies in regulatory capture of regulatory agencies by regulated institutions. In short, he argues, Basel II is a prime example of regulatory capture. Large international banks were able to systematically manipulate the process and outcomes of Basel II, effectively transferring wealth to themselves at the expense of their smaller competitors and, above all, the society and systemic financial stability [16, p. 10]. Basel II hence failed to attain its declared objectives of promoting safety and soundness in financial sector, constituting a more comprehensive approach to risk management and promoting competitive equality in the sector.

Departing point for his analysis is the neo-proceduralist approach to regulation, developed recently by Walter Mattli and Ngaire Woods [16, p. 10]. It has much in common with the emerging field of global administrative law, which represents the core of the proceduralist approach to global regulation [13]. These scholars identify public interest with a certain type of due process that meets certain standards [14, p. 10]. As Mattli and Woods put it, "regulation is said to be in the public interest if it is arrived at through a deliberation process that allows everyone likely to be affected by it to have a voice in its formation" [16, p. 13].

Nevertheless, similarities with proceduralists end here. Mattli and Woods discard the idea that improvements on the institutional side alone are sufficient to secure optimal, common interest regulation. Neo-proceduralists emphasize two types of conditions that must be met to produce the optimal result. The first are the so-called supply side conditions, concerning the institutional conditions in which any regulation is being drafted and implemented, and the demand side conditions encompassing the extent and intensity of societal pressure for efficient and effective regulation. In their opinion, these demand side conditions make the difference. They argue that, first, constituencies adversely affected by regulatory status quo must be aware of and have proper information about the social cost of capture and international regulatory agenda. Where large market players have information monopoly, it is likely that they reach their preferred outcomes at the expense of the less-informed. Second, these constituencies must be supported by public or private agents that facilitate technical expertise, financial resources and an organizational platform for them. Finally, and crucially for the success of these alliances, is a shared set of ideas about how to regulate that serves as a departing point in deliberations [14, p. 10].

To clarify the approach, let us distinguish between regulatory change that serves vested interests of a narrow group and that beneficial for the whole society. Mattli and Woods draw up broad conditions under which different outcomes are expected to occur in international regulatory framework, indicating a plausible set of hypotheses about the factors facilitating capture in regulatory process [14, p. 9] . To be able to tell when one outcome is more likely than the other, they argue, we must assess the 'supply-side' institutional context in which new regulation is prepared, implemented

and enforced [14, p. 10] . An ‘extensive’ institutional context, characterized by open forums for debates, multiple-stakeholder and proper oversight, is less likely to produce outcomes that serve one particular interest group and which shows signs of being captured than a ‘limited’ context that is exclusive, closed and secretive [14]. It is only when both supply and the aforementioned demand conditions are met, however, that the process can generate desired results – a claim made by Mattli and Woods that extends the original proceduralist approach. A mere extensive forum without wider societal input in the form of desire for change is not enough, in their opinion. In addition to that, constituencies affected by the change must have proper information. This can be labelled as an attempt to bring politics back into proceduralism - regulatory outcomes are thus defined not only in terms of the procedure that generates them but also by the range of societal input into it ([14], p. 10).

1.1 Temporal contextualization

By identifying an important condition for the regulatory process to produce desired results, Mattli and Woods have made a significant step forward in the study of international regulatory process. Nevertheless, as Lall argues, they have failed to account for a key variable that influences the outcome in their comparative-static analysis – the temporal dimension. As Lall puts it, we must conceive of regulatory capture as a cumulative, gradual process that unfolds over time. Recognizing that processes and their outcomes are rooted in a particular temporal context enables us to notice key causal effects and draw conclusions that we would not be able to see or make from an ahistorical, snapshot perspective [17].

The benefit we gain from extending the framework over time is enormous. By recognizing that regulatory process unfolds over time we get a better understanding of how agents with informational advantage may turn this into specific regulatory outcomes. In particular, these actors can claim a ‘first-mover advantage’ – they are able to arrive at the decision-making table first and employ significant leverage in later stages, since decisions made early tend to be self-reinforcing [14, p. 12]. As Paul Pierson argues, “If early competitive advantages may be self-reinforcing, then relative timing may have enormous implications...groups able to consolidate early advantages may achieve enduring superiority” [17, p. 71].

Lall [14] further extends this argument by adding that early participation matters only if negotiators have little or none accountability to domestic constituencies. That is, in a limited institutional context where decisions do not have to be endorsed by domestic bodies such as parliament, regulator or other similar bodies. Clearly, when an agreement is to be endorsed by a wide domestic constituency, a first-mover advantage does not facilitate outcomes desired by the interest group having it. In this context, Lall argues, the framework allows us to expect that banks arriving first at negotiations of Basel II were able to gain significant first-mover advantage and shape decisions in a way that was favourable for them, and at the same time, increasingly more difficult to change in later stages. He further argues that “the question of who arrives first is not a matter of chance, but a function of the distribution of information among actors” [14, p. 12]. Clearly, large international banks had to be the best informed, given their wide scope of actions and a global network. Moreover, informal connections play

an enormously important role. Again, large international banks had the best informal connections to their benefit and utilized this privileged status during the Basel II process to a large extent.

1.2 Basel II outcomes

Ranjit Lall uses a method he calls 'process-tracing' to identify key points when regulators made concessions to large international banks and, in doing so, have jeopardized the stability of the financial system. He examines and compares closely various press releases, statements, official documents and interview transcripts to assess whether there is evidence for his hypothesis that the Basel Committee on Banking Supervision (BCBS), and Basel II as a consequence, was captured by large international banks.;

He starts by identifying BCBS to have *"one of the worst records of all international standard-setters in terms of transparency, representation and accountability. The Committee's meetings, which occur four times a year, are closed to the public, with no record of who was present or what was discussed."* [14, p. 12]. BCBS further breaks down into four policy groups in charge of fourteen subcommittees, where most of the technical work is done, usually in close cooperation with industry experts. We have no illusions as to which institutions these experts come from and in whose interest they act. Seen from the outside, BCBS is a rather opaque institution that is not accountable to any national or supranational body, the European Commission (EC) and European Central Bank (ECB) having only an observer status. BCBS is only accountable to a group of G-10 central bank governors and among these, only a few are responsible for banking regulation in their home country [14, p. 13].

Extension of the analysis

The prospects presented by Mr. Lall seem very grim. In this section, we will apply his methodology and extend the analysis by current events trying to find evidence for his hypothesis that Basel III will be yet another case of regulatory capture. In doing so, we gathered information from various publicly available sources, such as the Risk magazine, Financial Times or Reuters, as well as compare and analyze the individual stages of Basel III reform proposals to see if there is evidence in favour or against the hypothesis. In our opinion, it can give us a very valuable insight into the problematic of regulatory capture, how it evolves over time, what are its symptoms and what repercussions it may have in future.

1.3 Basel III evolution

Let us examine the wording of Basel III per se and how it evolved over time. As has been mentioned before, BCBS has published a preliminary version on Basel III in December 2009 [1], subject to comments until April 2010 and released in July 2010 [2], with final version made public in December 2010 [3 and 4]. We shall now turn our attention to the time interval between April and December 2010 to see if, and how, effective individual lobbying groups were at influencing the Committee, and find evidence for or against the hypothesis that Basel III is an example of regulatory capture.

1.4 Capital, capital ratios and counterparty credit risk

In general, the Committee retained most of the proposals set out in December 2009. There have been, however, certain concessions made to the definition of capital. As the Committee put it, "certain deductions could have potentially adverse consequences for particular business models and provisioning practices, and may not appropriately take into account evidence of realisable valuations during periods of extreme stress" [2]. The Committee allowed for partial recognition of minority interest supporting the risk of a subsidiary that is a bank. This means that banks that report minority interest of a party on their consolidated balance sheets can deduct that portion of capital required by the regulator attributable to the minority party from their capital requirement, in proportion to the minority share.

In addition to minority interest, the Committee has also announced changes to the treatment of:

- Deferred tax assets (DTA) that arise from timing differences,
- significant investments (more than 10% of the issued share capital) in unconsolidated financial institutions; and
- mortgage servicing rights (MSR).

Instead of a full deduction, these items receive a limited recognition capped at 10% of bank's common equity for each item and 15% aggregate over the items. The amount that by which the sum of the three exceeds 15% must be deducted from bank's Common Equity Tier 1 (CET1).

Formerly, DTA could rely on estimates of future profitability of a bank. In Basel III, DTA will be recognized only if they stem from timing differences, such as allowances for credit losses. All other assets that could be carried forward as unused tax losses or tax credits will be deducted in full from CET1. The decision to remove DTA in their previous form from CET1 capital is certainly a step in the right direction. Nevertheless, in our opinion, retaining them even in a limited scope is at odds with prudential regulation. DTA are by definition not readily available for loss absorption. Recognition of DTA in its current form is based on the notion of postponed cash realization. Hence, for the bank to make use of DTA, it must wait until cash inflow occurs, which takes too long a time in period of distress and therefore cannot contribute to loss absorption. In our opinion, DTA should be moved to Tier 2 capital, if not eliminated from regulatory capital altogether.

The question of mortgage servicing rights is particularly important for US banks. MSR represent a contractual agreement between the mortgage lender and the servicing entity that performs all servicing functions, i.e. collects payments and distributes interest and principal repayments, taxes etc. The market for MSR is a multi-billion industry in the USA and they have represented a significant portion of banks' income prior to the crisis.

The problem with MSR is that they are very difficult, if not impossible, to attach a reasonable value to. There exists no liquid market for MSR, being traded solely over-the-counter (OTC). Banks can essentially attach any value to them. This depends on the creditworthiness of mortgage borrower, open market value of collateral property, the willingness to refinance when interest rates decline and many other factors that are

difficult to predict. The regulator has therefore no reliable clue to confront bank's estimates of MSR value with economic reality. MSR retention on the list of eligible capital instruments can therefore be viewed as a concession to US banks that use them to enhance their capital position.

1.5 Leverage ratio

Leverage ratio has been watered down rather significantly. Initial proposals have been met with strong opposition from the industry, calling it redundant, insensitive to different business models and excessive. Despite this critique, BCBS retained leverage ratio in final version of Basel III, although some concessions have been made along the way. The most important is timing. Leverage ratio will enter into an observation period, starting January 2011, when supervisors will develop tools to track and evaluate the ratio. The parallel run period commences January 2013 and runs until January 2017. During this time, the Committee will closely monitor the behaviour of the leverage ratio in relation to other regulatory measures. Based on the results from the parallel run period, the Committee will make final adjustments to it in the first half of 2017, *"with a view to migrating to a Pillar 1 treatment in January 2018, based on appropriate review and calibration"* [3, p. 63]. In our opinion, this prolonged review and calibration period will contribute to leverage ratio not being binding, or being significantly diluted in the end. Seven years is a long period – many things can change and banks can exert quiet but steady pressure on the Committee to change the rules to their benefit. The Institute of International Finance (IIF) lobbied for the ratio to be implemented as a part of Pillar II guidance, being at national supervisors' discretion [5]. Concessions made to implementation timing are suggestive of partially successful lobbying from the industry.

1.6 Liquidity measures

Liquidity measures have also experienced changes during 2010. These can be divided into three categories. First, certain adjustments have been made to numerical values of run-off rates, availability and required factors for stable funding calculation and haircuts to market values of assets in the stock of liquid assets. These are quite noticeable in some instances, such as lowering the minimum required credit rating for some assets held in the stock of liquid assets. On the other hand, the definition of Level 1 assets is now more limiting than in the original proposal.

Second, original proposal contained no distinction between Level 1 and Level 2 liquid assets. The final proposal adds this division, reflecting the industry's call for a wider scope of eligible assets. Given our current state of knowledge, the judgment whether this division is an example of regulatory capture would amount to pure speculation.

Third, the timeline of implementation and observation period commences in January 2012 for both standards. Any revisions to the Liquidity Coverage Ratio (LCR) must be made until mid-2013. LCR will be introduced in January 2015, including any revisions. Net Stable Funding Ratio (NSFR) can undergo changes until mid-2016, being enforceable as a minimum standard from January 2018. Again, as in the case of leverage ratio, the industry has succeeded in postponing the binding power of liquidity

ratios until well into the future. This can give banks enough space to influence the Committee and try to influence the final shape of regulation.

1.7 Timeline of implementation

In our opinion, concessions made to the timeline of implementation of changes introduced by Basel III are the most serious among the dilutions made to Basel II. In effect, despite the fact that final version of Basel III contains most of the originally proposed measures, the desired effect can be watered down as a result of a very long transition period. As Stephen Green, chairman of HSBC, said at the end of consultation period in April 2010, "*changes should be gradually phased in over several years and must be internationally co-ordinated"* [5].

The following G-20 meeting in Toronto in June acknowledged delays in implementation timeline. The original plan was that the talks would be completed by the end of 2010 and new rules would be enforceable by the end of 2012. Hopes for a swift and timely implementation were put to rest when Canadian finance minister James Flaherty announced major postponements of implementation deadlines, saying that *"there can be a compromise on that"* [7]. George Osborne, the Chancellor of the Exchequer, said at the very same meeting that he is prepared to bear some delay, provided that there are no attempts at diluting the accord. With troubles heaping in the Eurozone, French and German banks were in favour of up to 10-year transitional period, in connection with their reliance on hybrid capital instruments that were scrapped by Basel III and which have to be refinanced by some form of Tier 1 capital upon maturity [7].

A few days later, Nout Wellink, chairman of BCBS, said at the meeting organized by IIF that "*where there are trade-offs, these should go in the direction of giving banks the time to reach the new standards instead of watering down the standards themselves"* and *"we do realize, on the basis of quoted impact studies, that we have to compromise on certain elements...but I think we will find a very acceptable solution"* [8]. Mr. Wellink further stated that regulators will also *"take into account the impact on the economy so as not to hamper the recovery,"* but there is no doubt that *"major part of the banking sector will go through a difficult period"* [9]. Praise from the sector was heard, stating that regulators *"have gone for the pragmatic outcome in which they recognize that they need a long glide path,"* [10] together with warm embrace of a wider capital definition and easements to some critical definitions concerning liquid assets. Timothy Geithner, US Treasury secretary, said at a conference in New York in August 2010 that *"We know [capital ratios] need to be substantially higher than they were. But we also know that if we set them too high too fast, we could hurt economic recovery or simply end up pushing risk outside of the banking system – something that could ultimately come back to haunt us. To limit that potential, we plan to give banks a reasonable transition period"* [19]. But in general, there is a consensus that Basel III has achieved most of what it originally set for, at least in the initial phase of the process – "*We went out with an initial proposal that was very conservative and have naturally made some adjustments as part of the normal consultative process. But when people step back and look at the whole package in comparison with the current status quo, they will see this is a major rising of the*

bar in terms of capital and liquidity," Stefan Walter, secretary general of BCBS, said [19]. What remains to be done is the actual implementation, where the risk of watering the final effect down is anything but negligible.

1.8 Summary of Basel III process achievements

When we take a big picture of the Basel III process so far, there are salient distinctions from that of Basel II. The biggest one is the extent and intensity of political pressure exerted on the Committee. In reaction to recent crisis, G-20 and Financial Stability Board (FSB) have been the key international players that influenced the shape of new regulation. Times when politicians were mere observers of the decision-making process at the Committee seem to be gone. The Committee had to obey a mandate set by G-20 in successive communiqués since April 2009, which made a number of people at the Committee, who were accustomed to a more secretive and much slower *modus operandi,* very uncomfortable.

Basel II was being completed over a few years. It seems almost unbelievable that Basel III has been completed in a year, given the scope of changes made to the framework. On the other hand, we have to acknowledge that this rush could cause a number of imperfections or measures that can manifest themselves as inappropriate or ill-fitted. As one senior Committee member put it, *"We have been pushed very hard by politicians to rush, so very often we have not been able to complete our assessment of all the changes, and the economic and financial situation is still very difficult. That means the old way of working hasn't been appropriate, and because of the pressure to complete, the secretariat has had to be very strong, even if some countries resisted"* [19]. This could be seen in July, when Germany refused to sign changes endorsed by the Committee to the initial proposal until the calibration and transitional arrangements had been completed.

When we evaluate Basel III process from the neo-proceduralist point of view, we have to acknowledge that it fulfils the requirements proposed by Mr. Lall to a large extent. First, supply side conditions were largely fulfilled with the extension of BCBS to encompass members from 27 countries, represented by no less than 45 institutions [19]. The Committee was pushed to open itself much more to the public. Bankers were blamed for the crisis and politicians throughout the world took advantage of this public anger to take more decisive steps in their attitude toward the banking sector. As has been stated above, it was G-20 that initiated Basel II reform and subsequently overlooked the process. Without this globalized political pressure on the Committee, we doubt Basel III to be adopted as fast and the changes to be as deep. In effect, the Committee was an extensive forum, with changes being approved by an external authority (G-20). In this setup, the effect of early arrival at the decision-making table does not constitute a comparative advantage. Even if an interest group had a privileged and early access and could influence the process to its benefit, it could not expect that decisions made at an early stage will not be revoked later.

Second, and more importantly, demand side conditions were much better than during the Basel II process. Bankers stood at the forefront when culprits of the crisis were being identified. Reform proposals concentrated on the banking sector, both due to the substantiality of the need for reform, and public pressure. To use the terms of

neo-proceduralists, wide constituencies were aware and well-informed about the causes and costs of the crisis. Moreover, the public was supported by supervisory bodies and other public agencies in their calls for a deep and substantial change to the way banking sector operates. This unison is unprecedented and we identify it with two facts, the degree of globalization of banking business and the ease of access to reliable sources of information.

To summarize, the conditions for a process to fall victim of regulatory capture were largely not fulfilled in the case of Basel II. Despite certain imperfections and concessions outlined herein, we argue that, in general, the process achieved the desired results to a large extent. Therefore, we reject our hypothesis that Basel III is another example of regulatory capture due to the reasons stated above. Finding that Basel III has not been captured, however, by no means do we imply that this cannot happen in future, when public attention diverges from banking regulation and banks will again have a lot of time to lobby during the very long implementation period, when significant dilution can take place. This long implementation period is, in our opinion, the most vulnerable point in Basel III framework, as we further argue below.

2 What remains to be done

As successful in reaching the goals originally set as Basel III may seem to be, there still remain a number of open issues, some of which can potentially cause a salient threat to the desired outcomes. We shall now examine some of them and evaluate their potential adverse impact onto regulatory process. First and foremost, the question of actual implementation arises. There are two dimensions to that; time and consistency. Considering the timeline of implementation, there are open issues with regard to liquidity ratios and the leverage ratio - the Committee has only set dates by which certain landmarks are to be achieved. There is still a lot of uncertainty about the actual shape of the process and development both within the Committee and the industry itself. These new regulatory instruments were adopted in a very short time span and hence can entail major unintended and unpredicted consequences.

Second, the Committee based its predictions and calculations on the assumption that Basel III is implemented at the same time and consistently throughout its jurisdictions. This assumption might be rather daring, since the actual process of implementation can result in a much less degree of consistency than the Committee would wish to achieve. National legislators and regulatory bodies must now transpose the rules into their own legal systems, which can cause a good deal of delay and cause a knock-on effect in postponing the deadlines. Regulators and the industry are well aware of this fact – *"I certainly think the hard work on this starts now. Politicians have said this is a prime opportunity to get consistency of capital and liquidity rules across all countries, but that will be very difficult to achieve. The countries may have all signed up at a broad level, but whether they implement consistently will be the real challenge"* Pamela Walkden of the London's Standard Chartered said [20].

Third, there is an imminent risk that a major banking jurisdiction delays significantly with the implementation. The USA has recently adopted their own extensive financial reform, known as the Dodd-Frank Act. This piece of legislation puts an enormous deal of requirements on US banks and there are concerns whether

these will have sufficient capacity to absorb Basel III. We can be sure to expect that US banks will first strive to conform to their home regulation, before being concerned with Basel III. As one senior European regulator put it, "*If the US does not implement it, Basel III will fail. I fear more the US not implementing Basel III than Europe or the emerging markets. If US banks don't have to implement it, the European banks will lobby they are at a competitive disadvantage. If banks lobby for years and years, I'm not sure we would be able to resist*" [20].

However, there are also open issues that remain to be resolved in the near future. The Committee has expressed the desire to add a capital surcharge for the so-called systemically important financial institutions (SIFI) to account for the additional risk they pose. The industry did not hesitate to issue a warning that this could lead to even more severe curb in lending activity and, hence, economic growth. In addition to capital surcharges, regulators are trying to figure out a failure resolution scheme in case a major global bank failed, without the enormous costs to taxpayers witnessed recently. IIF did not lose time to present its own proposal in January, in a fashion akin to the practice observed during Basel II creation when it was the industry that was setting the agenda. It came in a time when there are divergent plans on how to treat SIFIs among global players. This pre-emptive action came immediately after it had become obvious that a resolution scheme of kind or the other is more or less inevitable. We could argue that they changed their minds because alternatives offered by sticking to refusing any additional requirements could be worse in the end.

Regulators, however, differ substantially in their approach to SIFI treatment. There is no international coordination on this topic whatsoever. FSB presented a paper in November 2010 at the G-20 summit in Seoul containing various measures, such as capital surcharges, contingent or bail-in capital and additional liquidity requirements. Switzerland plans to impose additional capital charges on its two largest banks, UBS and Credit Suisse, that would contain some hybrid instruments currently not treated in Basel III. National regulators are presenting their own, conflicting ways to address the topic and so far, there has not been any major breakthrough agreement.

As far-reaching and successful in addressing the problems surfaced during the latest crisis as Basel III is in our opinion, there are a number of issues that remain to be addressed and resolved in a timely fashion to avoid dilution or evasion of some proposals, preventing a regulatory failure akin to that of Basel II. We argue that the timeline of implementation and unresolved issues concerning liquidity standards and treatment of SIFIs can pose a serious risk to Basel III being successful in the end. This risk is very material and politicians should remain alert about further regulatory agenda to prevent interest groups from capturing the Committee, after financial regulation has retreated from prominence in political agenda in the months and years to come.

Conclusion

This article was devoted to the institutional assessment of new capital adequacy rules commonly known as Basel III. These react to recent global financial crisis and ensuing recession that uncovered serious flaws in regulatory approach that failed to

account for most serious sources of risk. Banking sector was the originator of some of the most salient problems and Basel III aims to prevent this from happening again.

We adopt the neo-proceduralist approach to regulation assessment put forth by Ranjit Lall who uses a method of "process-tracing" to analyze regulatory process from the regulatory capture point of view. Based on that, we find that Basel III has successfully evaded the fate of its predecessor and is not a victim of regulatory capture. On the other hand, as we argue further, Basel III can once again fail to meet its objectives, if it is watered down by the affected institutions during the lengthy transitional period.

Finally, we focus on the challenges that remain to be faced by regulators. In particular, we point to the problem of systemically important financial institutions and consistency of implementation across jurisdictions. We argue that failure to resolve these issues can jeopardize regulatory reforms and stability and soundness of global financial markets.

Politicians and the society in general should remain alert to further developments in regulatory agenda. Banking sector has shown immense ingenuity at lobbying for more favourable rules in the past, always at the expense of the society as a whole. Therefore, it is of utmost importance for us to remain observant of regulatory agenda once banking regulation retreats from global flashlights.

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