Penn State Journal of Law & International Affairs

Volume 3
Issue 1 *3:1*

April 2014

Third Time's the Charm: Will Basel III Have a Measurable Impact on Limiting Future Financial Turmoil?

Erin Pentz
J.D. Candidate, 2014, Dickinson School of Law, Pennsylvania State University

ISSN: 2168-7951

Custom Citation
Erin Pentz, Comment, *Third Time's the Charm: Will Basel III Have a Measurable Impact on Limiting Future Financial Turmoil?*, 3 Penn. St. J.L. & Int'l Aff. 261 (2014).

Penn State
Journal of Law & International Affairs

2014 VOLUME 3 NO. 1

THIRD TIME'S THE CHARM: WILL BASEL III HAVE A MEASURABLE IMPACT ON LIMITING FUTURE FINANCIAL TURMOIL?

*Erin Pentz**

INTRODUCTION

Although international economies have faced financial turmoil many times over the last century, the 2008 financial crisis brought catastrophic bank failures not seen since the Great Depression.[1] Regulatory agencies responded swiftly to identify the source of the developing crisis and establish new rules to reduce vulnerability in the banking sector and prevent future crises.[2] With the endorsement of the G-20 Leaders,[3] the Basel Committee on Banking Supervision established the Basel III capital requirements to be implemented by all member nations[4] by January 1, 2018.[5]

* J.D. Candidate, 2014, Dickinson School of Law, Pennsylvania State University.

1 *See* Marilyn Geewax, *Did the Great Recession Bring Back the 1930s?*, NAT'L PUB. RADIO (July 11, 2012, 11:52 AM), http://www.npr.org/2012/07/11/155991507/did-the-great-recession-bring-back-the-1930s.

2 Stefan Walter, Secretary General, Basel Committee on Banking Supervision at the 5th Biennial Conference on Risk Management and Supervision: Basel III and Financial Stability (Nov. 3, 2010), http://www.bis.org/speeches/sp101109a.htm.

3 Press Release, Basel Committee on Banking Supervision, Results of the Dec. 2010 Meeting (Dec. 1, 2010), http://www.bis.org/press/p101201a.htm.

4 Member nations include: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS

This comment will consider the feasibility of international banking regulations under Basel III as applied to varying economies. Part I will address the rise of "Too Big to Fail" financial institutions and their effect on international economies, which sparked the desire for uniform international banking standards.[6] Part II will summarize historic international banking regulations and the failures of those measures that have set the groundwork for development of Basel III.[7]

Part III will discuss the post-recession stability of varying economies, the level of pre-recession banking regulation in each of those economies, and the path each is taking to implement the Basel III standards.[8] In Part IV, this comment will evaluate whether Basel III's uniform application of banking regulation across highly differing economies is feasible or productive.[9]

This comment concludes that Basel III is unlikely to have a major impact on the ability of financial sectors to weather economic storms. As a baseline measure, Basel III may hinder increased efforts for stability because its minimums are set with an eye towards concerns of competitiveness in the international marketplace. Historical practices show that changes to minimum capital requirements may be useless without strong financial regulation and diverse banking sectors.

I. "TOO-BIG-TO-FAIL"

The Secretary General of the Basel Committee on Banking Supervision, Stefan Walter summarized the general causes of banking crises as "excess leverage, too little capital of insufficient quality, and

AND BANKING SYSTEMS 1 n.1 (Dec. 2010) (rev. June 2011), [hereinafter BASEL III], http://www.bis.org/publ/bcbs189.pdf.

5 BASEL III, *supra* note 4, at 10.

6 *See infra* Part I.

7 *See infra* Part II.

8 *See infra* Part III.

9 *See infra* Part IV.

inadequate liquidity buffers" to weather economic downturns.[10] In the United States, Washington Mutual's failure in 2008 was record breaking.[11] With assets of $307 billion, but only about $188 billion in deposits, Washington Mutual simply had insufficient liquidity to outlast the collapse of the U.S. housing market.[12]

The U.S. government did nothing to prevent the failure of Washington Mutual.[13] However, in his speech in 2010, Walter recognized that some troubled banks could not be allowed to fail; some were simply "too-big-to-fail."[14] Certain financial institutions in both the U.S. and abroad[15] have become so interconnected with the global financial system that failure could have repercussions that extend to the entire international banking system.[16] Additionally, in nations with established insurance protocols to protect consumer deposits—for example, the United States' Federal Deposit Insurance Corporation (FDIC)—some financial institutions have become so large that available insurance funds may not adequately cover

---

[10] Stefan Walter, Secretary General, Basel Committee on Banking Supervision, 5th Biennial Conference on Risk Management and Supervision: Basel III and Financial Stability (Nov. 3, 2010), http://www.bis.org/speeches/sp101109a.htm.

[11] *Regulator Sells Washington Mutual*, BBC NEWS (Sept. 26, 2008), http://news.bbc.co.uk/2/hi/business/7637026.stm; Eric Dash & Andrew R. Sorkin, *WaMu is Seized in Largest Bank Failure in U.S. History*, STARTRIBUNE, Sept. 25, 2008, http://www.startribune.com/business/29776529.html?refer=y.

[12] *Regulator Sells Washington Mutual*, BBC NEWS (Sept. 26, 2008), http://news.bbc.co.uk/2/hi/business/7637026.stm.

[13] Eric Dash & Andrew R. Sorkin*, WaMu is Seized in Largest Bank Failure in U.S. History*, STARTRIBUNE, Sept. 25, 2008, http://www.startribune.com/business/29776529.html?refer=y (Regulators brokered an emergency sale of nearly all of the bank's assets, rather than injecting substantial sums of taxpayer dollars to prevent collapse).

[14] Stefan Walter, Secretary General, Basel Committee on Banking Supervision, 5th Biennial Conference on Risk Management and Supervision: Basel III and Financial Stability (Nov. 3, 2010), http://www.bis.org/speeches/sp101109a.htm.

[15] The Financial Services Authority in the United Kingdom chose to nationalize Bradford & Bingley before it failed due to over-leveraging because failure may have harmed the banking system as a whole. *Treasury to Nationalise B&B Bank*, BBC NEWS (Sept. 28, 2008), http://news.bbc.co.uk/2/hi/business/7640143.stm.

[16] Dash & Sorkin, *supra* note 13.

depositor losses in the event of the institution's bankruptcy.[17] If one of these large financial institutions failed, agencies like the FDIC would be forced either to seek additional funds from the government or to allow consumers to suffer.[18]

One solution for governments facing the potential failure of a "Too-Big-to-Fail" institution has been for the government to inject capital, occasionally in substantial proportions, into the flailing institutions.[19] In 2008, the government revived Citigroup, a U.S. financial institution with 200 million customers and branches in over 100 countries, by injecting the bank with $45 million in capital.[20] First, the U.S. government attempted to recruit Wachovia, another major financial institution, to help Citigroup reduce risky assets and acquire low-cost funding.[21] When the deal fell through, concerns about the effect of Citigroup's potential bankruptcy inspired the U.S. to infuse millions in taxpayer dollars into the bank.[22]

In the European Union (E.U.), governments are prohibited from injecting funds into the private sector.[23] However, the extreme repercussions of the failure of "Too-Big-to-Fail" institutions has led to certain exceptions, such as the German banking sector's injection of $4.8 billion into the failing IKB Deutsche Industriebank.[24]

---

17 Economists predicted that if Washington Mutual had not been seized and the FDIC was forced to insure consumer's deposits, the funds available would not have been adequate. *Regulator Sells Washington Mutual*, BBC NEWS (Sept. 26, 2008), http://news.bbc.co.uk/2/hi/business/7637026.stm.

18 *Id.*

19 *See* David Enrich et al., *U.S. Agrees to Rescue Struggling Citigroup*, WALL ST. JOURNAL, Nov. 24, 2008, http://online.wsj.com/article/SB122747680752551447.html.

20 *Id.*

21 Tobias Buck, *National Reputation Hangs on IKB Rescue*, FIN. TIMES, Aug. 2, 2007, http://www.ft.com/intl/cms/s/0/7017b0c0-411a-11dc-8f37-0000779fd2ac.html - axzz2ABEJZjXP.

22 Enrich, *supra* note 19.

23 Buck, *supra* note 21.

24 German banks, public and private, recognized the need to protect IKB or risk the reputation of the entire industry. They feared a perception of "insufficient risks standards" at German banks and reduced trust in the German banking system. Buck, *supra* note 21.

When possible, governments have facilitated mergers to avoid bailing out failing institutions using taxpayer dollars.[25] When successful, mergers can help increase funding or decrease liquidity shortfalls by diversifying capital, as was the hope in the proposed Citigroup-Wachovia merger.[26] In other instances, mergers can simply allow larger, more stable banks to absorb the assets and liabilities of failing institutions while increasing their own market share, as was the case in the United Kingdom based Lloyd's TSB-Halifax Bank of Scotland merger.[27]

One final solution, although utilized less frequently than other options, is the nationalization of failing banks. In 2007, the United Kingdom (U.K.) temporarily nationalized Northern Rock Bank after all other stabilization options seemed ineffective.[28] Taxpayers footed the bill to rescue the bank at a cost of nearly £55 billion.[29]

Although the government injection of capital, the facilitation of mergers, and the nationalization of private banks prevented the failure of major financial institutions during the Great Recession of 2007-2009, the problems within the banking industry became the problems of the entire financial system due to the interconnectivity of the system.[30] These problems have had long-lasting impacts on national economies.[31]

---

25 *See Thousands Face Axe in HBOS Merger*, BBC NEWS (Sept. 18, 2008), http://news.bbc.co.uk/2/hi/business/7622380.stm.

26 Enrich, *supra* note 19.

27 *Thousands Face Axe in HBOS Merger*, BBC NEWS (Sept. 18, 2008), http://news.bbc.co.uk/2/hi/business/7622380.stm.

28 *Northern Rock to be Nationalized*, BBC NEWS (Feb. 17, 2008), http://news.bbc.co.uk/2/hi/business/7249575.stm.

29 *Id.*; *see also* Michael Steen & Peter T. Larsen, *Dutch Alter Terms of Fortis Bail-out*, FIN. TIMES, Oct. 4, 2008, http://www.ft.com/intl/cms/s/0/f93a9b08-91ad-11dd-b5cd-0000779fd18c.html - axzz2H3FnY7f9 (discussing the Dutch government's nationalization of banks Fortis and ABN Amro, after attempts to facilitate mergers failed to save the floundering institutions).

30 *See generally* Jill Treanor, *Toxic Shock: How the Banking Industry Created a Global Crisis,* GUARDIAN (Apr. 7, 2008), http://www.theguardian.com/business/2008/apr/08/creditcrunch.banking.

31 BASEL III, *supra* note 4, at 1.

II. THE BASEL ACCORDS: RESPONSES TO CRISES

A. The Basel Committee's Purpose

The Basel Committee on Baking Supervision (BCBS) is one of several committees within the Bank for International Settlements (BIS).[32] The BIS is not a consumer bank, but rather serves central banks to aid in establishing monetary and financial stability and international cooperation.[33] BCBS was created to develop guidelines and supervisory standards for financial institutions and is best known for its development of international standards on capital adequacy.[34] The BCBS does not possess any actual legal authority; rather, it develops best practices and makes recommendations to supervisory leaders to help implement those initiatives endorsed by member nations.[35]

B. Historic Basel

In 1988, the BCBS introduced a framework, known as the Basel Capital Accord or Basel I,[36] designed to manage credit risk in major financial institutions through the establishment of minimum capital requirements.[37] The initial iteration called for a minimum capital ratio[38] of eight percent.[39] Basel I was never intended to be a

---

32 *About BIS*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/about/index.htm (last visited Jan. 4, 2013).

33 Established in 1930, BIS is the world's oldest international financial institution. *Id.*

34 *About the Basel Committee*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/about.htm (last updated Oct. 7, 2012).

35 Basel Comm. on Banking Supervision, History of the Basel Committee and its Membership 1 (2009), http://www.bis.org/bcbs/history.pdf.

36 With the introduction of new iterations of the Basel Capital Accord, this first framework has become known as Basel I. *About the Basel Committee*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/about.htm (last updated Oct. 7, 2012).

37 Basel Comm. on Banking Supervision, *supra* note 35, at 2.

38 Established by factoring capital to risk-weighted assets (with risk based on the credit risk of the borrow). *Id.*

39 *Id.*

static, long-term solution.[40] Its evolution began in 1991,[41] and its first amendment was published in 1995.[42]

Throughout the 1990s and early 2000s, Basel I's development continued with the addition of measures to manage market risk and improve evaluation of capital adequacy.[43] Basel II was released in 2004.[44] The new framework focused on three main "pillars": (1) minimum capital requirements; (2) supervisory review of an institution's capital adequacy and internal assessment process; and (3) effective use of disclosure to encourage discipline and sound banking practices.[45] Under Basel II, the minimum capital requirement remained at eight percent.[46] However, unlike under Basel I, the BCBS required half of the total capital under Basel II to consist of Tier 1 capital—the purest and most adequate form of capital (i.e. shareholder capital).[47] Basel II also assigned more stringent risk weights to certain forms of investments and long-past-due loans.[48]

Although implementation of Basel II effectively began in 2004,[49] the Great Recession began only a few short years later in 2007.[50] The causes of the Great Recession are many, but prominent commentators attributed bank failures to the insufficiency of capital

---

40 *Id.* at 3.

41 Some critics argue that even early evolution could not save a scheme that was doomed to fail due to its crudely define risk categories and unfortunate incentives to increase risk, effectively reducing the capital banks actually held. Ranjit Lall, *From Failure to Failure: The Politics of International Banking Regulation*, 19 REV. INT'L POL. ECON. 609, 612 (2012).

42 Basel Comm. on Banking Supervision, *supra* note 35, at 3.

43 *Id.*

44 *Id.*

45 *Id.*

46 Just as under Basel I. *See supra* Part I.

47 Basel Comm. on Banking Supervision, International Convergence of Capital Measurement and Capital Standards: A Revised Framework 12 (2004), http://www.bis.org/publ/bcbs107.pdf.

48 *Id.* at 27, 33 (assigning a risk weight of 150% to consumers whose credit is rated lower than a B- and to past due loans with less than 20% equity).

49 *See Basel II: Revised International Capital Framework*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/publ/bcbsca.htm (last visited Jan. 4, 2013) (for a detailed breakdown of the implementation timeline).

50 *See supra* Introduction.

on bank balance sheets coupled with over-leveraging and insufficient liquidity buffers to weather downturns.[51] Thus, the very problems that BCBS intended to avoid by introducing far-reaching international banking regulation were the causes of a crisis three years after Basel II's implementation began.[52] The result was the failure of 443 financial institutions in the U.S. alone.[53]

C. Basel III

In the wake of the 2008 crisis, the BCBS returned to the drawing board.[54] Intent on "raising the resilience of the banking sector", committee members took a five-fold approach to regulation: (1) raising the quality, consistency, and transparency of the capital base; (2) enhancing risk coverage; (3) supplementing the risk-based capital requirement with a leverage ratio; (4) promoting countercyclical buffers and capital conservation buffers; and (5) addressing systemic risk and interconnectedness.[55] Specifically, Basel III made adjustments to the minimum capital requirement.[56] Although the total capital[57] remained at eight percent,[58] Tier 1 Capital[59] overall was raised to six percent, and Common Equity Tier 1 Capital[60] was raised to at least four-and-a-half percent of risk-

---

51 Stefan Walter, Secretary General, Basel Committee on Banking Supervision, 5th Biennial Conference on Risk Management and Supervision: Basel III and Financial Stability (Nov. 3, 2010), http://www.bis.org/speeches/sp101109a.htm.

52 *Id.*

53 Marilyn Geewax, *Did the Great Recession Bring Back the 1930s?*, NAT'L PUB. RADIO (July 11, 2012), http://www.npr.org/2012/07/11/155991507/did-the-great-recession-bring-back-the-1930s.

54 BASEL III, *supra* note 4, at 2.

55 BASEL III, *supra* note 4, at 2-5, 7.

56 BASEL III, *supra* note 4, at 12.

57 Tier 1 Capital plus Tier 2 Capital. BASEL III, *supra* note 4, at 12.

58 As in Basel I and Basel II. *See supra* Part II.B.

59 Tier 1 Capital consists of Common Equity Capital, and instruments issued by the bank that meet the criteria outlined in Basel III, which may include subordinated instruments or those instruments with nearly negligible credit risk. BASEL III, *supra* note 4, at 15-17.

60 Common Equity Tier 1 capital consists of common shares, stock surplus, retained earnings, and other accumulated income. BASEL III, *supra* note 4, at 13.

weighted assets.[61] Basel III also established "stress testing" measures.[62]

Basel III's main focus has been the rise of "Too-Big-to-Fail" institutions.[63] The BCBS worked with the Financial Stability Board (FSB)[64] to determine which financial institutions met the status of "Too-Big-to-Fail", or termed more specifically, "Systemically Important Banks"[65] (SIBs), upon which Basel III will have the most significant impact.[66] In November of 2011, the FSB released a list of 29 SIBs, including eight U.S. banks, seventeen European banks, three Japanese banks, and one Chinese bank.[67] The BCBS comment regarding SIBs recognized that some institutions are so large that individual operating procedures must be conducted with an eye towards the potential impact on the entire international banking

---

61 BASEL III, *supra* note 4, at 12.

62 BASEL III, *supra* note 4, at 46.

63 Agustino Fontevecchia, *The 29 Global Banks that are Too Big to Fail*, FORBES (Nov. 4, 2011), http://www.forbes.com/sites/afontevecchia/2011/11/04/the-worlds-29-most-systemically-important-banks/.

64 The FSB was established to enhance cooperation among national and international supervisory boards and financial institutions. Membership spans the G20 countries, and the intent is to address vulnerabilities and develop and implement regulations and policies in the interest of advancing financial stability. The mandate of the FSB focuses on assessing vulnerabilities, promoting coordination, monitoring and advising markets and policies, and undertaking joint actions to plan and develop guidelines. *About the FSB: Overview*, FIN. STABILITY BOARD, http://www.financialstabilityboard.org/about/overview.htm (last visited Jan. 4, 2013).

65 Defined as: "Financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. To avoid this outcome, authorities have all too frequently had no choice but to forestall the failure of such institutions through public solvency support." Fontevecchia, *supra* note 63.

66 Press Release, Basel Committee on Banking Supervision, Dealing with Domestic Systemically Important Banks: Framework Issued by the Basel Committee (Oct. 11, 2012), http://www.bis.org/press/p121011.htm.

67 Fontevecchia, *supra* note 63.

system.[68] For these 29 banks, BCBS created higher loss absorbency standards, which range from additional Common Equity Tier 1 Capital of one percent to two-and-a-half percent greater than the non-SIB standard, depending on the size and systemic importance of the institution.[69] The BCBS also discouraged these institutions from becoming even more systemically important.[70]

III. Comparative Analysis in Implementation Efforts

A. Canada

The Canadian economy is one of the fifteen largest in the world (while occasionally breaking into the top ten).[71] And yet, not one of its banks failed during the Great Recession.[72] In fact, the Canadian economy survived the Great Recession relatively unscathed.[73]

One of the potential sources of Canadian economic stability may be the drastic difference between the Canadian banking system

[68] Basel Comm. on Banking Supervision, Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement: Cover Note (Nov. 2011), http://www.bis.org/publ/bcbs207cn.pdf.

[69] Press Release, Basel Committee on Banking Supervision, Measures for Global Systemically Important Banks Agreed by the Group of Governors and Heads of Supervision (June 25, 2011), http://www.bis.org/press/p110625.htm.

[70] Basel Comm. on Banking Supervision, Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement: Rules Text (Nov. 2011), http://www.bis.org/publ/bcbs207.pdf.

[71] Kevin Carmichael, *A Middling Grade for Canada in Latest Economic Ranking*, Globe & Mail (Mar. 17, 2011), http://www.theglobeandmail.com/report-on-business/economy/economy-lab/a-middling-grade-for-canada-in-latest-economic-ranking/article612747/.

[72] Mark Perry, *Due North: Canada's Marvelous Mortgage and Banking System*, Am. (Feb. 26, 2010), http://www.american.com/archive/2010/february/due-north-canadas-marvelous-mortgage-and-banking-system.

[73] "In 2008, the World Economic Forum ranked Canada's banking system the healthiest in the world. America's ranked 40th, Britain's 44th." Fareed Zakaria, *Worthwhile Canadian Initiative,* Newsweek (Feb. 6, 2009), http://www.thedailybeast.com/newsweek/2009/02/06/worthwhile-canadian-initiative.html.

and other industrialized nations.[74] First, the Canadian banking system consists of five major banks out of a mere 82 banks in the entire country.[75] These 82 banks benefit from great diversity across geographic regions.[76] Because of the concentration of banks, coordination between the banks and regulators is facilitated.[77] Substantial discussions regarding best banking practices and brainstorming on methods to weather downturns are feasible and likely.[78]

Second, the Canadian mortgage market has built-in protections that advance the stability of the banking system.[79] For example, all mortgages in Canada are "Full Recourse" mortgages, meaning that a borrower remains fully responsible for any mortgage, even if the home has been foreclosed upon.[80] This provides a lesser incentive for borrowers to walk away from mortgages[81] while ensuring that lending institutions retain the ability to recoup all mortgage liabilities.[82] Additionally, Canadian mortgage insurance is more widespread than in the U.S.,[83] giving Canadian banks a guarantee of repayment for a significant portion of all mortgages. Finally, Canadian banks fix interest rates for only five years at a time for mortgages,[84] retain a large portion of originated loans on their

---

74 Perry, *supra* note 72.

75 *Id.*

76 *Id.*

77 *Id.*

78 *Id.*

79 *Id.*

80 Fareed Zakaria, *Worthwhile Canadian Initiative,* NEWSWEEK (Feb. 6, 2009), http://www.thedailybeast.com/newsweek/2009/02/06/worthwhile-canadian-initiative.html.

81 Economies not using full recourse mortgages incentivize the borrower to walk away from his home and his loan when times become tough. *Id.*

82 Interestingly, home ownership in Canada is 69%, as compared to homeownership in the U.S. at 67.2%. Perry, *supra* note 72.

83 Roughly half of all Canadian mortgages carry mortgage insurance; yet, in the U.S. pre-Great Recession, mortgage insurance was found on only fifteen percent of all mortgages and typically only on high leveraged mortgages with less than twenty percent equity. *Id.*

84 Because rates are fixed for only a short time, every five years an adjustment to interest rates occurs, allowing the interest rates on mortgages to adjust with market conditions. *Id.*

own balance sheets,[85] and engage in the subprime mortgage market to a lesser degree than banks in other major economies.[86]

Additional sources of Canadian economic stability lie in the Country's pre-Great Recession regulation of its banks. Canadian banks have maintained a strong regulatory framework since the economic crisis in the early 2000s.[87] They are regulated on a federal level by four major regulatory agencies: The Department of Finance,[88] the Bank of Canada,[89] the Office of the Superintendent of Financial Institutions (OSFI),[90] and the Canada Deposit Insurance Corporation.[91] Each agency has a specific focus or area of expertise.[92] In addition, non-national banks are regulated by agencies at the provincial level.[93] Canada also has several committees that facilitate collaboration between the regulatory agencies, both federal and provincial, so that all issues and regulations are addressed between the sister agencies on both a regional and national scale.[94] Most importantly, however, is the "sunset clause" which causes all federal financial regulations to lapse every five years, ensuring that each of the above named agencies review financial legislation periodically for soundness.[95]

---

85 Canadian banks service sixty-eight percent of the mortgages they originate; therefore, they have a continued interest in the risk associated with each loan they write. *Id.*

86 *Id.*

87 During that same time period, however, U.S. and E.U. banks were loosening banking regulations to stimulate economic growth following the recession of 2001. Zakaria, *supra* note 80.

88 The Department of Finance is responsible for the overall stability of the financial system and overarching financial sector legislation. FIN. STABILITY BOARD, PEER REVIEW OF CANADA 9 (Jan. 30, 2012), http://www.financialstabilityboard.org/publications/r_120130.pdf.

89 The Bank of Canada assesses risk and provides liquidity to the Canadian financial system. *Id.*

90 OSFI is the regulator and supervisor of federal Canadian financial institutions. *Id.*

91 The Canada Deposit Insurance Corporation insures deposits of financial institutions. *Id.*

92 *Id.*

93 *Id.* at 10.

94 *Id.* at 10-11.

95 *Id.* at 11.

To increase stability further, Canadian regulatory agencies have mandated significant minimum capital requirements since 1999.[96] At that time, banks were required to meet or exceed seven percent Tier 1 capital ratios and ten percent total capital ratios.[97] Additionally, OSFI reserved the right to direct a bank to increase its capital through institution-specific requirements.[98] Regulatory agencies also required Canadian banks to limit leverage to twenty-to-one,[99] and in 2009, Canadian banks were typically leveraged below that rate at eighteen-to-one.[100]

Overall, no one element has led to the strength of the Canadian economy. Certainly the development of a strong regulatory framework, the self-protecting practices of the lending market, and the comparatively high capital requirements[101] in the banking sector had a major impact on the stability of Canadian financial institutions. Nonetheless, Canada, as a member of the G-20, is taking steps to make changes following Basel III's adoption.

The OSFI established a plan to complete its interpretation of Basel III requirements by the end of 2012 and began implementation in the first fiscal quarter of 2013.[102] In its plan, all deposit-taking institutions were required to meet the seven percent Tier 1 target.[103] Although Canadian deposit institutions were previously required to meet a seven percent Tier 1 minimum, OSFI recognized that some institutions may have fallen below the minimum as a result of pressure from international financial instability.[104] OSFI, therefore,

---

96 *Id.* at 12.

97 *Id.*; Compare *supra* Section III.B. and III.C. for a discussion of Basel II and Basel III capital requirements.

98 FIN. STABILITY BOARD, *supra* note 88, at 12.

99 *Id.*

100 Zakaria, *supra* note 80.

101 *See supra* Section III. As compared to the overall requirements under the Basel models.

102 Press Release, Office of the Superintendent of Fin. Insts. Canada, Basel III Implementation – Capital Adequacy and Liquidity Requirements (Feb. 1, 2011), http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/cptlq_e.pdf.

103 *Id.*

104 *Id.*

recognized that banks should continue to "maintain prudent earnings retention policies and avoid actions that weaken their capital position."[105] Additionally, OSFI acknowledged that its current leverage ratio calculation did not necessarily conform with the Basel III rules, but intended not to take steps to alter its own ratios and monitoring until the Basel III leverage ratio was finalized.[106] Finally, OSFI made no plans to begin implementation of the liquidity coverage ratio until BCBS deemed such actions necessary.[107] Rather, OSFI planned to work with small banks and foreign bank branches to determine how the new metrics established under Basel III might work with their operations.[108]

In addition to the minimum capital requirements, OSFI addressed the quality of capital necessary under Basel III. It planned a mandatory requirement that all non-common share capital instruments contain a provision in their contract terms that allows for the conversion to common share capital upon a triggering event.[109] Specifically, OSFI established regulations allowing the mandate of a full and permanent conversion of the class of capital if OSFI determines that the financial institution's viability has ceased or the Canadian government has decided to support the financial institution for any other reason.[110] OSFI also encouraged financial institutions to confirm the quality of capital with OSFI[111] prior to issuing questionable capital instruments.[112] Additionally, financial institutions

105 *Id.*

106 *Id.*

107 FIN. STABILITY BOARD, *supra* note 88, at 15.

108 *Id.*

109 Press Release, Office of the Superintendent of Fin. Insts. Canada, Non-Viability Contingent Capital (Aug. 2011), http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/nvcc_e.pdf.

110 *Id.*; *see also* John Greenwood, *Canadian Banks Stronger Than They Look: OSFI*, FIN. POST (May 8, 2013), http://business.financialpost.com/2013/05/08/osfi-canadian-banks-stronger-than-they-look/.

111 Although such action is encouraged, OSFI has no current intention to make confirmation of quality of capital mandatory. Press Release, Office of the Superintendent of Fin. Insts. Canada, Non-Viability Contingent Capital (Aug. 2011), http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/nvcc_e.pdf.

112 *Id.*

are instructed to redeem any capital instruments that do not meet Basel III standards at their regular redemption dates, rather than waiting for regulatory events to trigger redemption.[113]

The BCSB and FSB did not include any Canadian banks on the SIB list.[114] As a result, OSFI and other Canadian regulatory agencies were not required to establish heightened minimum capital requirements for its largest financial institutions.[115] Overall, because Canada has no SIBs, already has substantial minimum capital requirements for financial institutions, and intends to make no additional changes until Basel III liquidity and leverage ratios are finalized, Canadian financial institutions will be in substantial compliance with Basel III goals from its implementation in the first fiscal quarter of 2013.

B. Switzerland

Switzerland has long been known as one of the safest places in the world for affluent individuals to store their wealth.[116] Prior to the Great Recession, Swiss banks held assets worth more than six times the country's overall gross domestic product (GDP).[117] In comparison, U.S. banks held assets totaling a mere seventy percent of

113 Press Release, Office of the Superintendent of Fin. Insts. Canada, Treatment of Non-qualifying Capital Instruments (Feb. 2011), http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/nqcibIII_e.pdf.

114 *See supra* Part II.C.

115 *See supra* Part II.C. Although no Canadian banks were included on the SIB list, the OSFI designated all of Canada's six largest banks as domestic systemically important banks. These six banks are subject to a 1% risk-weighted capital surcharge and subject to continued supervisory intensity and enhanced disclosure requirements. Stephen B. Kerr, *Canadian Banks Come to Grips with Basel III*, LEXOLOGY (Oct. 10, 2013), http://www.lexology.com/library/detail.aspx?g=a815f72b-005e-43b0-b366-0a52f62cda12.

116 Craig Whitlock, *Banking Crisis Has Made Even the Swiss Uneasy*, WASH. POST, Oct. 15, 2008, http://www.washingtonpost.com/wp-dyn/content/story/2008/10/15/ST2008101500708.html.

117 Stefan Theil, *What the Swiss Did Right*, NEWSWEEK (Dec. 27, 2010), http://www.thedailybeast.com/newsweek/2010/12/27/how-switzerland-saved-its-banking-industry.html.

its GDP during the same time period.[118] The sheer size of the Swiss banking sector compared to the Swiss economy substantiates the importance of financial stability to the country.

Two major banks, UBS and Credit Suisse, dominate the Swiss banking sector.[119] Together, UBS and Credit Suisse held $2.85 trillion in assets before the Great Recession, totaling more than four times Switzerland's GDP at the time.[120] UBS and Credit Suisse operate internationally and focus on investment banking and wealth management, with half of the wealth management assets coming from foreign clients.[121] The Swiss banking sector is also composed of cantonal banks[122] and other regional banks that operate domestically.[123]

In 2008, when the Great Recession began and international financial institutions began failing, the Swiss government looked to UBS and Credit Suisse as possible sources of economic instability.[124] Because of the size of the two banks, Swiss agencies recognized that the Swiss economy was simply not large enough to bail out the banks if they failed[125] and feared that collapse in either could throw the entire country into financial turmoil.[126]

---

118 *Id.*

119 FIN. STABILITY BOARD, PEER REVIEW OF SWITZERLAND 9 (Jan. 25, 2011), http://www.financialstabilityboard.org/publications/r_250112.pdf.

120 In 2011, the assets of UBS and Credit Suisse totaled more than twice Switzerland's GDP, a sharp reduction from 2007-2008 dominance. *Id.*; Whitlock, *supra* note 116.

121 FIN. STABILITY BOARD, *supra* note 119, at 9 n.3.

122 Cantonal banks operate within Switzerland's individual cantons, or states, typically servicing only individual cantons and owned either entirely or in the large majority by the canton. As of early 2013, 24 cantonal banks exist. *Cantonal Banks*, CANTONAL BANK, http://www.kantonalbank.ch/e/gruppe/kantonalbanken/index.php (last visited Jan. 4, 2013).

123 FIN. STABILITY BOARD, *supra* note 119, at 9.

124 Whitlock, *supra* note 116.

125 Theil, *supra* note 117.

126 Whitlock, *supra* note 116.

In the same time period, as a result of aggressive expansion to its investment banking business, UBS found itself in trouble.[127] The bank quickly secured billions in capital from new share offerings and injections from international investors and governments,[128] but the effort was insufficient to stabilize the bank.[129] As a result, the Swiss government took additional steps to secure the bank.[130] The Swiss central bank nationalized $54 billion[131] of UBS's assets and recapitalized the remaining private assets.[132] UBS did not fail as a result of the financial crisis, but public perception of the bank did not recover from the negativity surrounding its instability.[133]

Credit Suisse also suffered major losses as a result of the financial crisis.[134] However, unlike UBS, a capital injection from international investors was sufficient to prevent the need for government intervention.[135]

The smaller Swiss banking institutions did not face similar struggles during the financial crisis.[136] Instead, they were able to gain market share at the expense of UBS' and Credit Suisse's questionable

---

127 *Id.*

128 *Id.*

129 Theil, *supra* note 117.

130 *Id.*

131 Alan Cowell, *UBS and Credit Suisse get Urgent Bailout Funds*, N.Y. TIMES, Oct.16, 2008, http://www.nytimes.com/2008/10/16/business/worldbusiness/16iht-17swiss.17006058.html?_r=0 (last visited Jan. 4, 2013).

132 Theil, *supra* note 117.

133 *See* Whitlock, *supra* note 116.

134 Totaling $19 billion in comparison to UBS's $53 billion in losses from 2007 until 2009. FIN. STABILITY BOARD, *supra* note 119, at 11 n.10.

135 Alan Cowell, *UBS and Credit Suisse get Urgent Bailout Funds*, N.Y. TIMES, Oct. 16, 2008, http://www.nytimes.com/2008/10/16/business/worldbusiness/16iht-17swiss.17006058.html?_r=0 (last visited Jan. 4 2013).

136 *See* FIN. STABILITY BOARD, *supra* note 119, at 7; SWISS FIN. MKT. SUPERVISORY AUTH. FINMA, FINANCIAL MARKET CRISIS AND FINANCIAL MARKET SUPERVISION 15 (Sept. 14. 2009), http://www.finma.ch/e/aktuell/Documents/Finanzmarktkrise-und-Finanzmarktaufsicht_e.pdf.

stability.[137] Cantonal banks, in particular, were well capitalized, had higher quality capital than the two largest banks, and in some cases, had their liabilities fully guaranteed by their cantons.[138] Each of these factors led to stability during the crisis.

Three agencies regulate the Swiss financial market.[139] The Swiss Financial Market Supervisory Authority (FINMA) is the supervisory and regulatory authority responsible for the financial industry.[140] It was created in 2007 but did not receive full power until 2009.[141] FINMA works in conjunction with the Swiss National Bank (SNB), the nation's central bank in charge of monetary policy,[142] and the Federal Department of Finance (FDF), the nation's ministry of finance in charge of policy.[143]

As a result of the 2008 financial crisis, Swiss regulatory agencies moved quickly to ensure the stability of its two largest banks and to begin tightening banking regulations concerning capital minimums and adequacy.[144] During this time, FINMA mandated quarterly "stress-testing" to determine risk within each institution.[145] FINMA, working with SNB, also set new capital standards for the two major banks, requiring each institution to hold ten percent Tier 1 Common Equity capital by 2018.[146] Additionally, UBS and Credit

---

[137] FIN. STABILITY BOARD, *supra* note 119, at 7; SWISS FIN. MKT. SUPERVISORY AUTH. FINMA, FINANCIAL MARKET CRISIS AND FINANCIAL MARKET SUPERVISION 15 (Sept. 14. 2009), http://www.finma.ch/e/aktuell/Documents/Finanzmarktkrise-und-Finanzmarktaufsicht_e.pdf.

[138] FIN. STABILITY BOARD, *supra* note 119, at 7.

[139] *See id.* at 10.

[140] *Id.*

[141] *Id.*

[142] FINMA, Memorandum of Understanding in the Field of Financial Stability Between the Swiss Financial Market Supervisory Authority FINMA and the Swiss National Bank SNB 1 (Feb. 23, 2010), http://www.snb.ch/en/mmr/reference/mofu/source.

[143] FIN. STABILITY BOARD, *supra* note 119, at 10.

[144] *Id.* at 12.

[145] *Id.* at 25

[146] *Swiss Banks get Stricter Rules than Basel III*, SWISS BROADCASTING CORP., Oct. 4, 2010,

Suisse will be mandated to increase their current total capital requirements to nineteen percent after including nine percent contingent convertible bonds.[147] Contingent convertible bonds are newly developed instruments that would commit their holders to buy shares from the banks in times of dire financial straits.[148] For cantonal and smaller banks, the Basel III framework's eight percent minimum capital requirement is expected to be adopted into Swiss law, with complete implementation by 2019.[149]

The Swiss Bankers Association predicted in 2010 that Swiss authorities would pressure international agencies like the BCBS to adopt strict standards equal to those the Swiss agencies previously adopted.[150] When the Basel III requirements were subsequently approved, however, swift acting Swiss agencies were forced to confront the reality that such extreme differences in regulations could have a negative impact on the Swiss financial sector.[151] UBS and Credit Suisse's heightened capital requirements could easily impact Switzerland's international competitiveness in an already competitive market.[152]

Through the fourth quarter of 2012, UBS struggled greatly to remain competitive in its investment banking business, experiencing a $2.3 billion loss in the third quarter of 2012.[153] The bank also announced plans to lay off more than 10,000 workers over a three-year period.[154] Credit Suisse faced similar problems and potential

---

http://www.swissinfo.ch/eng/Specials/Rebuilding_the_financial_sector/News,_results,_regulations/Swiss_banks_get_stricter_rules_than_Basel_III.html?cid=28464958.

147 *Id.*

148 *Id.*

149 FIN. STABILITY BOARD, *supra* note 119, at 14.

150 Matthew Allen, *Swiss Banking Regulation Leads the Field*, SWISS BROADCASTING CORP., Oct. 5, 2010, http://www.swissinfo.ch/eng/Specials/Rebuilding_the_financial_sector/News,_results,_regulations/Swiss_banking_regulation_leads_the_field.html?cid=28472592.

151 Tim Devaney, *Global Crisis Squeezes Swiss Banks*, WASH. TIMES, Nov. 4, 2012, http://www.washingtontimes.com/news/2012/nov/4/global-crisis-squeezes-swiss-banks-as-regulations-/?page=all.

152 Allen, *supra* note 150.

153 Devaney, *supra* note 151.

154 *Id.*

restructuring, but with a smaller investment banking business, the pressure to drop the entire business segment was not as great as that which UBS faced.[155] This deteriorating effect on risky investment banking may likely have been well within the Swiss regulators' intentions when it implemented more stringent capital regulations than those adopted under Basel III.[156]

In addition to its struggling investment banking business, UBS stopped paying dividends, hoping that holding onto retained earnings would help it secure the required minimum capital.[157] Credit Suisse, reporting solid progress towards the new capital minimum goals, continued to pay dividends to its shareholders.[158] Unfortunately, the bank lagged far behind competitors abroad when using Basel III[159] standards to evaluate capital adequacy.[160] Although some approaches to valuation projected Credit Suisse's 2012 Tier 1 capital above the benchmark required by Swiss law after full implementation in 2019, financial services firm Barclays applied new capital adequacy standards to Credit Suisse's assets and projected just under six percent adjusted capital.[161]

---

155 *Id.*; *see also* David Jolly & Chad Bray, *Credit Suisse to Streamline and Shrink*, N.Y. TIMES, Oct 24, 2013, http://dealbook.nytimes.com/2013/10/24/credit-suisse-profits-rise-but-results-fall-short-of-expectations/?_r=1.

156 *Swiss Banks get Stricter Rules than Basel III*, SWISS BROADCASTING CORP., Oct. 4, 2010, http://www.swissinfo.ch/eng/Specials/Rebuilding_the_financial_sector/News,_results,_regulations/Swiss_banks_get_stricter_rules_than_Basel_III.html?cid=28464958.

157 As of June 2012, UBS held seven-and-a-half percent Tier 1 capital under Basel III's capital adequacy standards. Julia Werdigier, *Switzerland and Britain Gird Against the Storm*, N.Y. TIMES, June 14, 2012, http://www.nytimes.com/2012/06/15/business/global/british-plan-offers-more-funds-to-banks.html?pagewanted=all&_r=0.

158 *Id.*

159 As opposed to earlier Swiss standards.

160 Peter Eavis, *Why European Bank Buffers May Not be Quite What They Seem*, N.Y. TIMES (May 7, 2012), http://dealbook.nytimes.com/2012/05/07/why-european-bank-buffers-may-not-be-quite-what-they-seem/.

161 *Id.*

Although Swiss banking is synonymous with safety, the structure of the industry showed stability issues that may have remained hidden without the widespread international financial turmoil of the Great Recession. Switzerland's quick action was likely facilitated by its small regulatory system and may have aided the country in warding off major problems. Yet, such swift action may reduce industry competitiveness in the future when Swiss banks vie for business against institutions following Basel III's requirements.[162] Furthermore, implementation may prove to be a burdensome if not impractical task.

C. European Union

The European Union's financial industry saw some of the earliest turmoil during the Great Recession.[163] In fact, as early as August 2007, Deutsche Bank and other private German lending institutions were forced to inject $4.8 billion in capital to save the struggling IKB Deutsche Industriebank.[164] Shortly thereafter in September 2007, the Bank of England provided emergency aid to Northern Rock.[165] Since those initial rescues, and as recently as June of 2012,[166] E.U. member countries chose to rescue major banks within their financial sector.[167] The size and importance of many

---

[162] *See UBS Profits Slide, Risk Assets High Ahead of Stress Tests,* IFA MAGAZINE, Oct. 29. 2013, http://www.ifamagazine.com/news/ubs-profits-slide-risk-assets-high-ahead-of-stress-tests-286230.

[163] *See* Tobias Buck, *National Reputation Hangs on IKB Rescue*, FIN. TIMES, Aug. 2, 2007, http://www.ft.com/intl/cms/s/0/7017b0c0-411a-11dc-8f37-0000779fd2ac.html - axzz2ABEJZjXP.

[164] *Id*

[165] EUROPEAN COMMISSION, HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR 5 (Oct. 2, 2012), http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf.

[166] Alan Wheatley, *Proud, Too-Big-to-Fail Spain Ponder Bank Rescue*, REUTERS, June 7, 2012, http://www.reuters.com/article/2012/06/07/us-spain-europe-outlook-idUSBRE85619U20120607.

[167] Landon Thomas & Nelson Schwartz, *In Euro Zone, Banking Fear Feeds on Itself*, N.Y. TIMES, Sept. 6, 2011, http://www.nytimes.com/2011/09/07/business/global/in-euro-zone-banking-fear-feeds-on-itself.html?hp&_r=0.

European banks means that countries cannot allow banks to fail without compromising the stability of the E.U.'s entire economy.[168]

The framework of the European banking sector is complex.[169] Although the E.U. is made up of seventeen independent banking systems using a singular currency,[170] since the adoption of the Euro, financial integration across member states increased up until the Great Recession.[171] The European banking sector as a whole is large, even when compared to other major financial powerhouses.[172] Banking sector assets are five times as great in the E.U. than in the U.S., and make up about 350% of the E.U.'s GDP.[173] The United Kingdom, Germany, and France are home to the largest banking sectors when measured by total assets.[174] Additionally, the size of individual financial institutions within the E.U. is great—half of the world's thirty largest banks when ranked by total assets are in the E.U.[175] Specifically, fifteen of the twenty-nine SIBs[176] are located in E.U. member countries.[177] However, the E.U. is not made up exclusively of large financial institutions, as Europe is home to more than 8,000 banks with smaller institutions comprising a quarter of total banking assets in the E.U.[178]

---

168 Stephen Castle, *Europe to Approve Guidelines on Bank Failures*, N.Y. TIMES, Apr. 4, 2008, http://www.nytimes.com/2008/04/04/business/worldbusiness/04regs.html.

169 *See generally* EUROPEAN COMMISSION, *supra* note 165, at 11-19.

170 Angelo Young, *Danger from European Banks' Too-Big-To-Fail Syndrome Keeps Growing: Report*, INTERNATIONAL BUS. TIMES (Sept. 18, 2012), http://www.ibtimes.com/danger-european-banks-too-big-fail-syndrome-keeps-growing-report-790102.

171 EUROPEAN COMMISSION, *supra* note 165, at 11, 30.

172 *Id.* at 13.

173 *Id.* at 11-12.

174 *Id.* at 12-13.

175 France, Sweden, and the United Kingdom each have banking markets dominated by large domestic banks, while countries such as Austria, Germany, and Spain, have more, smaller banks. *Id.* at 18.

176 *See supra* Part II.C.

177 Agustino Fontevecchia, *The 29 Global Banks That Are Too Big to Fail*, FORBES, Nov. 4, 2011, http://www.forbes.com/sites/afontevecchia/2011/11/04/the-worlds-29-most-systemically-important-banks/; EUROPEAN COMMISSION, *supra* note 165, at 38.

178 EUROPEAN COMMISSION, *supra* note 165, at 34-35.

The integration of the E.U. financial network across member countries increases need for a stable banking industry because failure in any of the major banks within a single member country raises the likelihood of economic crisis affecting multiple member countries.[179] As a result of such overlap and potential repercussions of bank failures, E.U. governments recognized the compelling need to inject funding into the private sector, even though such action violates traditional E.U. policy.[180] In addition, in 2010, the E.U. chose to create the European Banking Authority (EBA).[181] The E.U. had a predecessor advisory group,[182] but the EBA is the first body with the power to create a singular E.U. rulebook that will be binding on all E.U. banks.[183] In December of 2012, the E.U. also agreed to expand the European Central Bank's (ECB) supervisory power to include direct supervision of the largest 100 to 200 banks in the E.U.[184] Previously, banks were overseen primarily by national regulators.[185] Under the agreement, smaller banking institutions would remain subject to their current regulators.[186] The aim of ECB in its improved

---

[179] Stephen Castle, *Europe to Approve Guidelines on Bank Failures*, N.Y. TIMES, Apr. 4, 2008, http://www.nytimes.com/2008/04/04/business/worldbusiness/04regs.html.

[180] Buck, *supra* note 163.

[181] Council Regulation 1093/2010, 2010 O.J. (L331), 12-47 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0012:01:EN:HTML.

[182] *About us*, COMM. OF EUROPEAN BANKING SUPERVISORS, http://www.eba.europa.eu/Aboutus.aspx.

[183] Matthew Elderfield, Deputy Governor of the Central Bank of Ireland and Alternative Chairman of the European Banking Authority, Address to the 4th CDU/CSU Congress in the Bundestag: European Banking Regulation and the Eurozone Crisis (Mar. 26, 2012), http://www.bis.org/review/r120327f.pdf.

[184] James Kanter, *European Leaders Hail Accord on Banking Supervision,* N.Y. TIMES, Dec. 13, 2012, http://www.nytimes.com/2012/12/14/business/global/eu-leaders-hail-accord-on-banking-supervision.html?_r=0.

[185] Such a set up proved ineffective when dealing with a financial sector that has become integrated across national borders. EUROPEAN COMMISSION, *supra* note 165, at 107.

[186] Under the agreement, the ECB at its discretion could step in and take over supervisions of any bank in the E.U., if deemed necessary. Kanter, *supra* note 184.

state is to create uniformity and reduce the domestic political influences that permeated the national banking regulation scheme.[187]

Leading up to the Great Recession and in response to the Basel I and II frameworks, the E.U. passed two directives designed to implement minimum capital requirements.[188] These directives were known as Capital Requirements Directives (CRD) I and II, and were packages of non-binding legislation designed to implement the various aspects of Basel I and II.[189] Each directive established a minimum and total common equity requirement of two percent,[190] and each required no countercyclical buffer and no capital conservation buffer, but permitted banks to use their own internal risk models to calculate risk weights.[191] Additionally, because CRD I and CRD II were directives, they were not binding.[192] Rather, they were merely legislative acts that set out goals for each EU state to achieve, and member states were permitted to diverge significantly in their own individual implementations.[193] In fact, some member states chose a transitional opt-out of the standards.[194] Moreover, leverage ratios in European banks often exceed thirty-to-one, and in some cases, are as great as fifty-to-one.[195]

---

187 Peter Gumble, *Too European To Fail? New E.U. Banking Safety Net Takes Shape,* TIME, Dec. 17, 2012, http://business.time.com/2012/12/17/too-european-to-fail-new-eu-banking-safety-net-takes-shape/.

188 EUROPEAN COMMISSION, *supra* note 165, at 68-69.

189 *Capital Requirements Directive: Repealed Legislation*, EUROPEAN COMMISSION, http://ec.europa.eu/internal_market/bank/regcapital/repealed-legislation_en.htm (last visited Jan. 31, 2014).

190 EUROPEAN COMMISSION, *supra* note 165, at 11.

191 *Id.* at 69.

192 *See*, *Regulations, Directives and other acts*, EUROPEAN UNION, http://europa.eu/eu-law/decision-making/legal-acts/index_en.htm (last visited Jan. 31, 2014), for a brief overview of European law.

193 EUROPEAN COMMISSION, *supra* note 165, at 71.

194 CRD II was passed after the transitional opt-out for CRD I, but still, several member states did not meet the implementation requirements CRD II. *Id.*

195 Colin Barr, *Europe: The New Wall Street?*, CNN.COM (Oct. 7, 2008), http://money.cnn.com/2008/10/06/news/europe.leverage.fortune/index.htm.

Under the E.U. legislation implementing Basel III, CRD IV, the capital requirements generally follow those outlined by BIS.[196] Total capital requirements under the legislation are eight percent, a total of four-and-a-half percent of which must be common Tier 1 capital.[197] The E.U. differs from Basel III requirements in that the percentage of Tier 1 capital must be gradually increased until it reaches six percent by 2019.[198] The legislation also permits member states, in coordination with the E.U., to require higher levels than those established under CRD IV.[199] Unlike previous regulations, however, the E.U. will enforce the law as a mandatory regulation, rather than a directive, to reduce the ability of national regulators to diverge or reduce the weight of the proposal.[200] Although the percentages of capital remain consistent with the aims of Basel III, the E.U. legislation does diverge on certain details.[201] Specifically, the E.U. counts as Tier 1 capital lesser types of capital[202] than those supplied under Basel III and places a maximum on the capital ratio that member states may impose on their banks.[203]

Even though the E.U. took steps to increase the stability of its financial sector by increasing union-wide banking regulations for the first time since the formation of the E.U., it failed to meet a major benchmark in Basel III implementation.[204] The E.U.'s new minimum capital rules would complement the creation of the banking-union and create a measure for the ECB to enforce through

---

196 *Compare* BASEL III, *supra* note 4, at 2, *with* EUROPEAN COMMISSION, *supra* note 165, at 69.

197 Commission Regulation 575/2013, art. 92, 2013 O.J. (L176) 64; EUROPEAN COMMISSION, *supra* note 165, at 69.

198 Commission Regulation 575/2013, art. 92, 2013 O.J. (L176) 64.

199 *See* EUROPEAN COMMISSION*, supra* note 165 at 70.

200 Geoffrey Smith, *EU's Proposal to Implement Basel III Undermines Spirit*, WALL ST. JOURNAL, July 28, 2011, http://online.wsj.com/article/SB10001424053111904800304576472393933772876.html; *see* Commission Regulation 575/2013, 2013 O.J. (L176) 1.

201 *Id.*

202 Such as deferred tax assets and minority interests. *Id.*

203 *Id.*

204 *See Europe 'to Push for Basel III Delay as it Lobbies U.S.,'* TELEGRAPH (Nov. 12, 2012 6:11AM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9704822/Europe-to-push-for-Basel-III-delay-as-it-lobbies-US.html.

its new supervisory powers.[205] However, the E.U. failed to pass Basel III regulation by the January 1, 2013 deadline established by BIS.[206] Although the E.U. legislature recognized the need for stronger regulation of the banking industry, given the systemic importance of the many E.U. banks, passing new minimum capital measures before other competitive nations (such as the U.S.) could have compromised the recovery of the E.U. financial sector and may have been the major cause for the delay.[207] The regulation was adopted on June 27, 2013 with implementation set to commence on January 1, 2014 and full implementation to be reached by 2019.[208]

IV. IS UNIFORMITY POSSIBLE?

Enacting capital requirements for financial institutions across industrialized nations seems to be the most basic step in preventing the recurrence of financial turmoil similar to that of the Great Recession. Establishing minimum capital levels for banks, with increased requirements for large, systemically important institutions, may help institutions weather the storm of financial strife so that banks do not go bankrupt or suffer bank runs.[209]

Several major problems exist with Basel III. Because Basel III is a recommendation of best practices, introduced with no legal

---

205 *Id.*

206 *Id.*; The U.S. and fifteen other members of the Basel Committee also failed to meet the deadline. Lianna Brinded, *Basel III: Less Than Half of Nations Meet Deadline for New Bank Capital Rules,* INT'L BUS. TIMES (Jan. 3, 2012), http://www.ibtimes.co.uk/articles/420179/20130103/basel-iii-capital-requirements-committee-regulation.htm.

207 *Europe 'to Push for Basel III Delay as it Lobbies U.S.,'* TELEGRAPH, Nov. 12, 2012, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9704822/Europe-to-push-for-Basel-III-delay-as-it-lobbies-US.html; *see also* Eric Vidal, *EU's Barnier Says U.S. Should Respect Basel III,* REUTERS, Jan. 31, 2013, http://www.reuters.com/article/2013/01/31/us-eu-banks-idUSBRE90U0D520130131.

208 *See Implementing Basel III Europe: CRD IV Package*, EUROPEAN BANKING AUTH., http://www.eba.europa.eu/regulation-and-policy/implementing-basel-iii-europe (last visited Dec. 28, 2013).

209 *See supra* Part II.C.

authority from BCBS, countries may modify the terms or fail to implement the measures altogether. The E.U.'s passage of directives concerning Basel I and II and national failures to adopt such measures are a stark example of the ineffectiveness of recommendations lacking legal authority.[210] As mentioned above, after the directive implementing Basel I and II, some E.U. member states failed to follow through with their own regulations by taking advantage of a transitional opt-out period. Still many E.U. member states failed to ever follow through with implementation of the new regulations.

Basel III implementation may face difficulties similar to Basel I and II in the E.U. The initial deadline for Basel III implementation to begin was January 1, 2013. Sixteen members of the G-20 did not meet that benchmark.[211] However, one year later, the majority of the G-20 took steps to implement some form of Basel III regulation, with most becoming effective on January 1, 2014.[212]

Of those member nations that chose to follow through with implementing Basel III regulations, the risk remains that the intent of Basel III will be diluted by changes at the national level. Switzerland has stepped up the recommendations of Basel III.[213] However, by acting ahead of the final Basel III recommendations, Swiss banks may face a disadvantage in competitiveness.[214] Nations slow to follow through with implementation may recognize the Swiss setback and set standards below those recommended under Basel III to protect the competitiveness and recovery of their own banking institutions. Further, the E.U., although adopting the minimum ratios, intends to

---

210 The E.U. proposal for Basel III implementation will likely take the form of a mandatory regulation to correct the problem of previous iterations. *See supra* pp. 22-23.

211 Brinded, *supra* note 206.

212 Basel Committee on Banking Supervision, Progress Report on Implementation of the Basel Regulatory Framework 4-13 (2013), http://www.bis.org/publ/bcbs263.pdf.

213 *See supra* pp. 17-18.

214 Matthew Allen, *Swiss Banking Regulation Leads the Field*, SWISS BROADCASTING CORP., Oct. 5, 2010, http://www.swissinfo.ch/eng/Specials/Rebuilding_the_financial_sector/News,_results,_regulations/Swiss_banking_regulation_leads_the_field.html?cid=28472592.

diverge from Basel III's capital adequacy standards.[215] The E.U. will accept lesser forms of capital than those suggested by Basel III as Tier 1, diluting the effectiveness of the minimum Tier 1 capital ratio established by the BCBS.[216]

Finally, the minimum recommendation may be deceiving as a baseline measure because it may ultimately function as a maximum requirement. Switzerland recognized the need for greater requirements than those suggested by Basel III in order to protect its massive institutions and the media responded with concerns regarding competitiveness.[217] Conversely, it is speculated that the E.U.'s delay in passing a final measure concerned the feared lack of competitiveness with the U.S. market due to the U.S.'s failure to meet the same deadline.[218] Thus, many nations may look to the actions of their peers and focus on competitiveness rather than stability, choosing not to enforce minimums above those established under Basel III even if such a choice is made at the expense of their financial sector's stability.

The Canadian financial sector is a great example of the positive effects of maintaining certain levels of capital has on the stability of a financial industry. As discussed in Part IV.A, Canadian regulations leading up to the Great Recession required Tier 1 and overall capital ratios just above those established by Basel III. In effect, the Canadian banking sector experienced no bank failures and managed to thrive while the international economy floundered.[219] Alternatively, the E.U. member states stand as a prime example that bank failures or necessary rescues may occur when capital minimums

---

215 *See supra* pp. 22-23.

216 Additionally, the E.U. proposal of a maximum capital ratio is troubling in light of the stabilizing aims of Basel III because banks should not be discouraged from favoring stability over competitiveness in a systemically important industry. *See supra* pp. 22-23.

217 Allen, *supra* note 214.

218 *Europe 'to Push for Basel III Delay as it Lobbies U.S.,'* TELEGRAPH (Nov. 12, 2012), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9704822/Europe-to-push-for-Basel-III-delay-as-it-lobbies-US.html; *see also supra*, Part III.C.

219 *See supra* p. 9, notes 72-74.

and liquidity are insufficient to weather downturns in related financial markets and economies.[220]

Conversely, although Swiss regulators have traditionally gone above and beyond recommended standards, including those under Basel I,[221] Swiss banking institutions struggled to maintain stability during the Great Recession.[222] In Switzerland, it was not the lack of capital alone that worried regulators. Rather, the sheer size of Swiss major banking institutions and the perceived inability of the government to bail out the institutions if they failed caused concern. It took a combination of international investors, nationalization of assets, and recapitalization of private assets to secure the fates of the largest institutions, even with minimum capital safeguards.[223]

Establishing minimum capital requirements may be a step towards stabilizing banking sectors,[224] but those measures alone, as evidenced by Switzerland's struggles, are insufficient to offer broad protection to the banking industry. From an analysis and comparison of the Canadian, Swiss, and E.U. financial industries, certain other factors appear to be necessary for long-term stability.

Using Canada as a blueprint, it appears that emphasis on a strong regulatory framework, control of the size of institutions, and strong coordination between institutions and regulators is necessary for resiliency in the banking industry.[225] Both Switzerland and the

---

220 *See supra* pp.19-20.

221 Press Release, Swiss Federal Banking Commission, Implementation of Basel II in Switzerland (Apr. 2004), http://www.finma.ch/archiv/ebk/e/archiv/2004/20040429/Referat_Z_E.pdf.

222 *See supra* Part III.B. (discussing the Swiss banking crisis in 2008).

223 *See supra* Part III.B.

224 The author recognizes that capital adequacy and minimums are not the sole focus of Basel III, however, points out that the "five-fold approach" of Basel III (raising the quality, consistency, and transparency of the capital base; enhancing risk coverage; supplementing the risk-based capital requirement with a leverage ratio; promoting countercyclical buffers and capital conservation buffers; and addressing systemic risk and interconnectedness) focuses on these measures as the saving grace of the regulation.

225 No doubt, the use of "sunset clauses," strict lending laws favoring creditors, and diversified financial institutions contribute to the strength of the industry. *See* discussion *supra* Part III.A.

E.U. seem to have recognized the importance of strong financial regulatory bodies, with each creating a new regulatory agency in the wake of the Great Recession.[226]

Further, the Great Recession has brought about financial institutions larger than those pre-Recession due to buyouts and mergers.[227] Because half of the world's SIBs lie in Europe, the stability of the region's financial sector may be increased by the reduction of such systemically important institutions.[228] Basel III acknowledges the necessity of regulating SIBs;[229] however, if the E.U. fails to take major steps towards regulation and size limitation, the presence of so many major institutions could prove destructive to its long-term financial stability.[230] Switzerland has already taken major steps to protect its two largest institutions, but long-term monitoring will likely be necessary for its continued stability.[231]

One final element to long-term stability may rest less on the regulations placed on the financial industry and more on the actions and goals of the industry itself. Canadian banks, for instance, seem to focus on the good of its economy and the long-term viability and success of its financial industry as the primary goals. Competitiveness in, and dominance of, the international financial sector appear not to be major focuses of business in Canada.[232] In contrast, Switzerland and the E.U. both have concerns about international competitiveness as a result of new minimum capital and liquidity requirements, appearing to deemphasize the resiliency and long-term viability of their banking sectors. Although the Canadian difference may be a cultural one, it should be a role model for other nations struggling to keep their banking industries and economies afloat.

---

226 *See supra* Parts III.B., III.C.
227 *See supra* Part I.
228 *See supra* pp. 20-21.
229 *See supra* pp. 8-9.
230 *See supra* Part III.C.
231 *See supra* Part III.B.
232 *See supra* Part III.A.

CONCLUSION

As international economies began to suffer financial distress as a result of the Great Recession, the Bank for International Settlements and the Basel Committee on Banking Supervision gathered with leaders of the G-20 to modify international banking standards to secure the stability of financial institutions. With the agreement known as Basel III, the Basel Committee recommended that members of the G-20 agree on national regulations with increased minimum capital and liquidity requirements for banks within their countries to help prevent future banking failures and the resultant impact such failures have on individual economies. Although some nations, such as Canada and Switzerland met the January 1, 2013 deadline, others, such as the E.U. and U.S. failed to do so.

Basel III, in its most basic form, appears to be a strong solution and response to the financial crisis of 2007 and 2008. Upon examination of divergent economies and a study of pre-Recession banking regulation, it becomes clear that standards which focus on capital and liquidity alone are not sufficient to prevent struggles in the banking sector. The measure, although agreed upon by members of the G-20, is plagued with difficulties that will limit its effectiveness. The ability of nations to dilute the recommendations or fail to implement the regulations altogether will likely have a detrimental effect on the sufficiency of Basel III. Additionally, earlier iterations have failed to prevent financial crises, and it is unlikely the third iteration will be any different without substantial changes to national financial regulation as a whole. Although any strengthening of the financial industry may provide some benefit to national economies, Basel III is unlikely to provide significant protections from future crises if economies face instability on par with that of the Great Recession.