



Λ S B Λ

ASSOCIATION OF SUPERVISORS OF BANKS OF THE AMERICAS



SUPERVISORY AND REGULATORY STANDARDS IMPLEMENTATION REPORT 2018

MEXICO CITY, MEXICO

2018

SUPERVISORY AND REGULATORY STANDARDS IMPLEMENTATION REPORT 2018:

WORKING GROUP:

MARCOS FABIAN C.

JOAQUÍN MAYORGA

JONAS LOPEZ NIÑO

EDITED BY:

RUDY ARAUJO MEDINACELLI, SECRETARY GENERAL

AUTHORIZED BY:

JUAN PEDRO CANTERA, CHAIRMAN OF THE BOARD OF DIRECTORS

ASSOCIATION OF SUPERVISORS OF BANKS OF THE AMERICAS

C. PICACHO AJUSCO 238 OFICINA 601, COL. JARDINES EN LA MONTAÑA, MEXICO CITY, MÉXICO C. P.14210

PHONE:

5255 56620085

EMAIL:

ASBA@ASBASUPERVISION.ORG

WWW.ASBASUPERVISION.COM

TERMS AND ACRONYMS USED

Risk weighed assets	RWA
Alliance for Financial Inclusion	AFI
Anti- money laundering and Fight Against Terrorism Financing	AML/CFT
Association of Supervisors of Banks in the Americas	ASBA or Association
Basel Committee on Banking Supervision	BCBS
Supervisory and Regulatory Standards Implementation Survey 2018	Survey
International Monetary Fund	IMF
Generally Accepted Accounting Principles	GAAP
Financial Inclusion in Latin America and the Caribbean	FILAC
International Accounting Standards	IAS
International Financial Reporting Standards	IFRS or NIIF
Associate Members	MAS or Members
U.S. Federal Reserve	FED

Contents

Terms and Acronyms Used	3
Introduction	5
I. Standards of the Basel Regulatory Framework.....	6
Overview of the Regulation	6
Implementation of Basel I Standards	9
Implementation of Basel II and II.5 Standards	10
a) Basel II. Pillar 1.....	10
b) Basel II. Pillar 2.....	11
c) Basel II. Pillar 3.....	12
d) Basel II.5.....	13
Implementation of Basel III Standards.....	14
II. Accounting Standards.....	17
III. Proportionality in Regulation and Supervision	19
IV. Analysis and final comments	21
References.....	23

Note: All rights reserved. Reproduction of the material contained in this publication is authorized only for educational, research or other non-commercial purposes without the prior authorization of the Association of Supervisors of Banks in the Americas, as long as the source is quoted. The information contained in this publication has been collected by the Association a reason why it does not make any representation over its relevance or certainty.

INTRODUCTION

In October 2017, the Association of Supervisors of Banks in the Americas distributed among its Associate Members the Survey on Supervisory and Regulatory Standards Implementation 2018 (from here onwards the Survey). This report presents the most important findings of the Survey about the state of implementation of Basel standards, their linkages with the implementation of international accounting standards and the potential relevance of developing a proportional regulatory framework in the region.

On last December, the Basel Committee on Banking Supervision published the latest revisions to the global banking regulation framework known as Basel III. The above implies a period of lower intensity in the issuance of macro prudential standards that can be used by the authorities to evaluate, assimilate, and possibly conduct in depth revisions on its current regulatory frameworks.

This document aims to become a tool for regional self-evaluation on the current status of the standards implementation for banking regulation and supervision. On one side, it is important to highlight the regional achievements made on the subject of prudential regulation during the past years, as well as in the enhancement of cooperation in the common search of a sound and stable financial system. On the other hand, it should be acknowledged that there are still opportunity areas in the implementation of some core elements of the macro prudential regulation that have received less attention in general.

The report is divided in four parts. The first part has to do with the implementation status of the Basel standards in the Americas. In this section an overview of regulatory standards throughout the region is presented. Besides, the implementation state of some key elements of the Basel I, II, II.5 and III regulatory frameworks is depicted. A fundamental difference with great information power in regard to last year's edition, is the possibility of capturing the "willingness to implement" of the standards hereby considered.

The second part corresponds to the implementation state of international accounting standards. In this section, research is made on the degree of heterogeneity and intensity in the use of accounting handbooks for the calculation of the elements considered in the risk measuring methods within the Basel framework.

In the third part, the research focus on if the Associate Members have some type of proportional approach both for regulation and supervision. This section gives us insight on the flexibility that banks have to operate and compete within a jurisdiction. In other words, it allows us to observe if banks with different characteristics are subject to the same rules and requirements.

In the last section, a general balance is made on the results submitted in the previous three sections. In spite that some final considerations are evident at a glance, a deeper analysis is made in order to understand the implications that might result of certain aspects related with the implementation degree of the standards established in the Basel regulatory framework.

I. STANDARDS OF THE BASEL REGULATORY FRAMEWORK

OVERVIEW OF THE REGULATION

Within the survey, participants were requested to respond to which banking regulatory framework they considered their jurisdiction was better fitted for. Sixteen of the twenty-four participants consider that their regulation is mainly based on Basel I, Basel II, and Basel II.5; six of them consider that their regulatory framework is aligned with the Basel III standards, while two think that their regulation is a combination of Basel I, II and III standards (Figure 1).

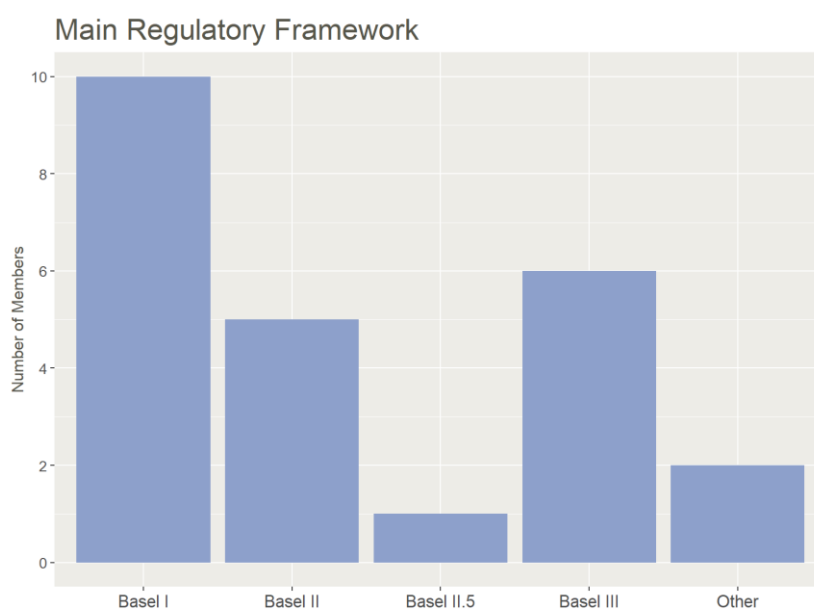


FIGURE 1.

Table 1 shows information on the main regulatory framework broken down by country. It can be appreciated that, both in Central America as the Caribbean, jurisdictions base their regulatory framework mainly on Basel I and Basel II. On the other hand, the Southern Cone and the Andean Region are mainly based on Basel II and they are in the process of implementing revisions in their regulatory frameworks towards an overall adequacy with the Basel III recommendations.

Differences in the current state of implementation of the Basel standards in the region can reflect the degree of development of financial markets. Furthermore, it puts in evidence that, in countries whose regulation is mainly based in the Basel I framework, there can be some frictions impeding the amendment of its regulation towards more complex frameworks, either by lack of technical capacity, for considering that their financial system is not adequately systemically interconnected to represent a risk, for a lack of flexibility in the legal framework to introduce new standards, or simply for considering that the current framework of their regulation is appropriate for their financial system features and that a revision of regulations would be too costly.

Country	Main Framework	Country	Main Framework
Argentina	Elements from Basel II and III	El Salvador	Elements from Basel II and III
Bahamas	Basel II	Spain	Basel III
Barbados	Basel II	Guatemala	Basel I
Belize	Basel I	Guyana	Basel I
Bolivia	Basel I	Haiti	Basel I
Brasil	Basel III	Honduras	Elements from Basel I, II, and III
Cayman Islands	Basel II	Peru	Elements from Basel II and III
Chile	Basel I	Panama	Basel III
Colombia	Basel II.5	Dominican Republic	Basel I
Costa Rica	Basel II	St Kitts	Basel I
Curacao	Basel II	Uruguay	Basel III
Ecuador	Basel I		

TABLE 1

Either way, the difference in the degree of standards implementation entails disadvantages both for private and public sectors: in the first place, limiting the comparability of prudential measures (for example, the minimum capital requirements in Table 2). On the one hand, this makes difficult conducting reliable assessments and studies promoting regional financial stability at the systemic level; on the other hand, restricting the capacity of investors to contrast their activities between different jurisdictions. In the second place, given the increasing regional expansion of banks and the participation of branches and subsidiaries of foreign banks with international presence in the Americas, the different regulatory frameworks can create unequal competition conditions, particularly for Banks with presence in more than one country.¹

¹ “Fitch: Implementation of Basel III Recommendations. Variable in Latin America” Fitch Ratings 2015.

País	Minimum Capital Requirement	Minimum Capital Requirement Tier 1	Country	Minimum Capital Requirement	Minimum Capital Requirement Tier 1
Argentina		8%	El Salvador	12%	6%
Bahamas		8%	España	8%	6%
Barbados		8%	Guatemala	10%	5%
Belize	Domestic banks-9% International banks-10%	Domestic banks-4.5% International banks-5%	Guyana	8%	4%
Bolivia		10%	Haiti	12%	This metric does not apply
Brasil		9.25%	Honduras	10%	This metric does not apply
Cayman Islands		10%			Not explicit but it can be deduced from rules that it is 5%
Chile		8%	Perú	10%	4.50%
Colombia		9%	República de Panamá	8%	6%
Costa Rica		10%	Republica Dominicana	10%	5%
		This metric does not apply	St Kitts	8%	4%
Curacao	Domestic banks-10.5% International banks-8%	Domestic banks-5% International banks-4%			
Ecuador		9%	Uruguay	8%	4.50%

TABLE 2

There are various factors that, in general, can determine the speed and efficiency with which the regulation and supervision standards are adopted, such as: the size and development of the financial system, the economic development level, and the capacity and resources of the regulation and supervision authorities. Particularly, Central America and the Caribbean are the Americas' regions that have experienced de-risking consequences the most, and therefore have directed a great amount of resources to meet this problem through the implementation of AML/CFT requirements; substituting probably the development of regulation and risk-based supervision capabilities aligned with international standards.

Finally, it is understandable that differences in the implementation degree of standards exist throughout the region, and that these differences may have various possible explanations. However, quoting Arthur Levitt, "If a country does not have the reputation given by sound corporate governance's practices, capital will flow to other side. If investors do not trust the transparency level of institutions, capital will flow to other side. If a country opts for lax accounting and disclosure standards, capital will flow to other side."²

² "Speech by SEC Chairman: Remarks Before the Conference on the Rise and Effectiveness of New Corporate Governance Standards". Arthur Levitt, 2000.

IMPLEMENTATION OF BASEL I STANDARDS

About Basel I elements, it is interesting to note that sixteen of the twenty-four countries that responded the survey allow the use of risk weights established in the Basel I framework, either in general or, in some cases, for specific institutions. On the subordinated debt, most of the participant countries allow subordinated debt to be part of the regulatory capital, while eight of them establish this requirement as mandatory.

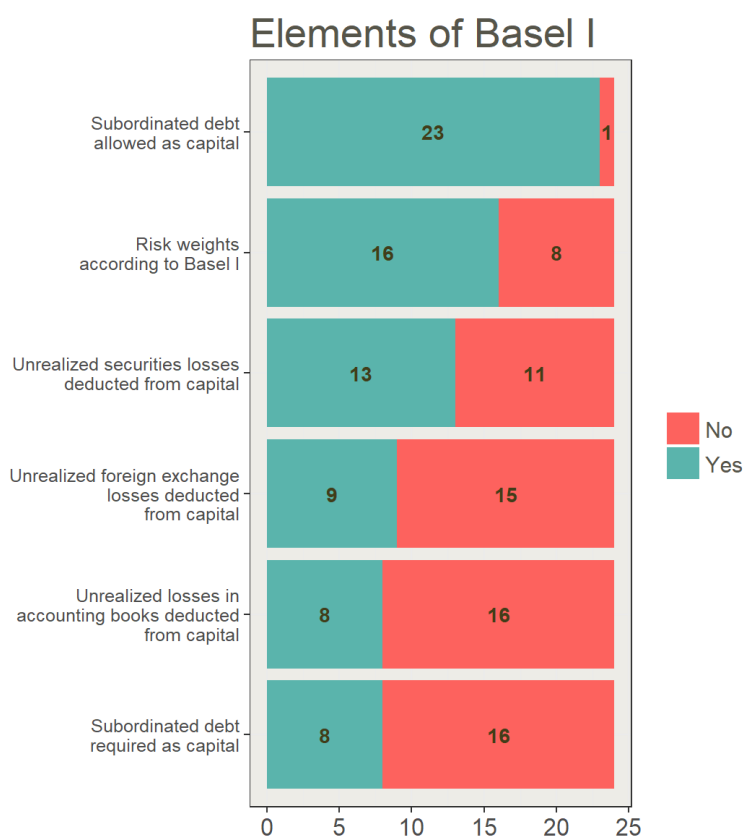


FIGURE 2

from the regulatory capital calculation.

There is empirical evidence that subordinated debt can provide an incentive so that participants in the financial market oversee more actively the risks that the issuing institutions might be facing since the use of these instruments can represent a measure of the institution's credit risk.³ Therefore, allowing these instruments to be part of regulatory capital, supervisors have a revealing mechanism to assess the overall risk profile of the institutions.

On deductions from regulatory capital, thirteen participants regulate that unrealized losses must be deducted from regulatory capital, nine of them that unrealized foreign exchange losses must also be deducted, and finally, eight of the participants establish that unrealized losses for loans in accounting books must be deducted

³ "Should the marketing of subordinated debt be restricted/different in one way or the other? What to do in the case of mis-selling?" European Parliament. March 2016.

IMPLEMENTATION OF BASEL II AND II.5 STANDARDS

One of the Basel II objectives was to make regulatory capital calculation be more sensitive to risks by incorporating methodologies that consider market and operational risks, complementing it with the integration of recommendations for deepening both supervision and market discipline processes through the introduction of the three Basel Framework Pillars. Results on the state of implementation of the Basel II and II.5 frameworks are shown below.

a) BASEL II. PILLAR 1

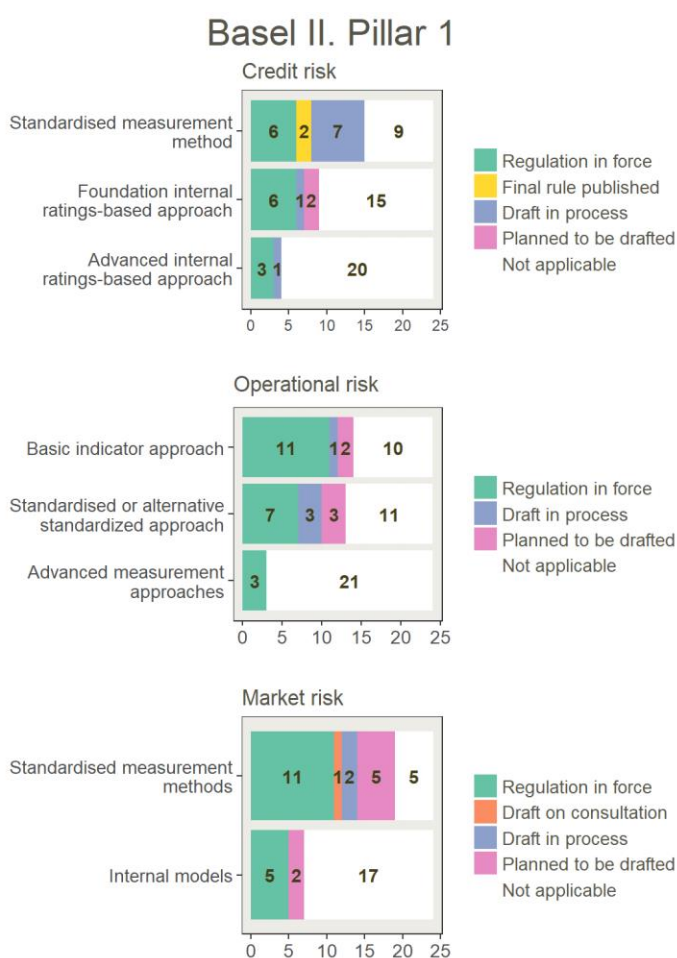


Figure 3 shows the state of implementation of the Basel II framework Pillar 1 components.

About recommendations for the treatment of the **credit risk**, the standardized method has the higher degree of implementation or willingness to implement for credit risk measurement, followed by the base method of internal ratings and, in a lesser degree, of the advanced method of internal ratings.

On the recommendations for the measurement of the **market risk**, the base indicators method has the higher implementation or willingness to implement. The standard method and the standardized alternative approaches are in force in seven countries, while six of them plan to write a draft or are in the process of writing it. While the advanced measurement methods are in force only in three of the participant countries.

Noteworthy is the fact that around half of the participants regulate, or are in the process of writing a regulation for the use of the standardized method, both for

FIGURE 3

credit risk as well as for **operational risk**. On the other hand most of the participant countries have a regulation or are in the process of writing a regulation for the use of the standard measurement of market risk. Countries that consider that these methods do not apply in their jurisdiction, base their risk measurement mainly on the framework proposed in Basel I, or in non-standardized methods.

In contrast, most of the countries in the region consider that the advanced measurement methods and the internal models are not yet appropriate for the characteristics and technical capabilities of the financial markets as well as regulatory and supervisory institutions in their jurisdictions.

b) BASEL II. PILLAR 2

Aside from the standards for risk measurement of financial institutions, the Basel II framework establishes recommendations on what is expected that the Banks would do in conducting their internal risk assessments and the capabilities, qualifications and activities that are expected from supervisors to ensure the reliability and soundness of these evaluations. Pillar 2 of the Basel II framework, contains four core principles, Figure 4 shows the state of implementation of some key elements contained in these four principles.

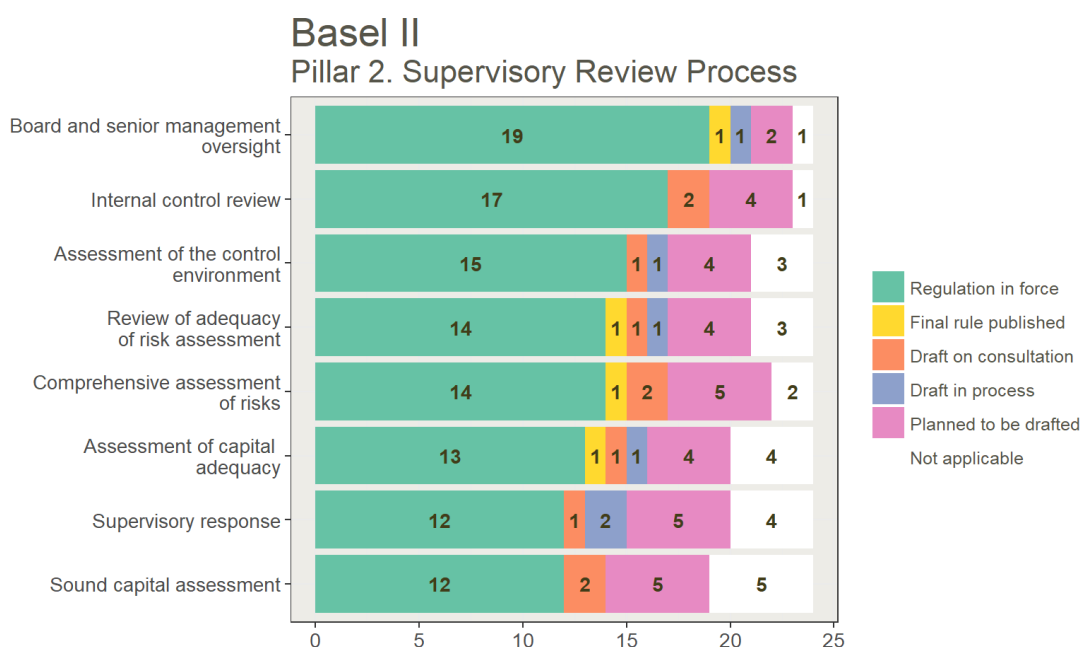


FIGURE 4.

It can be noted that the current state of implementation of Pillar 2 is, overall, high in the region. More than 75% of the participants have a regulation, a draft, or are in the writing process of a regulation of the key element requirements in the supervision process. The oversight process regarding administration council and senior management requested to Banks, has the higher degree of implementation among the Pillar 2 standards, with twenty countries with a regulation published or in force and two countries with plans for writing a draft.

On the contrary, only half of the countries have a regulation in force requiring financial institutions to have processes to perform sound capital assessments.⁴ Likewise, half of the jurisdictions stipulate supervisory response processes, in which the authority has powers to request Banks to retain capital above the minimum levels, when it is considered necessary. In both cases, between seven and eight countries have a draft or are planning to write it to address these elements.

c) BASEL II. PILLAR 3

The Basel II Pillar 3 integrates the two previous pillars in a set of disclosure principles that allows both participants in the financial market and supervising authorities to appropriately assess the institutions’



FIGURE 5

in the first place, a great part of the disclosure requirements depicted in Figure 5, belong to advanced or internal methods considered under Pillar 1. In this sense, these methods are not applicable in most region countries, and thus neither are their corresponding disclosure rules.

risk profile. In this respect, Figure 5 shows the implementation degree of requirements for the different disclosure requirements considered within the Basel II Framework.

Overall, the region is weak regarding disclosure and transparency requirements required to financial institutions. On the one hand, less than 40% of the participants have a regulation in force appropriate to the general disclosure principle.

On the other hand, few countries have a rule or operational regulation mandating financial institutions to disclose information on the capital structure, capital adequacy, and credit, market and operational measures risks.

It is important to highlight two situations in this case: in the

⁴ According to the Basel II Framework, the rigorous capital evaluation implies the creation of policies and processes to ensure that the Banks: identify, measure and report all the material risks; have a process that relate capital with risk level; have a process establishing objectives of capital adequacy taking into account the strategic and business approach of the bank; have a process of internal controls and audits to ensure the integrity of the management process.

In the second place, a subtle difference but with great information power between the surveys of 2017 and 2018, is the inclusion of options that capture the willingness to implement and draft in process for each one of the standards. In this regard, an important number of countries are in the process of writing regulation on the subject of transparency and disclosure, or they have the intention to do so.

In summary, the region overall is weak on the transparency and disclosure issues on the part of financial institutions. Relatively few countries have regulations that demand banks to disclose key information for risk evaluation. However, we can observe an interest or willingness to develop regulations addressing these weaknesses in the short and medium term. Therefore, cooperation and support from jurisdictions with more advanced regulation is indispensable in the development of regulations on the subject of transparency in jurisdictions that are in the process of writing them or with intention to do so, but that face some difficulties in the elaboration process.

d) BASEL II.5

The standards published as Basel II.5 are a review and enhancement of some elements in the Basel II framework. Also, they introduce new requirements and temporary measures that were fundamental to address the economic crisis of 2008, before fully develop the first version of Basel III framework and that had as an immediate consequence that banks retained a greater share of regulatory capital to absorb possible losses.

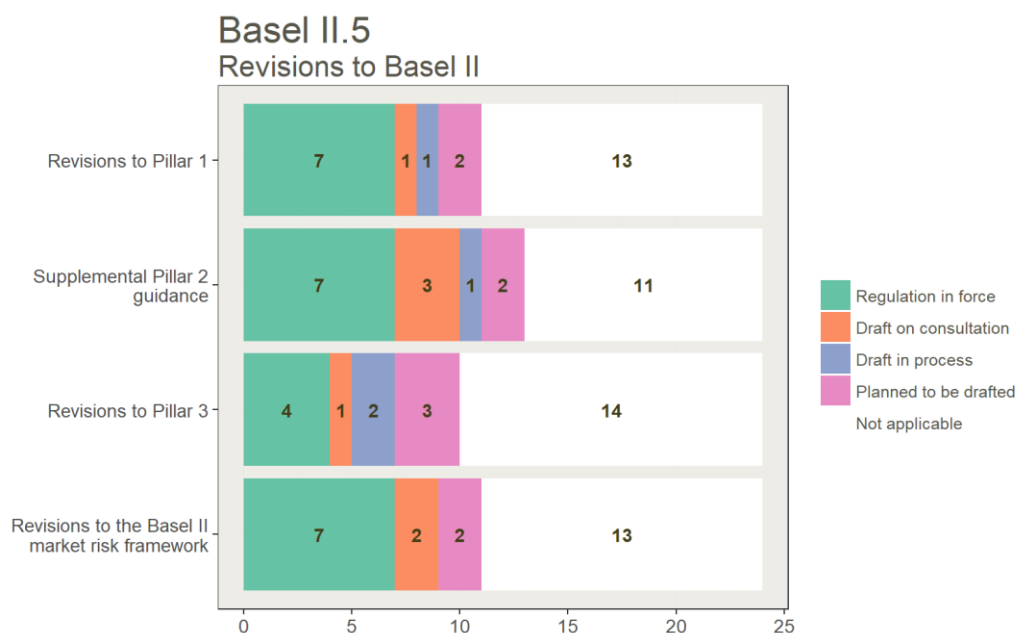


FIGURE 6.

Seven Members have regulations in force aligned with the Pillar 1, Pillar 2 and the market risk management framework revisions. On the other hand, only four countries implemented improvements to Pillar 3. Between three and four countries have a draft that is under consultation, in the writing process, or have the intention of writing it, in each case.

Most of the countries consider that the Basel II.5 revisions are not applicable at their jurisdictions, either because they implement less complex standards or because they have thought to migrate to sounder standards. It is interesting to point out again that the standards related to disclosure and transparencies are the ones with the weakest implementation in this revision.

IMPLEMENTATION OF BASEL III STANDARDS

The Basel III framework mitigates risk elements that are not widely considered in the previous versions and that were determinant and enhancers of the 2008 financial crisis. It is important to point out that Basel I and II frameworks have some weaknesses by not incorporating liquidity risk and procyclicality in credit supply; aside from the fact that part of the range of financial instruments that were considered as regulatory capital can be volatile in stress periods. Although the scope of this framework is particularly important for internationally active banks, some relevant concepts can be adapted and implemented by smaller institutions for a more solid risk management.

The Basel III recommendations are divided in this analysis in three sections: risk based capital, liquidity standards, and requirements for G-SIBs and D-SIBs. Revisions to Pillar 2 are not considered for not being fully identified and implemented in the region.

Figure 7 shows the implementation degree of the elements on Basel III risk-based capital. The standard of greater implementation in this case is the counter-cyclical buffer, with five jurisdictions implementing it. However, it is worth noting that the standards with greater willingness to implement are both the requirement for the counter-cyclical buffer as well as the minimum requirements for market risk management.

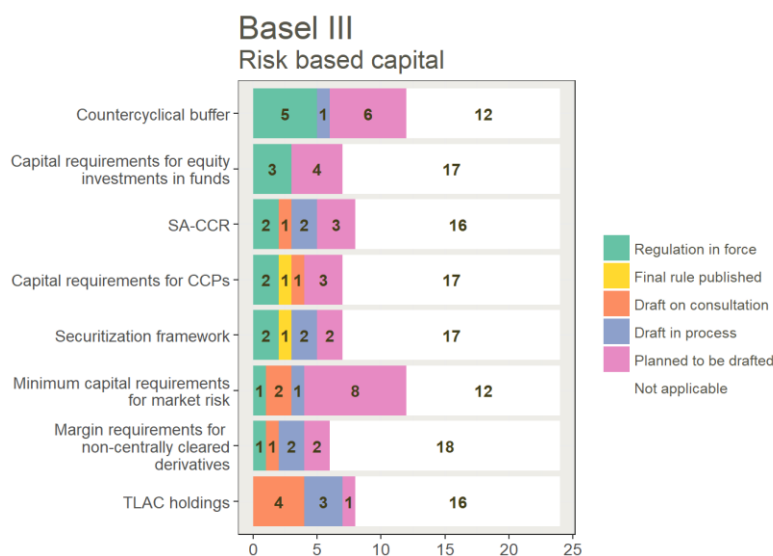


FIGURE 7

On the other hand, only two jurisdictions implement requirements related with central counterparties requirements, although between two and three jurisdictions have a final draft or a draft in process. Three members have planned to write a draft regulation on the subject. In contrast, the margin requirements for non-centrally cleared derivatives have the lesser implementation degree or implementation intention, which is understandable given the low development of derivative markets in the region.

Finally, no jurisdiction has a rule in force on requirements for Total Loss Absorbing Capacity holdings (TLAC holdings); nevertheless, four of them have a draft in consultation, three more are writing a draft of the regulation and one jurisdiction has the intention to writing a draft. It should be noted that the

presence of G-SIBs in the region is still relatively low; however, some countries are making efforts to offer regulation alternatives both for their branches or subsidiaries that are indeed present.⁵

During the 2008 financial crisis, turbulences generated from the non-payment in mortgages ranked as *subprime* had significant negative effects on the liquidity of primary markets, some fixed rent products, and inter banking market products. Due to the widespread liquidity crisis, it became necessary to create rules taking into account this type of events at stress periods. Figure 8 shows the implementation degree of the key liquidity standards proposed within the Basel III framework.

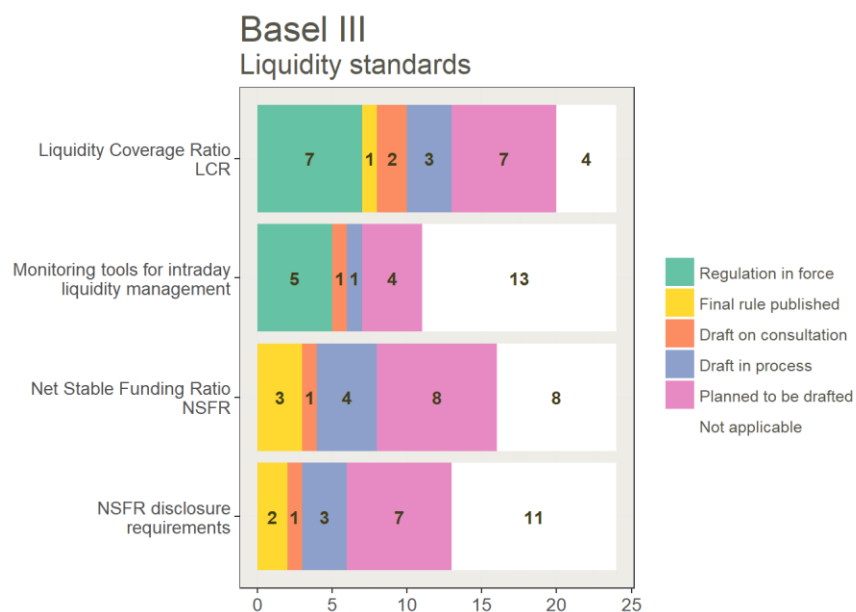


FIGURE 8.

Conversely to risk-based capital standards, liquidity standards have a greater implementation degree or intention to implement. The liquidity standard with the greater implementation and or intention to implement degree is the liquidity coverage ratio (LCR). In this case, eight jurisdictions have either a rule in force or published, or a draft in consultation; while ten jurisdictions are in the process of writing or planning to write a draft. Related to the above, five jurisdictions implement intraday liquidity management tools, and six of them have a draft in consultation, in process, or with plans to be written.

The second key liquidity requirement is the coefficient of net stable financing ratio (NSFR). None of the Associate Members participating in the survey have a rule in force considering the NSFR requirement, but four of them already have a final rule published or a draft in consultation. Moreover, a great interest can be noted of writing a draft on this aspect, even in Central America and the Caribbean countries.

The last key elements of Basel III considered are the implementation degree of the leverage coefficient and of requirements for D-SIBs and G-SIBs, shown in Figure 9. In the first place, five jurisdictions have a rule in force considering both the requirement of the leverage coefficient as well as its disclosure.

⁵ Argentina is an example in this case.

Besides, it is interesting to note that between seven and eight jurisdictions are in the process of writing a draft or have the intention to do so.

On the other hand, five jurisdictions implement regulation for requirements to domestic banks systemically important, while eight Associate Members are in the process of writing a draft or have the intention to do so. In contrast, the implementation degree of requirements G-SIBs is null.⁶ It is interesting to highlight that during the last years different countries in the region have made efforts to identify domestic banks systemically important operating in their jurisdictions. Instead, although the presence of banks globally important is relatively low yet in the region, some countries are developing regulatory alternatives to assist the branches and subsidiaries of these banks.

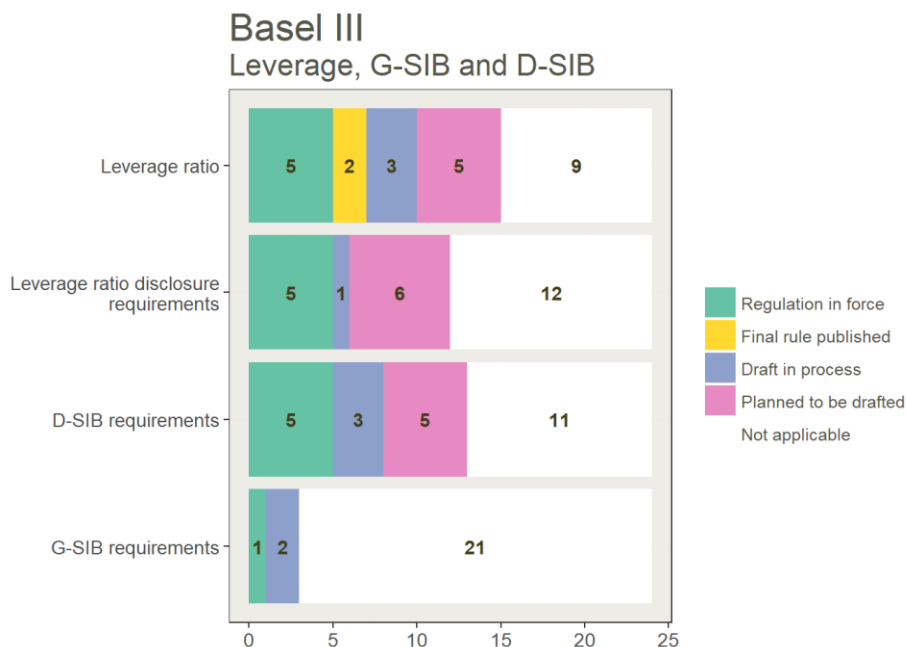


FIGURE 9.

From a regional perspective, Basel III elements have been implemented by a limited number of jurisdictions among the Associate Members. The foregoing is understandable given the degree of development and inter-connectivity in the regional financial system. The willingness to implement for liquidity, leverage and minimum requirements for market risk is to be noted. On the other side, requirements related to derivative financial instruments and global banks systemically important are not yet applicable in the region in general.

⁶ Spain has a rule in force for the treatment of G-SIBs, but is not part of the region.

II. ACCOUNTING STANDARDS

According to the BCBS, the application of accounting standards has a close relationship with prudential regulation and the banking supervision processes.⁷ This section shows the replies of Associate Members related to the accounting standards that are used within their jurisdictions and the conclusions that may be derived there from.

Figure 10 shows the proportion of countries using different accounting standards. The standards Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) were considered in the survey. Besides, flexibility was given to the answers allowing wide replies in case of implementing other types of accounting standards. It should be pointed out that replies are not mutually exclusive, that is, one jurisdiction can actually allow the use of more than one type of standard.

It can be noted that most of the jurisdictions allow or regulate the use of the IFRS accounting standards. In some cases, these same jurisdictions allow the use of GAAP standards or other type of accounting standards. By “other type of standards” the International Accounting Standards (IAS) and the combination of own rules developed within the public institutions with the international standards such as the IFRS are mentioned. In other cases, some countries do not have rules or accounting handbooks at all. Table 3 shows the results by country for a better understanding.

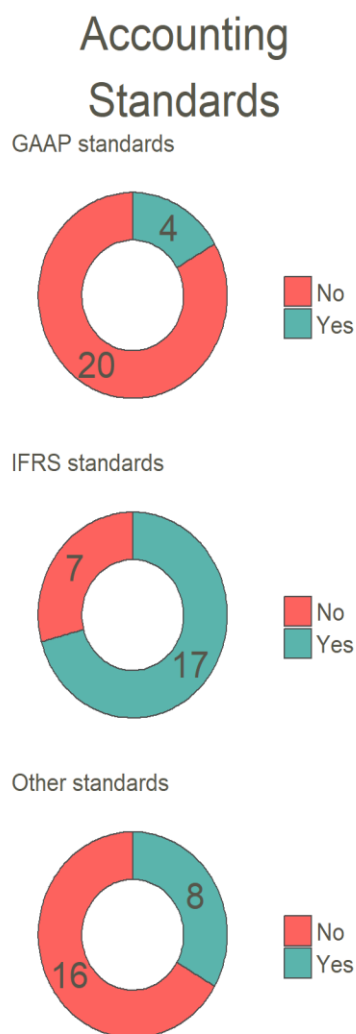


FIGURE 10

⁷ Basel Committee on Banking Supervision, “The interplay of accounting and regulation and its impact on bank behavior”, July 2017.

Several conclusions can be extracted from the analysis. In the first place, there is an important degree of heterogeneity in the application and use of accounting standards both within the jurisdictions as among jurisdictions. This heterogeneity has a significant impact on comparability in the supervision processes in assessing the banks' stability and soundness (both at the individual as at the consolidated levels) through the financial statements declared by these institutions.

Secondly, the lack of comparability in the definition of the different key terms, such as the elements considered as part of regulatory capital or the definition of non-performing assets, have repercussions on the risk assessment both by the supervisors as well as by the participants in the financial market. In this regard, it has to be taken into account that accounting standards have not been specifically designed to meet the supervisors' needs. However, these rules can be adjusted to include prudential aspects that allow a comprehensive evaluation of risk, sound and comparable on the part of authorities.

Finally, in spite of the heterogeneity observed in the region, it is possible to note a certain trend or intention to align the accounting requirements with the IFRS accounting standards. This last aspect is fundamental since, a mutual cooperation agreement has been formalized between the BCBS and the IFRS Foundation recently.⁸ In this agreement, both institutions share the objective that financial information must be elaborated and reported according with high quality accounting standards and used for the calculation of the regulatory capital and other regulatory measures established in the Basel agreements.

Country	GAAP	IFSR	Other standards	Country	GAAP	IFSR	Other standards
Argentina	No	Yes	IFRS standards will be in force as from January 1 2018, excluding point 5.5 "Impairment" temporarily. Currently, BCRA establishes accounting requirements.	Guatemala	No	No	Own rules issued by Junta Monetaria: "Manual de instrucciones contables para bancos". In non-regulated sector, standards IFRS.
Barbados	No	No	No	Guyana	No	Yes	No
Belize	No	Yes	No	Haiti	Yes	Yes	No
Bolivia	Yes	No	No	Honduras	No	Yes	No
Brazil	No	Yes	Rules elaborated by the Central Bank based on IFRS standards	Perú	No	No	Own rules issued by the Superintendencia de Banca y Seguros based on IFRS standards and incorporating prudential considerations.
Cayman Islands	No	No	No	República de Panamá	No	Yes	No
Chile	No	Yes	No	Republica Dominicana	No	Yes	No
Colombia	No	Yes	Adjustments to IFSR 4, IFSR 9, IAS 39 standards, based on domestic characteristics.	St Kitts	Yes	Yes	No
Costa Rica	No	Yes	No	Uruguay	No	Yes	No
Curacao	No	Yes	No				
Ecuador	Yes	Yes	Own rules issued by the Central Bank: "Catálogo Único de Cuentas"				
El Salvador	No	Yes	No				
Spain	No	Yes	Adjustments to IFRS standards.				

TABLE 3

⁸ BCBS, IFRS Foundation, "Memorandum of Understanding", September 2017.

III. PROPORTIONALITY IN REGULATION AND SUPERVISION

Proportionality is a principle on how to customize regulatory requirements and supervisors to banks that not internationally active, especially the smaller and less complex. Proportionality proposes to reduce compliance and disclosure requirements for smaller Banks without compromising neither soundness nor liquidity. A comprehensive introduction to proportionality is the document “Proportionality in banking regulation: a cross-country comparison” (BCBS, 2017) exposing proportionality approaches at various jurisdictions, including a country in the region, Brazil. Brazil segments Banks in five groups according to international activity criteria, size, complexity of operations and risk profile.

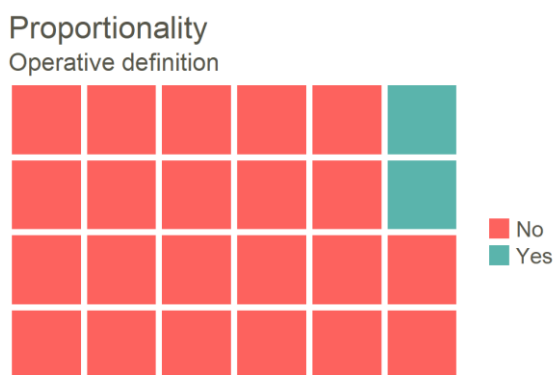


FIGURE 11

The survey results show that proportionality approaches in region’s countries are varied. Below we list the most relevant results which are: to have an operational definition of proportionality, banks’ segmentation according to certain characteristics, and regulatory and supervisory approaches to which each of the segments mentioned are subject to.

First, only two participant countries, Brazil and Honduras, declared that they have an operational definition of proportionality, as shown in Figure 11. Brazil has the bigger financial system and it can be argued, the most complex in the region; in this regard, it is the first country in Latin America and the

Caribbean that has developed a proportional approach in its financial regulation. On the other side, the proportional approach mentioned by Honduras is referred to a proportional approach in supervision based on the banks’ risk profile. In the last case, they add that the definition is not explicit, but that is intuited from applicable rules for supervision of financial institutions.

Secondly, as shown in Figure 12, some countries segment banks according to some criteria based on their size, their risk profile, international activity, and complexity of activities, or others. In total, fifteen jurisdictions make a segmentation considering at least one criterion. It should be stressed that some countries use one or more criteria to segment banks. For example, Colombia segments banks within its jurisdiction in two categories, considering all the criteria mentioned above. From the criteria made explicit in the survey, the categories most used by jurisdictions to segment banks are the risk profile and international activity. Then size is then considered and lastly complexity of activities.

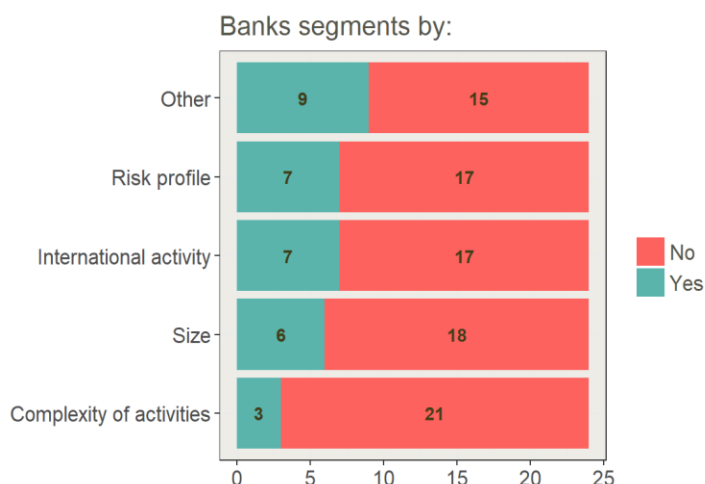


FIGURE 12

Third, the number of jurisdictions implementing some type of proportional approach either for regulation or for supervision is a lot higher than the number of jurisdictions defining it explicitly. According to Figure 11, only two countries declared having operational proportionality definitions, while twelve jurisdictions supervise in a focused way some banks as can be seen Figure 13. On the other side, nine jurisdictions declared having tailored regulatory approaches according to their banks' segmentation.

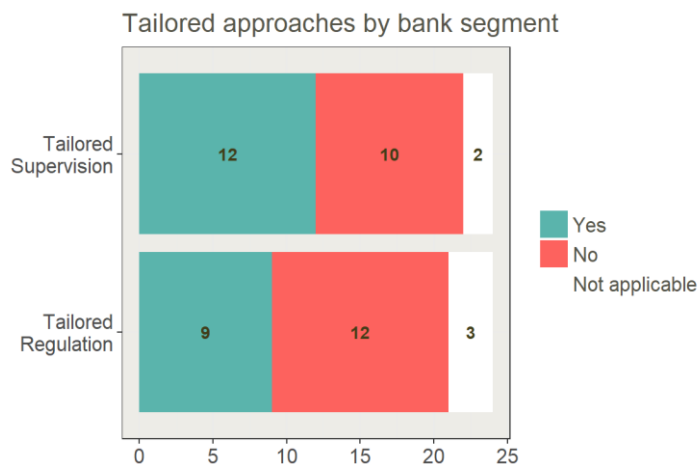


FIGURE 13.

From all the above, it is interesting to note that at least half of the participating countries, perform proportional approaches either in terms of regulation or in supervision, even in spite of not establishing it explicitly and officially. It should be remembered that the BCBS suggests a proportional approach in risk based supervision, in order to dedicate more time and resources to bigger, more complex and at higher risk banks.⁹ However, the Committee does not officially consider yet a proportional approach in regulation.

Finally, it is necessary to establish and clearly delimit what is understood as proportionality in regulation and proportionality in supervision. According with the analysis of the Associate Members' responses, there is a certain confusion between the two terms due probably to limitation or total absence of definitions on this subject within the current regulatory frameworks.

⁹ BCBS, "Core Principles for an Efficient Banking Supervision", September 2012.

IV. ANALYSIS AND FINAL COMMENTS

In this section an overall analysis is made and some considerations are presented derived from the results submitted in the previous sections. Some considerations become evident at a simple glance from the figures. However, it is essential to deepen the analysis in some issues, in order to understand implications that might result from certain aspects related with the implementation degree of international standards established in the Basel regulatory framework.

A great share of the countries in the region participating in the survey considers that their banking regulation is mainly based on the Basel I and II frameworks. A smaller proportion considers that its regulatory framework is aligned with Basel III or is in the adaptation process. From the responses on standards implementation we can note that instead of aligning with only one regulatory framework, the Associate Members' jurisdictions rather implement a combination of some elements in the three versions of the Basel framework.

In either case, an important issue to be pointed out is that all participants in the survey have a definition of regulatory capital. Elements that are considered as core capital (Tier 1) are homogeneous in the region. However, some elements of the secondary capital (Tier 2) can differ among jurisdictions. Besides, some countries consider the existence of a type of tertiary capital (Tier 3), which has been eliminated in the more recent Basel framework. In any case, in spite of some similarities, there is still a heterogeneity degree caused by the variation in the accounting standards used in the region.

Consequences on the heterogeneity degree in the standards implementation observed in the region can be ambiguous. On one side, these differences have the disadvantage of not allowing comparability of requirements among jurisdictions. The lack of comparability can have repercussions on the performance of banks operating at different jurisdictions, as well as in the capacity of participants in the financial market at the time of selecting their best investment options.

From other perspective, heterogeneity in the implementation degree can have a positive justification. In this aspect, the regulatory framework of a particular jurisdiction can be sound and ensure financial stability with less complex requirements than those established in Basel III, for example. The above will depend on the financial system characteristics and of the risk profile presented by financial institutions operating within the jurisdiction. At any rate, it must be taken into account that, from the private perspective, commercial investors and operators seek to conduct their activities within a solid and reliable system based on the highest international standards.

In the same vein, some Associate Members consider that their regulatory frameworks could be strengthened. The above is reflected in the willingness to implement degree of some elements both from Basel II as of Basel III, mainly in the use of standardized models for risk measurement in Central America and the Caribbean.

Due to the above, regional cooperation is essential so that countries that wish to develop more solid regulatory frameworks, but lack the technical capabilities or available resources to adapt them to their inherent characteristics, might do it in a more disciplined and flexible way. A benefit of this cooperation is a better leveled region in opportunities, promoting market competitiveness, stability and resilience at a systemic level. Available resources and optimal allocation in the Association are overriding to meet this objective.

Along this line, Latin American and Caribbean regulators have focused their interest on the implementation of the new risk based capital rules, liquidity standards, and leverage standards established within the Basel III framework. Although these elements are relevant in most of the countries in the region, the improvements in regulations to promote an effective and independent supervision, through implementation of Pillar 2, have received a moderate attention. Moreover, few countries in the region have made significant advances on the issues of transparency and disclosure, as established in Pillar 3.

It is also important to remember that the Basel III framework was initially designed for complex and internationally active banks and during the development process was transformed to cover other type of banks. Thus, the objective declared by the BCBS for this regulatory framework is “[...] to improve the capacity of the banking sector to absorb disturbances coming from financial or economic tensions of any type, reducing with it the contagion risk from the financial sector towards the real economy”.¹⁰

In this sense, it is indispensable to perform an assessment and wonder: Is the current regulatory framework strong enough to meet this objective? Does the financial system structure and institutions operating within represent a contagion risk at the internal and/or external level? Is it necessary to implement the more complex requirements of the Basel III framework to maintain stability and resilience within the jurisdiction? Is it necessary that all banking institutions meet the same set of requirements to operate safely and to maintain their stability?

On the other hand, there are various signals found along the survey indicating that the development of a proportional approach in banking regulation is essential throughout the region. The heterogeneity in the development of banking regulation both internal and among jurisdictions, corresponds to the degree of development and complexity of the financial systems in the region. On other side, some participants acknowledge that their jurisdiction considers some proportional approaches both in regulation as in supervision, without clearly distinguishing between both and without having an operational definition of proportionality.

As a consequence that some measures for proportional regulation and supervision are implemented either formally or informally in the region, it is important to give attention and channel resources in order to start to develop a sound framework contemplating the main elements that a proportional approach to regulation should have. Communication among jurisdictions that currently formalize a proportional regulatory framework is essential to identify the best practices on this subject. In this sense, ASBA is a valuable resource in the construction of channels that facilitate communication for our Associate Members.

In this same line, the objective should not be to implement at discretion each one of the latest revisions to the Basel framework. Instead, we should depart from an intensive analysis of the characteristics of financial systems to decide the best way to adjust and implement international standards, always seeking to provide stability and to promote resilience in the financial system.

Finally, from the perspective of the ASBA General Secretary, this document in combination with the report on Banking Regulation and Supervision Expectations in the Americas 2018, will contribute to clarify the Technical Agenda discussion and consideration, as well as to strengthen the development of training programs to enhance capabilities and technical cooperation in the region.

¹⁰ Bank for International Settlements. “Basel III: Global Regulatory Framework to Strengthen Banks and banking systems”, 2010.

REFERENCES

Bank of International Settlements; IFRS Foundation, *Memorandum of Understanding*, September 2017. <http://www.ifrs.org/-/media/feature/around-the-world/memoranda/bcbs-memorandum.pdf?la=en&hash=32437975FBDFDA51862A9BFE58C6A96A970A2D1B>

Bank of International Settlements. *Basel III: Global regulatory framework to strengthen Banks and banking systems* 2010. https://www.bis.org/publ/bcbs189_es.pdf

Basel Committee on Banking Supervision, *Core principles for an efficient banking supervision*, September 2012. https://www.bis.org/publ/bcbs230_es.pdf

Basel Committee on Banking Supervision, *The interplay of accounting and regulation and its impact on bank behavior*, July 2017. <https://www.bis.org/bcbs/publ/wp31.pdf>

Carvalho, Ana; Hohl Stefan; et.al, *Proportionality in banking regulation: a cross-country comparison*, 2017. <http://www.asbasupervision.com/en/bibl/recommended-reading/1555-lr240-1/file>

Fitch Ratings, *Fitch: Implementation of Basel III Recommendations. Variable in Latin America*, 2015. http://www.fitchratings.mx/ArchivosHTML/Coment_14761.pdf

Levitt, Arthur, *Speech by SEC Chairman: Remarks before the Conference on the Rise and Effectiveness of New Corporate Governance Standards*, 2000. <https://www.sec.gov/news/speech/spch449.htm>

Resti, Andrea, *Should the marketing of subordinated debt be restricted/different in one way or the other? What to do in the case of mis-selling?*, March 2016. [http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/497754/IPOL_IDA\(2016\)497754_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/497754/IPOL_IDA(2016)497754_EN.pdf)