The Financial Reform Agenda: Impact and inclusiveness for developing countries

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Since its report of June 2012 (prepared in collaboration with the IMF and the World Bank) the Financial Stability Board (FSB) has monitored the consequences for Emerging Market and Developing Economies (EMDEs) of the reforms agreed as part of the international reform agenda. An important objective of this monitoring is to check whether the consequences have been those intended by the agenda's framers (FSB, 2012; FSB, 2013; and FSB, 2014a).

These reports indicate that implementation of the reform agenda has so far progressed without major hitches. However, the conclusions are still preliminary and the progress observed has been accompanied by concerns as to eventual future problems. Moreover the reports are subject to the shortcoming that the countries to which the conclusions refer are not specified. Similarly the lack of identification of the banks included in the surveys means that there is no way of being sure how far the reports' conclusions apply to both domestic banks in EMDEs and to cross-border banks.

As is common in reports of this kind, less attention is given to typical problems of design and implementation in developing than in developed countries. This point is illustrated at length here for the issue of exposure to currency risk in EMDEs.

Reports of 2014

The FSB report of September 2014 was followed shortly afterwards by a report of the Basel Committee on Banking Supervision (BCBS) on the implementation of Basel II and Basel III in EMDEs (BCBS, 2014).The latter contains both findings and recommendations of the Basel Consultative Group (BCG), the main outreach group of the BCBS whose members are selected national regulators and supervisory bodies, regional groups of supervisors, and international financial institutions.

The November 2014 report of the FSB is upbeat about progress with the reform agenda in both EMDE member countries of the G20/FSB (Argentina, Brazil, China, India, Indonesia, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey) and a number of other unspecified EMDEs.

On Basel III the concerns of EMDEs raised in the FSB report relate principally to three areas. Firstly, there is a fear that differences in the risk weights applied to the same exposure to EMDEs by different units of a cross-border bank may be the source of inconsistent and possibly higher capital requirements or lending to such countries. In the case of global systemically important banks (G-SIBs) attention is drawn to the possibility that changes in banks' capital requirements will be accompanied by withdrawal from certain banking activities owing to the capital surcharge for G-SIBs. Moreover there is concern that limits in some EMDEs on the supply of the high quality liquid assets (HQLA) required for meeting Basel III's liquidity rules may mean that these rules have adverse effects on the liquidity of local financial markets and on their continuing development. Finally misgivings are expressed by EMDEs concerning the impact of Basel III on the provision of long-term investment finance.

Uncertainty amongst EMDEs as to the way in which the reforms will pan out for large cross-border banks are not limited to Basel III. There is also concern as to the effects of group-wide resolution plans for G-SIBs and of the rules for total loss-absorbing capacity (TLAC), which belong to the agenda of the FSB. The first covers the distribution of losses attributed in resolution after insolvency to different categories of G-SIBs' liabilities. The second specifies the level and character of loss-absorbing liabilities prescribed for G-SIBS (including but also over and above the capital requirements of Basel III). With the exception of China there are no banks designated as G-SIBs in EMDEs but both of these reforms will inevitably affect the lending and other exposures of these institutions to EMDEs.

EMDEs, which are members of the FSB and are implementing the G20 commitments on reforms of OTC derivatives markets, stress the need for adequate cross-border regulatory coordination if the reforms are to be successful – a point which equally applies to members of the FSB which are Advanced Economies. EMDEs outside of the FSB, which are not implementing these reforms in their local markets, believe that they may none the less be affected by spillover effects of reforms in Advanced Economies and may have difficulty in designing appropriate policy responses owing to their lack of relevant technical sophistication.

Concerns in these areas reflect unease among EMDEs – apparently inside as well as outside the G20/FSB - as to the degree to which they are adequately involved in both the design of the resolution plans and the implementation of the reform agenda.

The reform process in Advanced Economies has already led to initiatives regarding the structural reform of banks in advanced economies involving separation of core commercial banking activities – such as payments and retail banking – , on the one hand, and of participation in investment banking and other capital-market activities, on the other. The separation is being, or is to be, achieved through outright prohibition of certain activities or subsidiarisation in legally separate entities. The initiatives in this direction are still ongoing.

Although EMDEs acknowledge the contribution to greater financial stability which structural reforms are intended to make, they are also concerned about possible effects in the form of decreased liquidity in certain markets (such as those for sovereign debt), regulatory arbitrage, and leakage to the shadow-banking system. Moreover the structural reforms may complicate the supervision of the local units in EMDEs of banks affected.

As might be expected in an impact assessment of this kind, EMDEs draw attention to shortages of qualified staff for bank supervision. These result both from absolute scarcities of people with the required skills and from the frequently greater financial incentives for such people in the private sector. Such shortages have been a recurring concern of EMDEs since the early stages of the design and implementation of Basel II.

Reports of 2012 and 2013

Many of the points in the FSB report of November 2014 had already been raised in September 2013 and at greater length in June 2012.In the two earlier reports several points raised by EMDEs (as in that of 2014) were related to possible future effects rather than impacts which had actually been observed. In the case of Basel III, replies focussed on the possible unfavourable effects on lending of higher capital requirements, the need for coordination of risk management practices between entities in the parent and host countries of cross-border banks, and shortages of the HQLA required for meeting Basel III's liquidity rules. There was also criticism of the reliance on the index of the credit-to-GDP ratio for the activation of Basel III's countercyclical capital buffer owing to the widespread experience in EMDEs of larger swings in the cycles of credit and growth than in Advanced Economies.

The FSB reports of both June 2012 and of September2013 noted that the level and composition of capital in many EMDES left them well placed to meet the capital requirements of Basel III. The maintenance by banks in EMDEs of capital levels in excess of internationally agreed minima was viewed as reflecting the higher degree of macroeconomic volatility and overall risk in these jurisdictions.

The relatively high capital levels are evident in figures for financial soundness indicators for 213 countries at the end of 2009 in a report of the FSB, IMF and World Bank for the finance ministers and Central Bank governors of the G20 in October 2011(FSB, IMF and World Bank, 2011:45). The average ratio of regulatory capital to risk-weighted assets was 17 per cent for EMDEs compared to 14 per cent for advanced economies. Data published annually for the *Banker 1000* banks in more than 100 countries are consistent with this picture.

Implementation of Basel II and Basel III according to the BCBS/BCG

The report of the BCBS/BCG on the impact and implementation challenges of Basel II and Basel III for EMDEs and small economies (BCBS, 2014) is less an account of impacts than a listing of problems which have arisen under headings of the Basel framework and a set of recommendations for solving them.

The coverage of this report is organised under the following headings: Basel capital framework, Basel liquidity framework, OTC derivative market reforms, sovereign exposures, domestic systemically important banks, and cross-border supervisory colleges. Underlying the findings and recommendations of the report is the view that countries should move towards a version of the Basel framework incorporating most of the framework's rules. Although there are references to the need in some countries to take account of local conditions, these references are mostly not fleshed out and limited attention is given to problems likely to prove of greater importance in many EMDEs than in Advanced Economies.

Some examples of the reports' findings and recommendations are the following:

- Basel 2.5 (the revised version of the capital framework targeting weakness identified at an early stage of the implementation of Basel II regarding the rules for market risk and securitization) has led to increases in risk-weighted assets for exposures to market risk in the financial markets of EMDEs but estimation of the scale of these exposures is decided solely by parent banks and their home-country supervisors. The key recommendation of the BCG is the need for further guidance from the BCBS concerning the treatment of consolidated exposures.
- When adopting Basel II and Basel III banks may conceal some of the risks in their balance sheets or pressure supervisors to approve internal Ratings-Based (i.e. model-based) Approaches to estimating exposures when neither the bank nor the supervisor is ready. The BCG recommends that EMDEs should themselves set priorities for ensuring the robustness, reliability, and transparency in the adoption of Basel standards.
- A mechanistic implementation of the countercyclical capital buffer of the capital requirements of Basel III(reflected in a trigger based purely on the country's credit-to-GDP ratio) could have negative consequences owing to the lack of the necessary supervisory tools in some EMDEs and to inadequate experience dealing with fluctuations in aggregate credit. Here the BCG also recommends that examples of other macroprudential tools for controlling excessive fluctuations in credit should be explicitly set out in the text of the Basel capital framework.
- Attention is drawn to countries whose banking sectors combine large cross-border and smaller, less sophisticated institutions. The BCG acknowledges that Basel II and Basel III were designed primarily for the former. It recommends that regulatory and supervisory problems involving the former should be resolved on the basis of relationships with their parent authorities. However, there is no reference to experience which has indicated that effective relationships of this kind may be difficult to develop. Corresponding recommendations for the smaller, less sophisticated institutions are not provided.
- The challenges of implementing the Basel III liquidity framework (a concern of the FSB reports mentioned earlier) leads the BCG to recommend a Quantitative Impact Study for EMDEs specifically designed to facilitate their implementation of the liquidity framework.
- The BCG acknowledges that attempts by banks in EMDEs to meet the levels of HQLA required by Basel III's liquidity coverage ratio may lead to concentration risk in the form of excessive exposure

to sovereign debt and to increased currency risk due to resulting imbalances between assets and liabilities denominated in foreign and domestic currencies (the latter an issue treated at length below).The BCG's principal recommendations are full use of the flexibility provided by the rules of the liquidity coverage ratio and careful supervisory monitoring.

- The BCG also acknowledges that the liquidity rules of Basel III are currently encouraging the holding of liquid reserves in cross-border banking groups at the level of the parent institution, causing uncertainty as to how the reserves would be made available to foreign branches and subsidiaries when they are needed. The BCG recommends the development of understandings on the subject between home and host supervisors as well as encouragement by the BCBS of a wider sense of responsibility within groups for group-wide banking operations. Perhaps more trenchantly the BCG notes that, absent supervisory coordination, acceptance may be necessary of requirements by host supervisors that branches and subsidiaries maintain minimum levels of liquidity in their jurisdictions at all times.

Further revisions of Basel III

Basel III is continuing to be subject to revisions. In a report to the G20 the BCBS acknowledges that its studies have shown that there are material variations in banks' risk-weighting of assets for the purpose of estimating capital requirements for credit, market and operational risks (BCBS, 2014). An analysis in *The Banker* shows that for four United States universal banking groups (JPMorgan, Bank of America, Citigroup and Wells Fargo) risk-weighted assets were equivalent to 58 per cent of total assets unadjusted for risk in 2012, whereas for the top five European banks by size of assets (HSBC, Deutsche Bank, Credit Agricole, BNP Paribas and Barclays) the same ratio was 27.5 per cent (Alexander, 2013).

Such variations can be ascribed only partly to variations in the riskiness of these banks' portfolios. These may also reflect to a significant extent variation in supervisory standards and banks' own risk management. They none the less undermine confidence in the rules for regulatory capital, and are in contradiction with the Basel framework's objective of enhancing the equality of the conditions in which banks compete.

In response the BCBS is undertaking a review of not only the different approaches in Basel III to credit, market and operational risk but also of the models used in the more sophisticated approaches to risk estimation. The effect of these changes is to be reinforced by improved guidelines which target in particular the lack of consistency (and thus comparability across different banks) regarding both the form and the granularity of information which banks disclose.

Some other recent revisions of Basel III are in the direction of restraining national discretion (BIS, 2015). As the BCBS puts it, "National discretion allows countries to adapt the Basel standards to reflect differences in local financial systems. However, the use of national discretion can also impair comparability across jurisdictions and increase variability in risk-weighted assets."

Amongst the changes are the following: shortening the transition period for the application of flexibility in the recognition of collateral for past-due loans; less flexibility in the definition of retail exposures; abolition of the transitional period during which more flexible arrangements for data and rating systems used in the Internal Ratings-Based Approach are permitted for corporate, sovereign, bank and retail exposures; tightening the rules concerning standards for ratings used in the Internal Ratings-Based Approach for exposures to corporates, sovereigns and banks; and removal of the mention of a supervisory requirement for external audits of a bank's rating assignment process and estimation of losses.

As already mentioned, while the recommendations of the 2014 report of the BCG/BCBS recognise the importance of local conditions for the way in which the framework is implemented, their thrust none the less emphasises steps for moving towards as full as possible an implementation. This is a trait shared by the future programme of the BCBS. Acknowledgement of the problems which countries with less developed banking sectors will have in applying rules of a framework designed principally with the risks more sophisticated banks in mind now seems less than in the original text of Basel II which, for example, devoted annex 11 to the Simplified Standardised Approach. This annex assembled in one place the simplest options for calculating risk-weighted assets (BCBS, 2006).

Exposure to currency risk in developing countries

The Basel capital framework is often charged with taking insufficient account of conditions and problems in EMDEs and other developing economies which are less salient in advanced economies. The relevance of such conditions and problems is acknowledged in the commentary of international financial institutions but discussion has tended to be summary.

One such issue is exposure to foreign- exchange or currency risk in such countries. The issue did figure in a report on financial stability in EMDEs in 2011 (FSB, IMF, World Bank, 2011). Here were listed not only administrative and prudential measures for dealing with currency risks but also examples of their use by EMDEs. None the less the subject is only briefly mentioned but not given extended treatment in the reports on the impact of the reform agenda on EMDEs.

Currency risk manifests itself in the balance sheets and payments obligations associated with the liabilities not only of banks but also of the borrowers to which banks are exposed through their lending. Depreciation of a country's currency – due, for example, to capital outflows – exposes both its banks and its non-banks to currency risk through its effects on liabilities in relation to assets, when there is not matching of assets and liabilities denominated in foreign exchange, and on the domestic-currency value of payments obligations due on debts denominated in foreign currency. Appreciation of the country's currency can also be a problem but will not be considered in this article owing to its more remote connection to EMDE banking risks.

For banks the impact of currency depreciation is reflected in both its banking book and its trading book. The banking book contains assets and liabilities associated with commercial banking operations or intended to be held to maturity as a source of income. Balance-sheet items in the trading book on the other hand are held with the intention of reselling them in the short term to take advantage of changes in asset prices and interest rates.

The distinction between trading and banking books underlies the approach of the Basel capital framework to currency risk. The exposure to currency risk associated with positions in the trading book attracts capital requirements set in accordance with the separate rules for market risk (BCBS, 2006: 179-182 and 191-202).Exposures to currency risk (or its absence) associated with standard commercial banking operations, especially their funding, which would normally be classified as belonging to the banking book, are not the subject of special treatment in the Basel capital framework analogous to that of the currency risk in the trading book. Exposures in the banking book affected by fluctuations in exchange rates are translated into their equivalents in domestic currency on the basis of applicable accounting rules (which may of course vary between jurisdictions). Capital requirements corresponding to these exposures are then calculated in the standard way for credit and operational risk.

More detailed attention to short-term currency risk is provided in the liquidity framework of Basel III (BCBS, 2010: paras. 172-176).The inclusion of a metric on this subject "is meant to allow the bank and supervisor to track potential currency mismatch issues that could arise in a time of stress)". The Foreign Currency Liquidity Coverage Ratio (LCR) – the metric specified –is the ratio of the stock of high quality liquid assets in each significant currency to the total net cash outflows over a 30-day time period in each significant currency. This is simply the same metric used for measurement and control of a bank's overall liquidity position but here applied serially to the different currencies on its balance sheet. According to the metric the amount of estimated total net foreign-exchange outflows should be net of foreign-exchange hedges.

The metric is not a standard with an internationally defined minimum threshold. Setting standards is to be the task of different jurisdictions' supervisors based on their views as to what constitutes stress. These views should follow from an evaluation of "banks' ability to raise funds in foreign currency markets and the ability to transfer a liquidity surplus from one currency to another and across jurisdictions and legal entities". The ratio should be higher for currencies for which these abilities are assessed as limited.

How do such rules fit into what is known about actual bank practices regarding exposure to currency risk?

Large cross-border banks typically act as dealers in foreign exchange and have units which run this part of a bank's operations. The individuals who run these units may take speculative positions in different currencies within limits set by the bank. These risks of these positions will presumably be treated as part of management of market risk in accordance with Basel III (Basel, 2006: 179-182 and 191-202).

Funding for the commercial banking operations of such banks, on the other hand, will be conducted in accordance with internal rules designed to avoid large open currency positions and to ensure close matching of positions in different currencies. With the implementation of Basel III these rules can be expected to include application of the metric of its Foreign Currency Liquidity Coverage Ration as set by national supervisors.

Various arrangements are used by the banks of Advanced Economies as part of minimisation of exposure to short-term currency risk. The best known of the arrangements for controlling short-term currency risk is the Continuous Linked Settlement (CLS) Bank. However, less is known about the use of these or other similar arrangements by EMDE banks.

Surveys of foreign-exchange settlement have been periodically conducted by central banks for the Committee on Payments and Settlements Systems of the BIS (since renamed the Committee on Payments and Market Infrastructures). In the surveys banks are not classified by the country of the parent institution but it is reasonable to that the great majority are located in Advanced Economies.

Settlement through the CLS Bank is payment-versus-payment (PVP), i.e. the bought currency is paid out only when the sold currency is received, an arrangement which virtually eliminates principal risk. The CLS Bank holds accounts at the central banks of the countries whose currencies are eligible for its operations. At the time of the 2006 survey 69 per cent of the total value of foreign exchange obligations of the institutions included in the survey (obligations between CLS institutions and between CLS institutions and third parties) were settled by this method (Committee on Payment and Settlement Systems, 2008: 4-5). The importance of the CLS Bank, which is owned by 69 large financial groups with about 170 financial entities as participants in its settlement system, has increased since the 2006 (Scott and Gelpern, 2012: 700-702).

The most widely used alternative settlement method is traditional correspondent banking. Under this method each counterparty to a foreign-exchange transaction transfers to the other the currency it is selling, generally using their respective correspondent banks in the currencies concerned. Since the currency transfers take place independently of one another the method exposes the counterparties to principal and liquidity risk. Other arrangements with lesser coverage by jurisdictions and institutions are also used to control short-term exchange settlement risk.

The currency risk associated with foreign exchange settlement is the short-term exposure associated with the settlement transaction itself. Longer-term currency exposures are not covered.

While those responsible for funding strategies in the banks of Advanced Economies do take open positions which expose them to currency risk, these positions are mostly accompanied by hedging strategies which reduce or control the risk. Such strategies are facilitated by the availability of hedging instruments in the financial markets to which they have straightforward access (and which would reduce exposure according to the metric of the Basel liquidity framework).But the strategies are not covered by reporting systems like those for exchange settlement.

The proportion of short-term foreign-exchange transactions of EMDE banks settled through the arrangements described above is not known. It is reasonable to assume that cross-border banks with a presence in EMDEs and the correspondent banks of local EMDE banks use both the CLS Bank and traditional correspondent banking. Moreover several EMDES have domestic payments systems through which resident banks, foreign as well as domestic, can settle mutual transactions denominated in foreign currency. But the absence of data impedes a comprehensive picture. .

Nevertheless, the taking of open currency positions as part of the funding of banks in EMDEs and other developing countries appears to be fairly common, especially in countries where domestic rates of inflation higher than the rates of depreciation of the currency favour the value of assets in relation to that of liabilities. Attention is drawn to such cases by two analysts of bank credit with extensive experience of Asia (Golin and Delhaise, 2013: 672-674 and 713). While such positions will be brought under tighter control when supervisors introduce as part of their monitoring the Foreign Currency Liquidity Coverage Ratio of the Basel III liquidity framework, they are still likely to feature in banking operations in many EMDEs.

Such open currency positions help to explain the continuing concern with exposure to currency risk in EMDEs and other developing countries in conditions of large capital movements and unstable exchange rates such as those occasioned by actual or expected changes in monetary policy in major Advanced Economies, especially the United States. Even after the introduction by supervisors of the metric of the Basel III liquidity framework, greater vulnerability to currency risk in EMDEs than in Advanced Economies is likely to prove a problem which merits more attention and monitoring in reports on the implementation of the international reform agenda.

The reasons for the persistence of greater vulnerability in EMDEs are implicit in the remarks in the Basel III liquidity framework about the variation in the levels of the Foreign Currency Liquidity Ratio appropriate for different jurisdictions. Such variation will reflect differences in banks' access to foreign-currency financing and their ability to transfer liquidity surpluses between currencies and jurisdictions. Banks in EMDEs will generally be less well placed to manage their exposure to currency risk under both of these headings. Moreover the capacity of their central banks to provide foreign currencies to their countries' banks in periods of stress as an alternative to financial markets is also likely to be limited since during such periods the central banks may experience pressure on their foreign-exchange reserves and their own access to borrowing foreign currencies.

Policy guidelines on exposure to currency risk in the banking book could prescribe more comprehensive analysis of mismatches of currency exposures than that of the Foreign Currency Liquidity Coverage Ratio of the Basel III liquidity framework as currently drafted. This could take the form of a more comprehensive currency gap analysis, combining maturity mismatches of assets and liabilities with their currency denomination, extending beyond the short period of the Basel III liquidity framework. The difficulty of such analysis in practice should not be underestimated, especially in the case of banks with multiple cross-border operations. However, such an analysis by a bank should itself serve as a vehicle for improving their risk management.

Exposure to currency risk in the banking book could also be given more explicit treatment in the text of the Basel capital framework. Controlling such exposure (with a cross-reference to the liquidity framework) could be explicitly included in Pillar 2 of Basel III (the Supervisory Review Process) under comprehensive assessment of risks for the purpose of sound capital assessment, whose elements are specified as including the following: policies and procedures designed to ensure that the bank identifies, measures and reports all material risks; a process that specifies capital adequacy goals with respect to risk; and a process of internal controls, reviews and audit to ensure the integrity of the overall management process (paras. 731-742 of BCBS, 2006). Currently the comprehensive assessment of risk has headings for credit risk, operational risk, market risk, interest rate risk in the banking book, liquidity risk, and other risks. The last of these headings could be expanded to include full, explicit coverage of currency risk not covered as part of market risk.

Indirect currency exposure and credit risk

How would a more fully developed approach to currency risk accommodate that to which a bank is exposed via the currency-risk exposure of borrowers from it with loans in a foreign currency which has appreciated, thus making repayment obligations more onerous if the borrowers' revenues or incomes are in domestic currency?

The risk to the bank in such cases should be classified as credit rather than as currency risk since the risk to the bank is of borrowers' non-payment of their increased loan obligations. Non-payment of the obligations specified in the original loan contract may result from government action to lower them by fiat through, for example, redenomination in domestic currency on the basis of an exchange rate more favourable to borrowers than the appreciated market rate. Instances of such redenomination have accompanied depreciations of the local currency in some countries.

One way of handling the indirect exposure of a bank to credit risk stemming from the currency risks incurred by its counterparties could be through a supervisors' advisory which could also be part of the comprehensive assessment of risks prescribed of Pillar 2 of Basel III. Such an advisory would be consistent with the statement of the BCBS that "While the Committee recognises that not all risks can be measured precisely, a process should be developed to estimate risks" (BCBS, 2006: para. 732), which would now include not only different categories of currency risk to the bank but also credit risk resulting from the currency denomination of the liabilities of a bank's borrowers – and not just to its own balance sheet.

The study of the FSB, IMF, and Word Bank cited earlier (FSB, IMF and World Bank, 2011: 30) draws attention to the useful role which can be played by stress testing in alerting banks in EMDEs and other developing countries under the heading of indirect currency risk. This recommendation presupposes a certain level of technical capacity of both banks and their supervisors.

Broadening the approach to banking and other financial reforms

As mentioned above, the recommendations of report of the BCBS/BCG on Basel II and Basel III presuppose pretty complete implementation of these frameworks. But such recommendations raise questions as to universal appropriateness of the rules of this framework.

In 2006 the BCBS expressed the belief that "the revised Framework [at that date Basel II] will promote the adoption of stronger risk management practices by the banking industry, and views this as one of its major benefits" (BCBS, 2006: para. 4). This belief was to be belied by revelations concerning banks' conduct before the current financial crisis and their role in triggering it.

There is now a widespread view that –as expressed by a senior credit risk officer at the Northern Trust in London -"Although Basel II cannot be blamed for the current crisis, the view of risk management that it represents was a contributing factor" (Lumley, 2013: 691-695). What is being targeted in this observation is overreliance on statistical methods and methodologies, an overreliance which critics feel has been encouraged by Basel II and Basel III.

The reaction to the crisis of the BCBS has in fact included not only more stringent quantitative rules but also a new edition of its recommendations for the corporate governance of banks as well as an updating and extension of BCBS's *Core Principles of Effective Banking Supervision.* Nevertheless, the primary focus of the Basel capital framework remains the quantitative rules.

This focus would appear to be connected to the decision of the BCBS since the 1996 Market Risk Amendment of Basel I progressively to elaborate the rules of the Basel capital framework to cover banking risks posed by innovations and other changes in banking practice as they come to be widespread amongst major banks. Such an approach has been itself a considerable challenge to regulators and has arguably been responsible for much of the complexity targeted by critics of the Basel capital framework.

The approach has had the consequence that the elaboration of the Basel capital framework continues to be driven primarily by the weaknesses in the global financial system highlighted by the current crisis - as well of course by longstanding problems of risk management and capital requirements of the banks in Advanced Economies. Reticence on the part of the BCBS regarding an extensions of the Basel capital framework in directions not currently covered probably also reflects one of the framework's original objectives, namely "maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among internationally active banks" (BCBS, 2006: para. 4). The appropriateness of such reticence is now questionable since the Basel capital framework is no longer intended only for a small group of internationally active banks with parent institutions located in the Advanced Economies but for more global application.

The agenda of the FSB transcends that of the BCBS but is vulnerable to the same criticism that it reflects primarily responses to flaws highlighted by a financial crisis originating in Advanced Economies. The FSB has recently shown sensitivity to criticism concerning the lopsidedness of its agenda and its work.

An indication of such sensitivity is the FSB's brief report to the G20 Brisbane Summit in November 2014 on the structure of its representation (FSB, 2014b). The report proposes enhanced representation of EMDEs in plenary meetings of the FSB, greater use of the existing flexibility in the FSB's charter to enable non-member authorities to be involved in the work of the FSB's committees and working groups, better integration of the Regional Consultative Groups into the work of the FSB, and sharpening the FSB's focus on EMDE issues.

The last of these proposals bears most clearly on the issues discussed in this article. As the report puts it, "The FSB should continue to seek to identify policy and implementation issues of most relevance to EMDEs and ensure that they are addressed as part of the FSB's global work" (FSB, 2014b:3). This goal is to be the subject of an Emerging Market Forum in early 2015. Past experience none the less suggests that the required shift in the focus of the FSB's work towards more inclusiveness regarding the concerns of EMDEs will require not only good intentions but also in some respects a change in mind-set. The shift in the FSB's focus is thus likely to be gradual.

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