# February Article

## Is Basel III Enough?

In the years after the financial crisis, a new paradigm about risk arose, with a more preventive and forward looking way. Regulators seemed to agree that a new framework should be built for the banking industry to avoid more extreme situations as the one of 2008. Following Basel I and II, Basel III has been being designed as the most recent document providing the policies with which the whole industry should comply.

The new version of the European Regulatory Policy brings new requirements into the table and we can underline the most important ones: the new leverage ratio (requiring more and better capital in terms of quality); the new concept of Total Loss Absorbing Capacity, to force banks to have into account their relevance to the financial system; and the focus in the prevention and early intervention. It is still impossible to know if these recent measures will have a significant impact in avoiding new financial distressed periods, or if they are only hurting the industry profitability. However, when discussing the prevention of failures, some argue that although important, regulation is not the only driver that should be addressed and that the key to success might also be in the institutions' culture and organizational behavior.

In 2014, the London School of Economics (LSE) did a research on the cost of conduct failures in banking industry, from 2010 to 2014 - after the financial crisis. The study considers as conduct cost any cost borne by a bank related to regulatory proceedings, litigations or financial losses imposed by regulators or courts - for more about it, please read the provided link. The aim was to measure the value lost by investors due to the banks' misconduct. The researchers found that that value was, in total, roughly GBP 205 bn or USD 241 bn – a value which is higher than the annual economic output of Ireland - a very significant number considering the difficulties of the sector in the past few years. The most overwhelmed institution lost nearly GBP 64 bn. In the Portuguese case, the state-owned bank Caixa Geral de Depósitos and the failed bank Banco Espírito Santo, were the worst performers, with total losses around GBP 246 m (almost EUR 289 m). The study further states that even with the previously ruling Basel II, too much resources were still wasted in fines and other compliance processes - which suggests that the regulation might not be the only problem. Can the bonuses' culture induce workers in taking higher individual risk? And can this consequently mean more risk for firms? If so, a better regulation must be combined with deep cultural changes. Firms must develop internal initiatives that enhance confidence in the decision process and employee commitment, acknowledging the importance they have for the financial system. The success of this kind of measures could mean the avoidance of the financial losses previously mentioned, a sign that institutions are adapting to the future and authorities' requirements, while delivering a bold message of strength to the market and its consumers. This would allow firms to deliver the values investors are waiting for - impossible under the current interest and regulatory framework – and as so, it must be viewed as a huge opportunity of cost cutting and efficiency improvement within the industry.

Actually, banks are already embedding this organizational transition towards a more ethical, transparent and committed way of doing business, diminishing the operational risk and dodging actions that might incur in fines or losses. The on-going strategies will benefit not only the financial sector and its investors, but the economy as a whole.

The next years will show if the ECB's prescription will result and it will be interesting to witness how will it work. Can the key to success really be the change of institutions' cultures and organizational behavior?

**Author**

**Tomás Costa**

Tomas.costa@novainvestmentclub.com

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