

Did Basel III fail? The international post-mortems

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The Basel Committee and the Financial Stability Board both published reports on the banking turmoil of 2023 in October of that year. The Basel Committee's report examined the failures of Silicon Valley Bank and other regional banks in the United States as well as the collapse of Credit Suisse. Its central finding was that the turmoil had been caused above all by failures of risk management and governance in the banks and by weaknesses of supervision. Most of the American banks that failed were not subject to the full Basel framework, because the United States had exempted them. Credit Suisse, by contrast, had been subject to the framework and had complied with it.¹

The report stopped short of concluding that Basel III had failed. It identified several components whose performance required further examination. The outflows of deposits observed in March 2023 had far exceeded the assumptions of the liquidity coverage ratio and the net stable funding ratio. Credit Suisse had met both ratios until shortly before its collapse, although part of its liquidity was held in legal entities from which it could not be transferred within the group. The report also questioned the ability of AT1 instruments to absorb losses on a going-concern basis. It noted that Credit Suisse had continued to call and replace its instruments and to pay discretionary coupons despite consecutive quarterly losses, which had reinforced the market's perception of AT1 bonds as a form of debt.² The Committee decided to strengthen supervisory effectiveness through additional guidance, to analyse empirically whether specific features of the framework had performed as intended and to consider policy options in the medium term.

The report of the Financial Stability Board focused on resolution. The failure of Credit Suisse was the first test of the international resolution framework for a global systemically important bank. The board considered that the framework had been available and could have been applied.

According to its analysis, the Swiss authorities had been in a position to carry out a resolution, so that their decision to choose another path did not call the framework into question. The board nevertheless identified areas where work was needed: the operational readiness to carry out a bail-in across several jurisdictions, the availability of public sector liquidity in resolution, the role of deposit insurance and the communication of the treatment of AT1 instruments and the hierarchy of claims.³

The reports were cautious, as reports by bodies whose members wrote the rules under examination tend to be. Independent commentators were more critical. Some argued that the Basel framework had worked as designed and that the failure lay in governance and supervision. Others replied that a framework under which a bank with a common equity ratio of fourteen per cent could fail within days measured the wrong things. In Switzerland itself, the expert group on banking stability appointed by the Federal Department of Finance and the Federal Council's report of April 2024 reached a view between the two positions. They proposed to strengthen the existing regime and to keep its basic structure.⁴ The debate about the role of internal models, AT1 instruments and liquidity assumptions continues in the Basel Committee. The Swiss experience is one of its most important empirical references.

1 Notes

1. Basel Committee on Banking Supervision, Report on the 2023 banking turmoil (October 2023), and the FSI summary Lessons from the 2023 banking turmoil (2023). To be verified. ↩
2. On the findings of the Basel Committee's report on the performance of the liquidity standards, the trapped liquidity within the Credit Suisse group and the doubts about the going-concern loss absorption of AT1 instruments, see BCBS, Report on the 2023 banking turmoil (October 2023), and the FSI summary. To be verified. ↩
3. Financial Stability Board, 2023 Bank Failures: Preliminary lessons learnt for resolution (10 October 2023), on the assessment of the resolution framework and the areas for further work (bail-in execution, public sector liquidity backstops, deposit insurance, creditor hierarchy and communication). To be verified. ↩

4. On the report of the expert group on banking stability chaired by Yvan Lengwiler (September 2023) and the Federal Council's report on banking stability of 10 April 2024, see the publications of the Federal Department of Finance. To be verified. ↩

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