Chapter 5
The “Smart” Regulatory Features of Basel II and Basel III

ABSTRACT
This chapter explores the regulatory attributes of Basel II and Basel III. It demonstrates that the frameworks of Basel II and Basel III possess each of the benchmark attributes of the “third-way” regulatory approach to financial regulation. Owing to the demonstrated congruence between Basel II and Basel III and the benchmark attributes, this chapter concludes that Basel II and Basel III can clearly be viewed as an example of ‘smart’ financial regulation in the field of banking prudential control.

INTRODUCTION
As soon as the Basel II- international capital adequacy requirements framework was released, it attracted the attentions of regulators, bankers and market participations who sought to explore its effectiveness in stabilizing financial markets, enhancing the competitive advantage of banks, and protecting shareholders and stakeholders. Particularly after the Global Financial Crisis, certain issues were exposed that raise questions about the effectiveness of Basel II and Basel III in preventing any future happening of a similar disaster, and about its ability to stabilize economies.

To properly evaluate Basel II and Basel III, the core intention of this research, the first step should go towards closely understanding and evaluating the framework of these two new Basel Accords. So in this section, drawing on the history of regula-

DOI: 10.4018/978-1-4666-5950-6.ch005
The “Smart” Regulatory Features of Basel II and Basel III

tory strategies (command-and-control and self-regulation debate); and utilizing the new regulatory paradigm represented by the three concepts—reflexivity; responsive regulation and smart regulation, a foundational dichotomy\(^1\) is developed and used as a benchmark to evaluate the Basel II and Basel III’ frameworks. This approach provides the first part of the answer to the research question—how ‘smart’ is Basel II and III in the context of the Australian banking system.

EVALUATION BENCHMARK

Dichotomous Framework of “Smart” Financial Regulation

Responsive regulation can be split into two constituent parts—‘responsiveness’ and ability to ‘spread regulatory burden’. These two parts are broad and deploy different approaches to achieve them. However the earlier discussion has exposed functional similarities between these two broad parts and the four features of the concept of ‘reflexivity’—being system monitoring; intermediary structures; corporate social responsibility; and market-oriented strategies. This implies that these four features can be accommodated under the two broad aspects of responsive regulation. As a result, this dichotomy will be built on two themes: first, the mechanisms that *spread the burden* of regulation beyond the direct sphere of government; and mechanisms that *achieve responsive enforcement*. Under the *first* theme, approaches such as system monitoring, tripartism and intermediary structures are classified as mechanisms to spread regulatory burden. Under the *second* theme, approaches such as building corporate social responsibility and market-oriented strategies are seen as mechanisms to achieve responsive enforcement.

Each branch of the dichotomous framework brings together systems monitoring and the presence of intermediary structures from the concept of ‘reflexivity’; plus the notion of enforced self-regulation with its positioning in the middle of the enforcement pyramid between command regulation and self-regulation, and the idea of Tripartism from the concept of responsive regulation.

The first driver contributing to a sharing of the regulatory burden is system monitoring\(^2\), which compensates for a limited inspectorate capacity through promoting the internalization of goals and objectives. Inspectors are supposed to monitor and regulate the operation of self-control systems and, subsequently, intervene at the system level. Similarly, the model of enforced self-regulation, under responsive regulation, also has such a function. Reflecting its positioning in the middle of the pyramid, the enforcement and rule-writing segment is undertaken by firms at a system level, but regulatory agencies are responsible for authorizing these rules and making sure their implementation is aligned with regulatory prudential standards.
Related Content

Determinants of Financial Management Behaviors of Families
www.igi-global.com/chapter/determinants-of-financial-management-behaviors-of-families/128632?camid=4v1a

Ransomware: A Rising Threat of new age Digital Extortion
www.igi-global.com/chapter/ransomware/166872?camid=4v1a

CSR's Capability as a Conflict's Resolution to Enhance a Firm's Value in Indonesia
www.igi-global.com/article/csrs-capability-as-a-conflicts-resolution-to-enhance-a-firms-value-in-indonesia/134863?camid=4v1a
Crowdfunding: Waker of Small Hidden Insignificant Funds?
Zorica Golic (2016). Strategic Approaches to Successful Crowdfunding (pp. 250-269).
www.igi-global.com/chapter/crowdfunding/141736?camid=4v1a