

HOOVER INSTITUTION, STANFORD UNIVERSITY, PETER HENRY

Proposal and Comment Information

Title: Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-weighted Assets, R-1888

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Organization Name: Hoover Institution, Stanford University

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Name: Peter Henry

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Many non-regulatory factors hinder the flow of private financing for investment in emerging-market and developing economies (EMDEs). But multiple financial institutions report that certain parts of the current Basel framework (and plans for implementation) unintentionally deter banks from safely financing EMDE projects, many of them infrastructure and climate-related (Tiftik and Rismanchi 2025). This is counterproductive. Governments in developed markets use their taxpayers' money to fund MDBs to reduce the risk to their private sectors of investing in EMDEs. At the same time, these governments tighten regulations in their own markets that limit the usefulness of the very risk-mitigation products they fund the MDBs to create. Consider two examples.

First, the Basel III regulatory framework requires that banks hold more capital against the perceived risks of providing project finance loans to EMDEs than data on the actual risks of project finance lending require (Songwe Et Al 2025). For instance, in project finance, the riskiest time is the pre-operational phase. Around year five or so, risk starts to decline as projects transition from the pre-operational to the operational phase. As such, roughly five years after project finance loans commence, their marginal default rates tend to be less than that of corporate loans to investment-grade global corporate borrowers. Nevertheless, banks are often required to hold more capital against project finance loans than against loans to unrated corporates.

Insurers also face empirically unfounded capital charges. For a given EMDE infrastructure project, any insurer subject to EU Solvency II regulation that invests in the project will receive a capital charge of 49%, versus 25% if the investment had been in an OECD country. Yet historical data indicate that the credit performance of infrastructure loans that originated in EMDEs is no worse than that of infrastructure loans originated in advanced economies (Hu and Perraudin 2020). There is, therefore, no factual justification for applying different regulatory treatment to these categories of loans.

Second, because MDBs have AAA credit ratings (largely due to their preferred creditor status), specialized knowledge of EMDEs, and take first credit losses, co-lending and co-investing with MDBs leads assets to perform better than they do in the absence of co-lending and co-investing with MDBs. Yet, unless there is explicit credit support (for example, through a credit guarantee) existing regulation does not recognize the benefits of co-lending and co-investing with MDBs, even though such assets perform better than assets without MDB co-lending and co-investing. Because assets that benefit from MDB risk-sharing mechanisms are, nonetheless, often subject to a 100% capital charge, the current prudential framework works against blended finance.

Moreover, credit enhancement products from only a select number of MDBs are eligible to be assigned a 0% risk-weighting under the Basel III guidelines. Expanding the list of eligible MDBs will allow commercial banks to work with more partners and do more transactions to create more value for each dollar of developed-country taxpayer money used to fund the MDBs.

Compounding the limited-eligibility problem, for the MDBs that are eligible for a 0% risk-weighting, regulators require their guarantee on a project to be “unconditional” before a commercial bank can assign it a 0% weight. Due to a lack of clarity on what qualifies as unconditional, from a regulatory capital perspective, commercial banks often cannot make use of certain MDB guarantees.

The principles of Basel III are sound and have prevented systemic financial crisis in the last decade. Financial institutions should keep capital buffers and liquidity ratios proportionate to the risk of their assets. But the preceding examples indicate that in the vast and high-quality machinery of Basel III's prudential regulations, there are certain technical rules, incongruent with its philosophy, that inhibit strategic investments in EMDEs with no gain in financial stability.

Accordingly, we recommend that G20 leaders encourage the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) to remove the unintended regulatory barriers outlined above, in the cited references, and here. Doing so would enable global systemically important banks and financial institutions to more efficiently facilitate capital flows for investment in EMDEs with no impact on safety and soundness.

G20 Recommendation to Fix the Unintended Consequences of Basel III for Infrastructure Investment in Emerging-Market and Developing Economies

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First, the Basel III regulatory framework requires that banks hold more capital against the perceived risks of providing project finance loans to EMDEs than data on the actual risks of project finance lending require (Songwe Et Al 2025). For instance, in project finance, the riskiest time is the pre-operational phase. Around year five or so, risk starts to decline as projects transition from the pre-operational to the operational phase. As such, roughly five years after project finance loans commence, their marginal default rates tend to be less than that of corporate loans to investment-grade global corporate borrowers. Nevertheless, banks are often required to hold more capital against project finance loans than against loans to unrated corporates.

Insurers also face empirically unfounded capital charges. For a given EMDE infrastructure project, any insurer subject to EU Solvency II regulation that invests in the project will receive a capital charge of 49%, versus 25% if the investment had been in an OECD country.² Yet historical data indicate that the credit performance of infrastructure loans that originated in EMDEs is no worse than that of infrastructure loans originated in advanced economies (Hu and Perraudin 2020). There is, therefore, no factual justification for applying different regulatory treatment to these categories of loans.

Second, because MDBs have AAA credit ratings (largely due to their preferred creditor status), specialized knowledge of EMDEs, and take first credit losses, co-lending and co-investing with MDBs leads assets to perform better than they do in the absence of co-lending and co-investing with MDBs. Yet, unless there is explicit credit support (for example, through a credit guarantee) existing regulation does not recognize the benefits of co-lending and co-investing with MDBs, even though such assets perform better than assets without MDB co-lending and co-investing. Because assets that benefit from MDB risk-sharing mechanisms are, nonetheless, often subject to a 100% capital charge, the current prudential framework works against blended finance.

Moreover, credit enhancement products from only a select number of MDBs are eligible to be assigned a 0% risk-weighting under the Basel III guidelines. Expanding the list of eligible MDBs will allow commercial banks to work with more partners and do more transactions to create more value for each dollar of developed-country taxpayer money used to fund the MDBs.

*Frazer and Henry, Hoover Institution: jfrazer@stanford.edu; pbhenry@stanford.edu. Songwe, Brookings Institution: Vsongwe@brookings.edu

¹For additional examples, see pp. 13-17 of Songwe Et Al (2025).

²Only five EMDEs—Chile, Colombia, Costa Rica, Mexico, and Turkey—are members of the OECD.

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Accordingly, we recommend that G20 leaders encourage the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) to remove the unintended regulatory barriers outlined above, in the cited references, and [here](#). Doing so would enable global systemically important banks and financial institutions to more efficiently facilitate capital flows for investment in EMDEs with no impact on safety and soundness.

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