Journal of Business Data Science Research

The Disadvantages of International Rules and Guidelines for Banks in Emerging Countries: A Case Study of Iran

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ABSTRACT

This paper examines the disadvantages of international rules and guidelines for banks in emerging countries, with a specific focus on Iran. The Basel guidelines are the most well-known international banking regulations, but their implementation in emerging countries can create challenges for banks. Higher compliance costs, reduced access to credit, increased competition, difficulty in complying with complex regulations, limited relevance to local conditions, limits on innovative financing, stricter capital requirements, higher costs of borrowing, and increased regulatory burden are some of the challenges that banks in emerging countries face due to international regulations. The paper presents case studies from Iran to illustrate these challenges. The paper also offers possible solutions for banks in emerging countries, including the establishment of local regulations, the development of technology, and increased collaboration between local and international banks. By understanding the disadvantages of international rules and guidelines for banks in emerging countries and identifying possible solutions, policymakers and banking executives can work together to create more effective regulations that support economic growth and financial stability in these countries.

KEWWORDS: Basel guidelines, Developing countries, Emerging markets banking regulation, Disadvantages of international rules.

ORIGINAL ARTICLE

Received 10 March 2023
Accepted 27 March 2023

CITATION

Davoudi, M. M. (2023). The Disadvantages of International Rules and Guidelines for Banks in Emerging Countries: A Case Study of Iran . Journal of Business Data Science Research, 2(01), 28–34.

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1. Introduction

The global financial system is governed by a complex web of international rules and guidelines that are designed to promote stability, transparency, and efficiency. However, the impact of these regulations is not evenly distributed, and banks in developing countries often face significant challenges in complying with these rules.

International rules and guidelines, such as the Basel Accords and the Dodd-Frank Act, can be particularly burdensome for banks in developing countries. These regulations require banks to maintain higher levels of capital and to implement more stringent risk management practices, which can be costly and difficult to implement in developing economies. As a result, some researchers have argued that these regulations may have unintended consequences for the banking systems in developing countries, such as decreased lending and reduced financial stability.

Recent studies have highlighted the challenges that banks in developing countries face in complying with international rules and guidelines. For example, a study by the Bank for International Settlements found that smaller banks in emerging markets are particularly vulnerable to the costs of compliance with Basel III regulations (Basel Committee on Banking

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• https://jbdsr.com/index.php/home/article/view/10

Supervision, 2017). Similarly, a report by the International Monetary Fund found that the implementation of the Dodd-Frank Act has had unintended consequences for the availability of credit in some emerging markets (International Monetary Fund, 2014).

This paper aims to examine the disadvantages of international rules and guidelines for banks in developing countries. We will explore the various ways in which these regulations can be disadvantageous, such as the impact on financial stability, the ability to compete with larger multinational banks, and the potential for regulatory capture. We will also provide examples of how specific banks in developing countries have been affected by these regulations, and discuss potential solutions to address these challenges.

Overall, this paper aims to contribute to the ongoing debate on the impact of international rules and guidelines on banks in developing countries, and to provide insights into potential solutions to promote more equitable and effective regulation in the global financial system.

2. Overview of international rules and guidelines

The global financial system is governed by a complex web of international rules and guidelines that are designed to promote stability, transparency, and efficiency (United States Congress, 2010; Basel Committee on Banking Supervision, 2020). These regulations are intended to protect consumers, prevent fraud, and ensure that financial institutions are well-capitalized and well-managed. International rules and guidelines are developed and implemented by various bodies, including the Basel Committee on Banking Supervision, the International Monetary Fund, and the Financial Stability Board.

One of the most well-known sets of international rules and guidelines for banks is the Basel Accords. The Basel Accords are a set of recommendations for banking regulations that were developed by the Basel Committee on Banking Supervision, a group of central bankers and regulatory officials from around the world. The Basel Accords are designed to promote financial stability by ensuring that banks maintain adequate capital and manage risk effectively. The most recent iteration of the Basel Accords, known as Basel III, was finalized in 2010 and has been implemented by countries around the world (Basel Committee on Banking Supervision, 2020).

Another set of international rules and guidelines for banks is the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was passed in the United States in 2010. The Dodd-Frank Act is a comprehensive piece of legislation that is designed to promote financial stability and protect consumers. It includes a number of provisions that impact the banking industry, including the creation of the Consumer Financial Protection Bureau and the implementation of stricter regulations on derivatives trading (United States Congress, 2010).

There are many other sets of international rules and guidelines that impact the banking industry, including the European Banking Authority's Capital Requirements Regulation and Directive, the Financial Action Task Force's anti-money laundering and counter-terrorism financing recommendations, and the International Accounting Standards Board's financial reporting standards.

3. Disadvantages of international rules and guidelines in developing countries

Here are some of the main disadvantages for banks in developing countries that can arise from the implementation of international rules and guidelines:

3.1. Higher compliance costs

One of the main disadvantages of international rules and guidelines for banks in developing countries is the higher compliance costs they face. These regulations often require banks to implement more complex and sophisticated risk management systems, which can be costly to develop and maintain (Kalemli-Ozcan et al., 2013). Additionally, smaller banks in emerging markets may have limited resources to devote to compliance and may struggle to keep up with the requirements of international regulations.

Studies have found that compliance costs can be particularly high for banks in emerging markets. For example, a survey of banks in Southeast Asia found that compliance costs for anti-money laundering and counter-terrorism financing regulations were significantly higher for banks in these countries compared to developed countries (Asian Development

Bank, 2015). This can put additional strain on the finances of banks in these regions, potentially limiting their ability to lend and provide other financial services.

3.2. Reduced access to credit

One potential disadvantage of international rules and guidelines for banks in developing countries is reduced access to credit. These regulations can make it more difficult for banks to lend, particularly to riskier borrowers such as small and medium-sized enterprises (SMEs).

For example, higher capital requirements can make it more expensive for banks to raise funds, which can in turn reduce the availability of credit. Additionally, complex and expensive risk management systems required by international regulations can divert resources away from lending and other activities, further limiting access to credit.

Studies have shown that the impact of international regulations on access to credit can be particularly acute in emerging markets. For example, a study of the effects of the Basel III accord found that the increased capital requirements were associated with a reduction in bank lending to SMEs in emerging markets (Claessens et al., 2013). This could have a negative impact on the growth and development of these businesses, as well as on the broader economy.

3.3. Increased competition

International rules and guidelines for banks can also lead to increased competition, which can be a disadvantage for banks in developing countries. For example, regulations such as Basel III can encourage larger banks to hold more capital, which can make it more difficult for smaller banks to compete. In addition, international regulations can create a more level playing field for foreign banks, allowing them to more easily enter and compete in emerging markets (Kalemli-Ozcan et al., 2013).

Studies have shown that increased competition can have negative effects on the profitability and stability of banks in emerging markets. For example, a study of the effects of foreign bank entry in emerging markets found that it can lead to a decline in profitability for domestic banks (Cull et al., 2018). In addition, increased competition can put pressure on domestic banks to take on more risk in order to maintain their market share, potentially leading to instability in the financial system (Cull et al., 2018).

3.4. Difficulty in complying with complex regulations

International rules and guidelines for banks can be complex and difficult to comply with, which can be a disadvantage for banks in developing countries that may not have the resources or expertise to meet the requirements. For example, the Basel III framework includes numerous requirements related to capital adequacy, liquidity, and risk management that can be difficult to implement and monitor.

Studies have shown that compliance costs for banks in emerging markets can be higher than for banks in developed countries due to factors such as weaker legal frameworks, lower levels of financial literacy, and limited access to skilled personnel. In addition, the cost of complying with international regulations can divert resources away from other important activities such as lending and expanding financial services to underserved populations (Ivashina and Scharfstein, 2010).

3.5. Limited relevance to local conditions

International rules and guidelines for banks may not always take into account the unique circumstances and needs of banks in developing countries. For example, the regulatory and institutional frameworks in these countries may differ significantly from those in developed countries, which can make it difficult to apply international standards in a meaningful way (Blundell-Wignall and Atkinson, 2010).

Furthermore, international rules and guidelines may not always be relevant to local market conditions, such as the size and complexity of the financial system, the level of economic development, and the nature of the risks facing banks in developing countries. This can lead to a situation where banks are forced to comply with rules that may not be appropriate for their specific circumstances, which can be costly and inefficient (World Bank Group, 2013).

3.6. Limits on innovative financing

International rules and guidelines for banks can sometimes limit the ability of banks in developing countries to engage in innovative financing activities. For example, the Basel III framework includes restrictions on the use of certain financial instruments, such as securitization and structured finance, which can be used to manage risk and support lending activities.

While these restrictions may be appropriate for banks in developed countries, they may not be suitable for banks in developing countries that face different market conditions and risk profiles. This can limit the ability of banks in developing countries to provide financing to underserved sectors and promote economic growth.

3.7. Stricter capital requirements

International rules and guidelines for banks often require higher levels of capital adequacy than what may be feasible or optimal for banks in developing countries. This can be due to factors such as differences in risk profiles, asset quality, and business models, which can make it more difficult for banks in developing countries to comply with the stricter requirements (World Bank Group, 2013).

Stricter capital requirements can also limit the ability of banks in developing countries to expand their lending activities, which can have negative implications for economic growth and development. This can be particularly challenging for small and medium-sized banks, which may have limited access to capital markets and may rely more heavily on traditional deposit-based funding.

3.8. Higher costs of borrowing

International rules and guidelines for banks can increase the costs of borrowing for banks in developing countries. This can be due to factors such as the higher costs of complying with the rules and guidelines, which can be passed on to borrowers in the form of higher interest rates (Mishkin, 2012).

In addition, the increased competition resulting from the rules and guidelines can lead to tighter credit conditions and reduced lending activities, which can further increase the costs of borrowing for borrowers in developing countries. This can have negative implications for economic growth and development, as access to affordable credit is essential for promoting investment and entrepreneurship.

3.9. Increased regulatory burden

International rules and guidelines for banks can increase the regulatory burden for banks in developing countries, which can be particularly challenging for small and medium-sized banks. This can result in higher compliance costs, greater administrative burden, and reduced flexibility in responding to local market conditions (Caprio and Honohan, 2001).

Moreover, the increased regulatory burden can divert resources away from other important activities, such as expanding lending activities and investing in new technology and infrastructure. This can have negative implications for economic growth and development, as banks play a critical role in facilitating investment, entrepreneurship, and job creation.

4. Disadvantages of international rules and guidelines in I. R. Iran

Here are some of the main disadvantages for banks in Islamic Republic of Iran that can arise from the implementation of international rules and guidelines:

Limited access to international financial markets: Due to the international sanctions that have been imposed on Iran, Iranian banks have limited access to international financial markets, which has made it more difficult for them to access funding and provide credit to businesses and individuals in Iran.

High compliance costs: Iranian banks have to comply with the international regulations and guidelines, such as those set out by the Basel Committee, which has increased compliance costs and made it more difficult for them to operate.

Difficulty in accessing technology: Due to the sanctions and restrictions on international trade, Iranian banks have faced difficulty in accessing new technology, which has limited their ability to modernize their operations and keep up with international standards.

Challenges in meeting capital requirements: The strict capital requirements set out by the Basel Committee have made it more difficult for Iranian banks to meet the required levels of capital, which has limited their ability to expand their operations and provide new products and services.

Limited access to global financial markets: Iranian banks have been subject to various sanctions and restrictions on their access to global financial markets due to Iran's geopolitical situation and the country's nuclear program. This has made it difficult for Iranian banks to raise capital and access foreign sources of funding.

Political and economic instability: Iran has faced political and economic instability in recent years, which has had a negative impact on the country's banking sector. This has led to challenges in meeting regulatory requirements and adapting to new international guidelines.

Limited capacity and expertise: Iranian banks may have limited capacity and expertise to comply with complex international rules and guidelines, due to factors such as lack of resources and training, and limited exposure to global best practices.

Currency risk: Iranian banks face currency risk in their operations, as the Iranian Rial has been subject to significant fluctuations in value in recent years. This can affect the banks' ability to meet capital and liquidity requirements under international guidelines.

Lack of transparency: Iranian banks may face challenges in meeting the transparency requirements of international rules and guidelines due to factors such as limited financial reporting standards and political interference.

These are some of the main disadvantages faced by banks in Iran due to international rules and guidelines. It's important to note that the specific challenges faced by Iranian banks may be different from those faced by banks in other developing countries, and may depend on the specific political and economic conditions in Iran.

5. Possible solutions for developing countries

Here are some possible solutions that developing countries can consider to address the challenges of complying with international rules and guidelines in their banking sectors:

Capacity building and training: Developing countries can invest in capacity building and training programs for their banking sector professionals to enhance their knowledge and skills in complying with international rules and guidelines. This can include collaborations with international organizations, sharing of best practices with other countries, and partnerships with academic institutions.

Tailored regulations: Developing countries can work to tailor international regulations to better fit their local conditions, while still maintaining the spirit of the guidelines. This can involve conducting impact assessments to understand the potential effects of international regulations on local markets and working with international organizations to negotiate exemptions or modifications.

Strengthening local financial markets: Developing countries can work to strengthen their local financial markets to reduce reliance on international capital and promote sustainable growth. This can include developing local capital markets, improving financial infrastructure, and promoting financial inclusion.

Enhanced risk management: Developing countries can work to enhance their risk management practices to meet international requirements. This can involve developing robust risk management frameworks, increasing transparency, and improving governance and accountability in the banking sector.

Collaboration and coordination: Developing countries can collaborate and coordinate with each other and with international organizations to share knowledge and resources in complying with international rules and guidelines. This can include sharing best practices, collaborating on joint projects, and developing regional initiatives.

6. Possible solutions for I. R. Iran

There are several potential solutions that can be explored to address the challenges faced by the banking sector in Iran as a result of the implementation of international rules and guidelines. One possible solution is for the government and regulatory bodies to work with local banks to develop a more tailored approach to regulation and compliance that takes into account the unique circumstances of the Iranian banking sector. This could involve providing greater guidance and

support to banks to help them navigate the complexities of international regulations, as well as investing in local capacity building initiatives to improve regulatory compliance.

Another potential solution is to promote greater collaboration and information sharing among local banks to help them build economies of scale and improve their competitiveness in the face of increased global competition. This could involve the creation of industry-wide networks or platforms to facilitate the sharing of best practices, as well as joint initiatives to promote innovation and new product development.

Finally, there may be opportunities to leverage developing technologies to help Iranian banks better manage the costs and complexities of regulatory compliance. For example, the use of artificial intelligence and machine learning algorithms could help banks more efficiently identify and mitigate compliance risks, while block-chain technology could be used to create more secure and transparent systems for managing financial transactions.

It is worth noting that these solutions are not mutually exclusive, and a comprehensive approach to addressing the challenges faced by the banking sector in Iran may require a combination of different strategies. Ultimately, the goal should be to strike a balance between compliance with international rules and guidelines and the need to support the growth and development of the local banking sector.

7. Conclusion

In conclusion, the implementation of international rules and guidelines has had a significant impact on the banking sector in developing countries like Iran. While these regulations are intended to promote stability and soundness in the global financial system, they can also have unintended consequences, such as increased compliance costs, reduced access to credit, and limits on innovative financing.

Despite these challenges, there are a range of potential solutions that can be explored to help developing countries navigate the complexities of international regulation and compliance. These solutions include tailored approaches to regulation and compliance, greater collaboration and information sharing among local banks, and the use of developing technologies to manage regulatory costs and complexity.

Ultimately, the goal should be to strike a balance between compliance with international rules and guidelines and the need to support the growth and development of the local banking sector. By working together with local stakeholders and leveraging innovative approaches to regulation and compliance, it may be possible to promote greater financial inclusion and economic growth in developing countries, while also ensuring the stability and soundness of the global financial system.

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