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Perspectives on the "Mini-Basel III" Concept in the Supranationalization Process of EAEU Banking Regulation and Supervision[1]

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Abstract

The objectives of economic integration suggest countries' mutual efforts to their implementation. In fact, the post-crisis recovery demonstrated that there is virtually no alternative to Basel III standards and recommendations in protecting against external shocks and strengthening the stress resilience of banks. Besides, in the EU, the Basel III mechanism has become the basis for the standardization of regulatory policies. However, in the EAEU, integration processes are still missing any banking regulation accords, while the variety of the national regulatory regimes hinders integration and slows down the process of supranationalization of the regulatory architecture, threatening the exacerbation of systemic risks and, ultimately, the erosion of strategic focus within the framework of the EAEU's single financial market and the EAEU integration at large.

This article is the first attempt to propose the perspectives of bringing together the national regulatory regimes in the EAEU based on Basel III as well as reaching the consensus in the "Mini-Basel III" concept in order to further strengthen- ing the economic basis of integration processes, including minimization of systemic risks and ensuring financial stability. Based on the analysis of banking supervision standards in the EAEU member states and their quantitative metrics in 2015–2024 (i.e., from the moment the Basel III standards have been phasing-in in the EAEU member states), we came to the conclusion that different regulatory regimes are the main source of systemic risks, while single regulatory regime will minimize systemic stress subject to implementation of the Mini-Basel III framework. Furthermore, taking into consider- ation the increasing uncertainty and riskiness in the Eurasian financial market, we have developed scenarios of financial integration that are based on the Mini-Basel III concept and without it. At the same time, the dominance of implicit and often apparent advantages of the different vs. single regulatory regimes, as well as sanctions imposed on Russia and the threat of secondary sanctions against the remaining EAEU member states will impede implementation of the Mini-Basel III concept. The proposed Mini-Basel III concept could be used by financial regulators in developing an EAEU supranational banking regulation mechanism, including for regulation of the prospective regional banking union.

Keywords: banking regulation, "Basel III", "Mini-Basel III", supranationalization, systemic risks, integration, EAEU (Eurasian Economic Union)

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Introduction

The processes of economic integration in the Eurasian Economic Union (EAEU) are associated with the issues of minimization of systemic risks and financial stability. Effective macrofinancial policy and sound financial institutions are the key to sustainable development and growth in the financial sector. The post-crisis recovery highlighted the need for stress resilient banks and that the banking sector that would not be vulnerable to external shocks and crisis developments, which should bring the banks back to their role as of one of the pillars of economic growth.

The integration processes in the EAEU and the objectives of an EAEU single financial market suggest, among other things, that a holistic approach to ensuring stress resilience and financial stability would provide an additional impetus to integration in the Eurasian financial sector. In turn, reduction of the level of systemic stress is a factor of both the attractiveness of the financial market and the soundness of banking sector performance that are necessary for shaping the future EAEU banking union. The outcome of efforts in this area will largely depend on whether financial regulators will be able to reach consensus on common approaches to financial sector regulation and, if so, to what extent such consensus will be based on the convergence of the EAEU member states' mechanisms of banking regulation and supervision. The lack of alternative approaches is evidenced, in particular, by the financial integration processes in the European Union (EU), where the regulatory area is based on the commonly applied regulatory policy principles and supervisory standards. At the same time, it should be noted that harmonization of regulatory policy[1] in the EAEU and putting in place a banking union aimed at protection against systemic risks and external shocks will further contribute to integration processes. Achieving regulatory consensus in the EAEU will make it possible to address three interrelated objectives:

- enhancing stress resilience of banks to reduce vulnerability to macro level volatility;
- minimizing systemic risks in the financial sector;
- ensuring financial stability as a guarantee of the soundness, sustainability, and consistency of integration processes.

It is intuitively expected that the EAEU-based banks, as active providers of integration, will effectively contribute to the needs of the financial market participants should the EAEU member states agree on common approaches to shaping the regional mechanism of banking regulation. Additionally, once regulatory consensus is reached, it will contribute to the identification of priorities when delegating responsibility for regulatory policy from national regulators to the EAEU supranational regulator.

Based on the importance of a single regulatory mechanism for the Eurasian financial market, this article identifies paths to a convergence of the EAEU member states' regulatory mechanisms and clarifies whether such a convergence is one of the benchmarks of regional financial integration. The following questions are posed: To what extent are the existing differences in the national regulatory regimes an obstacle to financial integration in the EAEU? Will regulatory convergence be sufficient to minimize systemic risks and ensure financial stability

[1] A single mechanism of banking regulation agreed upon by all participants of the integration processes at the legislative level.

in the EAEU? Will the external economic sanctions adversely affect the outcome of convergence, keeping in mind the objectives of the EAEU single financial market?

This article is organized as follows. First, it assesses the prospects for the convergence of the EAEU member states' banking regulation regimes and the transition to a supranational regulatory mechanism. It then analyzes the advantages and risks of moving from national regulatory regimes to their convergence based on the Basel III standards in the "Mini-Basel III" format as the main approach to overcome the inconsistency of different regulatory regimes that may adversely affect financial integration, including in the context of external economic sanctions. Obstacles to, and risks of, a Mini-Basel III mechanism are then considered, and scenarios for its implementation in the context of financial stability and development of an EAEU single financial market are suggested. The article concludes with a presentation of the results of the study.

Why Move Toward Supranational Banking Regulation in the EAEU?

Issues of integration and supranationalization in the EAEU banking regulation area are addressed in a number of studies [Dzhagityan, 2017a, 2017b, 2019; Simanovskiy, 2016; Tabakh, Podrugina, 2015]. Nevertheless, the issues of convergence of national regulatory mechanisms based on consensus in regulatory policy require further analysis, stipulated by the Concept of the EAEU Single Financial Market. In our research, we assume that integration will increasingly require the development of a regional financial and banking mechanism that would meet the integration objectives and tasks. Stemming from the EU experience, the soundness and functionality of such a mechanism depend on consistent macrofinancial management, including the full-fledged regulatory mechanism on a regional scale. The single approach to the regional regulatory mechanism would optimize the integration road map in terms of cost efficiency stemming from the single banking supervisory standard and by supporting a single regulatory policy aimed at minimization of systemic risks. The post-crisis specifics of EU banking regulation based on the common interests of the banking regulation policy and supervisory rule-making has strengthened the market discipline of banks, which, in turn, has increased their stress resilience and reduced the risks of instability in the banking sector.

At the same time, we also assume that differences in the national regulatory mechanisms inhibit integration due to differences in banks' and banking sector's capabilities stemming from different regulatory requirements, on the one hand, and from the higher costs associated with fragmentation and asymmetries of the EAEU national financial markets, on the other hand. Meanwhile, the differences in the national regulatory mechanisms constrain the contagion effect of systemic risks, thereby contributing to financial stability, the relevance of which is increasing in the era of economic sanctions. Understanding the conflict between the positive and negative effects of the differences in the national regulatory mechanisms, we identify the advantages of both regulatory regimes (single regional regulatory policy vs. different regulatory regimes) in terms of the provisions and objectives set out in the above concept.

Specifics of Regulatory Convergence and Supranationalization in the EAEU

To date, the EAEU authorities have adopted a number of documents governing the transition to an EAEU single financial market:

the EAEU treaty, which provides, inter alia, the institution of a supranational regulator of the EAEU financial market by 2025;

the concept of an EAEU single financial market;

the agreement on harmonization of the EAEU member states' legislation in financial markets;

the agreement on the procedure for the exchange of credit record information;

a draft road map for the establishment of an EAEU common stock market, which provides mutual admission of the stock (securities) market participants, mutual recognition and use of financial instruments, disclosure of information, and an integrated settlements and clearing system;

a draft agreement on a supranational authority for regulation of the EAEU financial market;

a draft agreement on mutual placement and trading of securities at on-exchange auctions in the EAEU member states; and

a draft agreement on a standardized license for the EAEU financial institutions.

Some measures to bring financial markets regulation policies closer in the EAEU have already been completed. In July 2018, the Astana International Financial Centre (AIFC) commenced its operations. The AIFC is a regional financial centre aimed at improving the attractiveness of the EAEU's financial markets to investors through the application of a special legal mechanism based on the norms, procedures, and principles of English law. The International Stock Exchange operates within the framework of the AIFC. Previously founded EAEU financial institutions—the Eurasian Development Bank (EDB) and the Eurasian Fund for Stabilization and Development (EFSD)—are limited to supporting investment projects and providing liquidity in a way similar to the central bank's function as the lender of last resort. As the regional financial institutions lack traditional banking operations, the scope of their activity and specifics of their performance are insufficient for the consistent development of the EAEU's financial markets and do not meet the financial needs of the integration process.

Perspectives of Regulatory Convergence and Supranationalization in the EAEU

The shortage of macrofinancial instruments within the framework of Eurasian economic integration is aggravated by the problem of different banking regulation regimes in the EAEU member states, although by now an explicit tendency for the introduction of the Basel III elements in the national regulatory domains is observed. In fact, only a harmonized mechanism of regional banking regulation can contribute to financial stability, as evidenced by the post-crisis transformations of international regulatory practice. In addition, the experience of integration in the EU shows that a number of functional responsibilities of the national regulators are inevitability delegated to the European Central Bank (ECB), which is a supranational authority. Although EAEU rule-making on integration still lacks the road map of Eurasian banking regulation, it is likely that the mechanism of single financial market regulation, as well as supranationalization of the regulatory policy, will be based on the EU experience; however, the regional regulatory policy will take into account the specifics of the national banking sectors and the needs of national prudential banking supervision.

At the same time, the use of international experience can reduce costs of regulation in the EAEU; however, it cannot guarantee its full-fledged functionality [Dzhagityan, 2019] due to the asymmetries of financial markets, uneven sizes of financial institutions, and differences in the financial infrastructure of the EAEU member states. Thus, the Financial Development Index (FDI) of Russia is significantly ahead of the same indicator for the rest of the EAEU countries, and the indices of Armenia and Kazakhstan are significantly higher than the indices of Belarus and Kyrgyzstan (Fig. 1).

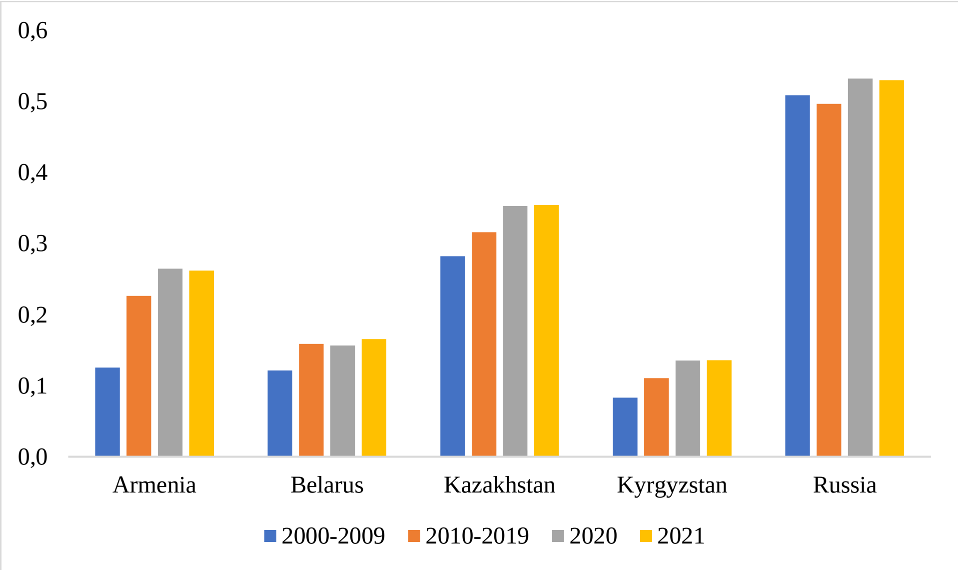

Fig. 1. Dynamics of the Financial Development Index in the EAEU Member States (2000–21)

Source: Compiled by the authors based on K. Svirydzenka [2016].

–Capital (Capital Adequacy Ratio) – bank's capital to risk-weighted assets (RWA)

–Leverage (Leverage Ratio) – Tier 1 capital to total assets and off-balance sheet items

–LCR (Liquidity Coverage Ratio) – high-quality liquid assets to total net cash outflow within 30 calendar days into the future

–NSFR (Net Stable Funding Ratio) – the amount of available stable funding to the amount of required stable funding for up to one year

–Capital Conservation Buffer – surcharge to CET 1 capital as a percentage to RWA (required surcharge)

–Countercyclical Capital Buffer – surcharge to CET 1 capital as a percentage to RWA (implementation of surcharge depends on credit cycle)

–SIB Surcharge (Systemically Important Bank Surcharge) – surcharge to CET 1 capital as a percentage to RWA (in addition to Capital Conservation Buffer and Countercyclical Capital Buffer).

Certain differences in the national financial areas are also demonstrated by the components of the FDI—a sub-index of the financial institutions dynamics (Financial Institutions Index, FII)[2] and a sub-index of the financial markets dynamics (Financial Markets Index, FMI).[3] According to the FII, financial institutions in the EAEU are rapidly developing, which will require timely alignment of regulatory standards to ensure the sustainable development of the financial sector during integration processes (Fig. 2). At the same time, the FMI of Armenia, Belarus, and Kyrgyzstan shows lower levels of financial markets development, unlike the development of financial markets of Kazakhstan and Russia (Fig. 3).

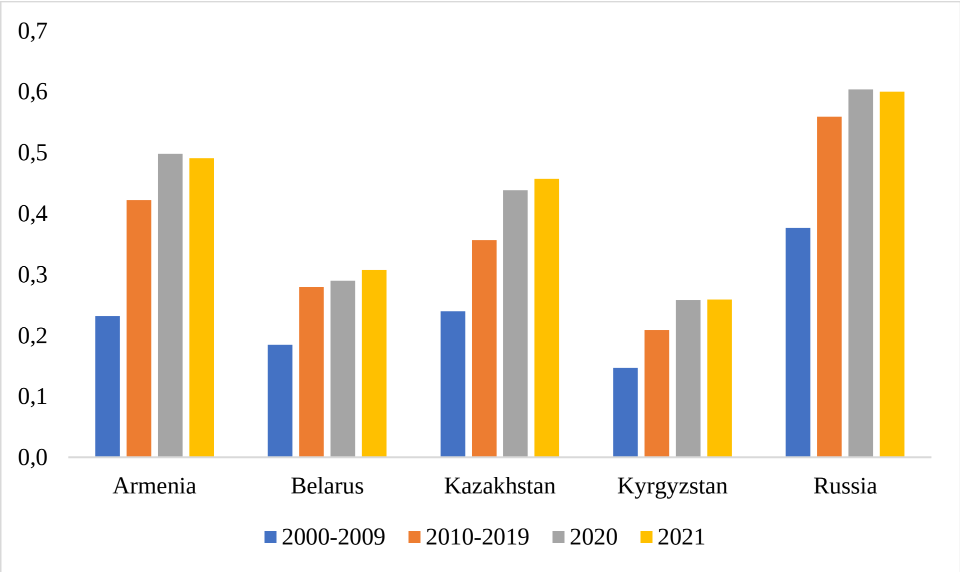

Fig. 2. Dynamics of the Sub-Index of Financial Institutions Index in the EAEU Member States (2000–21)

Source: Compiled by the authors based on K. Svirydzenka [2016].

[2] FII is measured based on the depth of the country's financial sector (the ratio of private lending, pension fund assets, and collective investment funds to gross domestic product (GDP)), the extent of inclusion of financial services (the number of banks and automatic teller machines (ATMs) per 100,000 of population), and the soundness of financial institutions (profitability indicators and the difference between interest rates on loans and deposits).

[3] FMI is measured based on the depth of the country's financial market (the ratio of various types of assets to the country's GDP), the extent of accessibility to the financial market (in particular, the number of bond issuers), and the soundness of the financial market (the ratio of traded stock to the stock market capitalization).

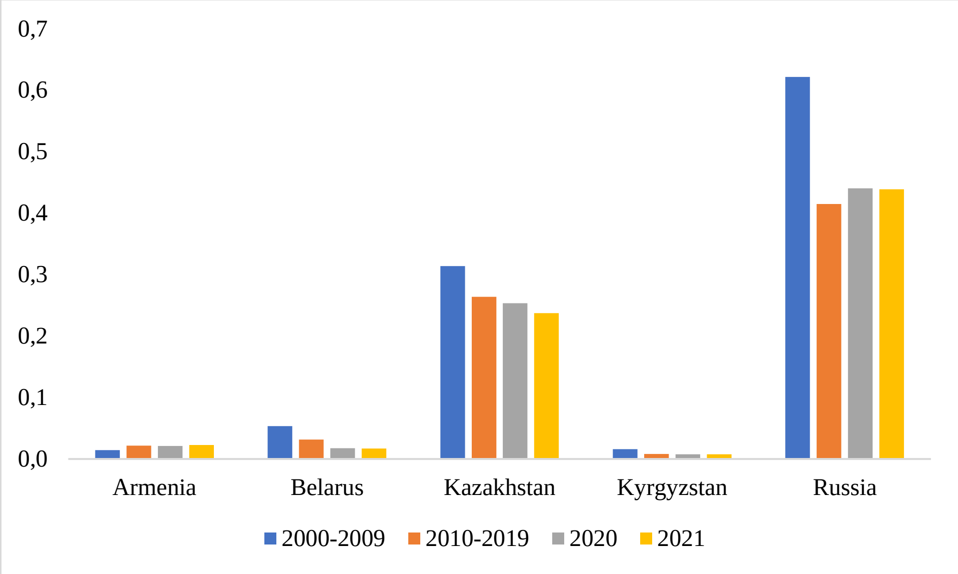

Fig. 3. Dynamics of the Sub-Index of Financial Markets Index of the EAEU Member States (2000–21)

Source: Compiled by the authors based on K. Svirydzenka [2016].

In the context of supranational banking regulation, the financial markets asymmetries are secondary; however, under certain economic conditions they may become sources of systemic risks and imbalances in integration processes that will ultimately threaten the outcome of financial integration. Nevertheless, bringing together national interests in regulatory policy is a bunch of unknowns, and its solution will depend on the extent to which differences in the national regulatory regimes will be an obstacle to regulatory convergence, whether such differences will not hinder the incentives for convergence and supranationalization, and whether convergence will fit the process of development of an EAEU single financial market. These issues are discussed in more detail below in the course of the dilemma of convergence.

Basel III Is the Present; Is Mini-Basel III the Future of the Framework of Banking Sector Regulation in the EAEU?

Basel III as a Benchmark of Regulatory Policy in the EAEU

The post-crisis recovery shows that Basel III has no alternative in strengthening the stress resilience of banks and reinstating their role as one of the pillars of economic growth. Moreover, the combination of Basel III and macroprudential policy instruments[4] contributed to minimization of risks in the financial sector, as well as to increasing the efficacy of macrofinancial management, which is one of the main determinants of financial

[4] Macroprudential policy is an integral part of the contemporary mechanism of international banking regulation aimed at ensuring the stress resilience of the banking sector at large, minimization of systemic risks, and ensuring financial stability. As macroprudential policy is a separate area of research, this article looks only into aspects associated with systemic risks and financial stability through the prism of microprudential regulation.

stability and a means in preventing crises. One of the explicit results of this approach is the fast recovery in international finance during and after the COVID-19 pandemic.

Currently, banking regulation policy in the EAEU member states is based on the Basel III concept. Nevertheless, the Basel standards are implemented to varying degrees (Table 1). In this regard, the readiness of the EAEU member states for a supranational banking regulation mechanism will largely be determined both by the current differences in their regulatory and supervisory policies and the prospects of overcoming those differences depending on the needs of integration processes.

Table 1. Supervisory Standards in the EAEU Member States (2015–24)

Supervisory Standards		Country	2015	2016	2017	2018	2019	2020	2021	2022	2023*	2024*
Capital	Common Equity Tier 1 (CET 1) capital	Armenia	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
		Belarus	5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
		Kazakhstan	5	5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
		Kyrgyzstan	---	4.5	4.5	4.5	4.5	4.5	4.5	4.5	5	6
		Russia	5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
	Tier 1 capital	Armenia	10	10	10	10	10	9	9	9	9	9
		Belarus	---	6	6	6	6	8.5	8	8.5	8.5	8.5
		Kazakhstan	6	6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
		Kyrgyzstan	---	6	6	6	6	6	6	6	6.5	7.5
		Russia	5.5	6	6	6	6	6	6	6	6	6
	Total capital	Armenia	12	12	12	12	12	12	12	12	12	12
		Belarus	10	10	10	10	10	10	10	10	10	10
		Kazakhstan	7.5	7.5	8	8	8	8	8	8	8	8
		Kyrgyzstan	12	12	12	12	12	12	12	12	12.5	14
		Russia	10	8	8	8	8	8	8	8	8	8
Leverage		Armenia	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
		Belarus	---	3	3	3	3	3	3	3	3	3
		Kazakhstan	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
		Kyrgyzstan	---	8	8	8	8	8	6	6	8	8
		Russia	---	---	---	3	3	3	3	3	3	3
Liquidity	LCR	Armenia	---	---	---	---	---	60	80	100	100	100
		Belarus	---	---	---	100	100	80	100	100	100	100

Supervisory Standards	Country	2015	2016	2017	2018	2019	2020	2021	2022	2023*	2024*
	Kazakhstan	---	---	---	50	60	80	90	100	100	100
	Kyrgyzstan	30	30	30	30	30	45	45	45	45	45
	Russia	---	70	80	90	100	100	100	100	100	100
NSFR	Armenia	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Belarus	---	---	---	---	100	100	100	100	100	100
	Kazakhstan	---	---	---	---	100	100	100	100	100	100
	Kyrgyzstan	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Russia	---	---	---	100	100	100	100	100	100	100
Capital Conservation Buffer	Armenia	---	---	---	---	---	0.5	1	1.5	2	2.5
	Belarus	---	0.625	1.25	1.875	2.5	2	2	2	2	2
	Kazakhstan	1	1	2	2	2	1	1	2	2	2
	Kyrgyzstan	---	6	6	6	6	6	6	6	6	6
	Russia	---	0.625	1.25	1.875	2.5	2.5	2.5	2.5	0	0.25
Countercyclical Capital Buffer	Armenia	---	---	---	---	0	0.5	1	1	1.5	1.5
	Belarus	---	---	---	0	0	0	0	0	0	0
	Kazakhstan	---	---	---	---	---	0	0	0	0	0
	Kyrgyzstan	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Russia	---	---	0	0	0	0	0	0	0	0
SIB Surcharge	Armenia	---	---	---	---	---	0.5	0.5	1	1.5	1.5
	Belarus	---	---	---	0.5-0.75	1–1.5	1–1.5	1–1.5	1–1.5	1–1.5	1–1.5
	Kazakhstan	---	---	2	2	2	2	2	2	2	2
	Kyrgyzstan	---	---	2	2	2	2	2	2	2	2

Supervisory Standards	**Country**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023***	**2024***
	Russia	---	0.15	0.35	0.65	1	1	1	1	0	0
Loan-to-Value Ratio (LTV) and Debt Service-to-Income Ratio (DSTI) (max. %)	Armenia	---	---	---	---	---	---	---	90	90	90
	Belarus	---	---	---	90	90	90	90	90	90	90
	Kazakhstan	50	50	50	50	50	50	50	50	50	50
	Kyrgyzstan	50	50	50	50	50	50	50	50	50	50
	Russia	---	---	---	---	Depending on the value of the borrower's debt burden (DSTI) and the total loan value (LTV)					

Notes:

* - preliminary data

LCR – Liquidity Coverage Ratio

NSFR – Net Stable Funding Ratio

SIB – Systemically Important Bank

N/A – information/data is not available

Source: Official websites of the national (central) banks of the EAEU member states, the Eurasian Economic Commission (EEC) [n.d.], and the International Monetary Fund (IMF) [Khandelwal et al., 2022].

The post-crisis transformation of regulatory policy in the EAEU member states, which is based on the Basel III framework, has largely contributed to sustainable development of the national financial sectors. At the same time, different regulatory regimes cause higher exposure of the EAEU financial sectors to volatility in the area of international finance and to systemic risks, as well as vulnerability to fragmentation and asymmetries of the global financial markets. Further, different regulatory regimes will slow down the processes of regulatory supranationalization, without which the soundness of the Eurasian financial market and the future banking union seems unlikely, and this is inconsistent with the purpose of an EAEU single financial market regulator.

Mini-Basel III as a Roadmap for the Convergence of EAEU Regulatory Policy

Evidenced from transition to Basel III as a platform for a single regulatory mechanism in the EU, regulatory convergence in the EAEU may follow a similar path; however, a single regulatory framework may not be an immediate outcome of the transition. At the first stages of the transition, prospects for convergence should be assessed in association with the interests of the EAEU member states' banking sectors as well as with "bringing more Basel III" to the national regulatory mechanisms, taking into consideration Basel III standards previously introduced into regulatory practice. Proposed regulatory consensus and further convergence should result in an agreed regulatory concept—Mini-Basel III—which should be based on the provisions of the Basel Accords and at the same time be designed according to the specifics of the EAEU financial sectors, including:

–the level of fragmentation and asymmetries of the national financial sectors, as well as the perspectives of banks' adaptation to the Mini-Basel III regulatory regime;

–differences in the needs, opportunities, and timing of the transition of the national regulatory mechanisms to convergence and then, to a supranational regulatory model; and

–differences in the institutional structure of national regulatory mechanisms.

Functionalization of the Mini-Basel III format is expected to become one of the determinants of defragmentation of the EAEU financial markets, which is necessary to facilitate integration efficiency and to enhance the market discipline of banks which, in turn, will reduce the riskiness of the financial sector. In addition, understanding that different regulatory regimes restrain integration processes will encourage national regulators to reach consensus on the Mini-Basel III framework.

Mini-Basel III and External Economic Sanctions

Analyzing the issues of financial integration in the EAEU, it is important to consider its prospects amid external economic sanctions. In the extant economic literature, the issue of economic sanctions is covered quite extensively; however, there hardly is any in-depth study of the effect of sanctions on integration processes. Nevertheless, most researchers agree that the sanctions that have been imposed since 2014 had a limited effect on the Russian economy at large; however, to a certain extent they destabilized key macro level parameters, including those of the financial sector [Simola, 2023].[5] Sanctions affected 70% of the Russian banking sector assets [European Council, 2023], while their negative impact mainly affected the performance of state-funded

[5] There is also an opposite stance: restrictions on trade and economic cooperation between Russia and foreign countries (for example, China) and the withdrawal of multinational corporations from Russia may lead to a decrease in real profits in the Russian economy by 12% [Du, Wang, 2022], which is likely to put pressure on Russia's economic contribution to the EAEU integration processes, including of the financial sector.

banks [Bolgorian, Mayeli, 2019; Gurvich, Prilepsky, 2015]. Given their dominance in the Russian financial sector, it is understood that sanctions adversely affected the efficiency of financial intermediation in the banking sector at large, which entailed increased volatility of banking sector profitability and market capitalization. In the meantime, the advantages of regional financial cooperation that mitigate the aftermath of sanctions [Andermo, Kragh, 2021] may result in the imposition of secondary sanctions against the rest of the EAEU member states because of their economic and financial ties with Russia. Understanding the relevance of integration processes in times of sanctions, a number of studies conclude that there is a positive impact of both sanctions and macro level instability on financial markets dynamics. Thus, increased inflation contributes to the positive dynamics of financial markets in the mid-term; however, this phenomenon is subject to the soundness of macrofinancial institutions, otherwise only a short-term positive effect is expected [Roudari et al., 2023]. Further, tightening of sanctions in a sound financial institutions environment contributes to long-term growth in the financial markets due to limitations to capital outflow; the same effect is observed in regional markets with negative financial markets dynamics and simultaneous depreciation of the national currency [Roudari et al., 2023; Sultonov, 2020]. As such, sanctions should not be considered as a significant obstacle to regional financial integration. When developing a sound network of regional financial institutions and infrastructure, sanctions may even incentivize the regulatory convergence that aims at stress resilience of banking sectors and financial stability (Table 2).

Table 2. Scenarios of Transition to a Mini-Basel III Regulatory Regime Amid Economic Sanctions

Scenario A		Sanctions will stimulate the transition to a Mini-Basel III framework in order to reduce the costs of different regulatory regimes, address the fragmentation and asymmetries of financial markets, minimize systemic risks, and achieve a synergetic effect of convergence, contributing to financial stability
Scenario B	Scenario B-1	Sanctions will not stimulate the transition to a Mini-Basel III framework due to successful adaptation of banks to sanctions, including through the introduction of regulatory easing and higher efficiency of regional macrofinancial institutions and financial infrastructure
	Scenario B-2	Sanctions will not stimulate the transition to a Mini-Basel III framework due to the expected costs of sanctions exceeding the synergetic effect of the transition

Source: Compiled by the authors.

Different regulatory regimes are also a source of regulatory arbitrage involving capital outflow to countries with relatively eased regulatory standards. Risks of arbitrage may hinder the path to the Mini-Basel III framework: loose regulatory compliance requirements, although contributing to lower costs and additional liquidity in the banking sector, at the same time are a potential source of risks to financial stability. Mini-Basel III reduces the risks of regulatory arbitrage and thus minimizes risks of systemic stress.

Mini-Basel III and Systemic Risks in the EAEU

Similar to the single financial market, the development of the EAEU banking regulation mechanism is yet in its initial stage: by following the Basel III framework, the EAEU member states focus primarily on the specifics and interests of their financial sectors; that is why they selectively apply Basel III standards amid the lack of intergovernmental coordination of their implementation and parameterization (Table 1). At the same time, despite the increased level of isolation of the Russian banking sector due to sanctions, banking activities in the rest of the EAEU countries are characterized by a high level of internationalization, which implies the likelihood of risk contagion effect and exacerbation of systemic risks[6] due to both interconnectedness of banks in the region [Chen, 2022; McLemore, Mihov, Sanz, 2022] and unexpected shocks like the COVID-19 pandemic [Ouyang et al., 2022]. Isolation is only one of the factors underlying systemic risks multiplication, and their transformation into crisis developments can have both short-term [Aghion et al., 2004] and long-term negative effects [Hwang, 2012; Josifidis et al., 2014], although they may be offset by a lower level of interconnectedness [McLemore, Mihov, Sanz, 2022]. Other factors include risks of the larger banks and systemically important financial institutions [Cincinelli, Pellini, Urga, 2021], including their reliance on government assistance during periods of illiquidity [Bicaba, Kapp, Molteni, 2014], and sanctions, which increase the risks of financial integration. In addition, the exacerbation of systemic risks is directly dependent on the level of the central bank independence, and the lower this level, the higher the riskiness of the banking sector [Nguyen, Dang, 2022], while the existing gap in the levels of independence of central (national) banks in the EAEU member states may complicate coordination between regulators as part of the transition to the Mini-Basel III framework.[7] It is logical that a relatively higher level of systemic risks puts pressure on financial stability [Chen, 2022], making it difficult to redistribute capital and restraining economic growth.

Integration processes in the financial sector are also a source of systemic risk [Fecht, Grüner, Hartmann, 2012], including materialized and potential systemic risks [Dzhagityan, Mukhametov, 2023]. The conflict between the lack of the single financial market and the full-scale integration in other segments of the economy widens the gap between the financial and operating cycles amid interconnectedness of the EAEU member states' financial markets. In fact, accumulation of a critical mass of systemic risks may contribute to instability and crises. At the same time, difference in regulatory regimes is a source of systemic risks, and it increases the vulnerability of integration processes to external shocks against the backdrop of a scarcity of tools that would be instrumental in reduction of pro-cyclicality in the financial sector [Josifidis et al., 2014]. Increasing instability within the framework of integration and rising interest rates also lead to the accumulation of systemic risks and their cross-border transmission. Exacerbation of systemic risks may appear later [Lim, Khon, Tan, 2015] and cause crisis developments due to the excess of the level of operational risks of banks over their ability to asset diversification within the framework of regional cooperation [Decressin, Fonteyne, Faruqee, 2007]. Accumulation of systemic risks in the financial sector becomes a threat to other sectors of the economy, especially during increased volatility of financial markets [Cotter, Hallam, Yilmaz, 2023; IMF, BIS, FSB, 2009] and sanctions. International trade and economic and investment cooperation appear as an additional channel of systemic risks transmission [Feng et al., 2023]. Another potential source of systemic risks is inflation [García,

[6] Systemic risks reflect the likelihood of a crisis in the financial sector due to unsatisfactory performance by one or more leading credit institutions of their financial intermediation function, or their insolvency/bankruptcy. The transmission of systemic risks occurs according to the domino effect, putting additional pressure on stress resilience in the banking sector and threatening financial stability.

[7] One of the key criteria for central bank independence is the appointing procedure of its head: the level of independence is considered higher if the head is approved by the legislative body (parliament), as, for example, in Armenia, Kyrgyzstan, and Russia, and not by the head of state alone, as, for example, in Belarus and Kazakhstan.

Rambaud, 2023], which was higher than the world average in the EAEU member states at the end of 2022 (with the exception of Armenia).[8] It is obvious that a critical level of systemic risks may prevent the full-fledged functionality of the EAEU single financial market and become one of the key reasons for the loss of strategic guidelines in the financial sector.

Against the backdrop of potential systemic risks, it is quite obvious that the effectiveness of financial integration in the EAEU will depend on regulators' understanding of the prospects for regional financial stability. Integration in the EU financial sector has shown that there is no alternative to Basel III in the development of a regional regulatory mechanism and raising the efficiency of financial intermediation to the level necessary to fulfill the objectives of integration and the formation of an EAEU banking union. In this regard, the advantages of the Mini-Basel III format are well suited to the task of creating an effective financial market for the EAEU. Moreover, given the different regulatory regimes along with economic sanctions, the growth of integration needs for financial instruments comes into conflict with the capabilities of EAEU banks to diversify them, which prevents the realization of the banking sector's potential for the purposes of integration. In addition, different regulatory regimes may delay or even prevent adequate representation of EAEU member states' banks in each other's financial markets, which, in turn, constrains their ability to diversify away risks, while in contrast to the issues of minimization of systemic risks [Dzhagityan, 2017a], the issue of different regulatory regimes turns out to be linked to the prospects for a future banking union.

However, given the higher level of the risk of crisis in the financial sector together with sanctions, EAEU supranationalization could be shaped as a regulatory structure ranging from different regulatory regimes to a full-fledged Mini-Basel III format. This produces a dilemma between the choice of a banking regulation regime that is based on the specifics of national banking sectors, on the one hand, and the limits of delegation of national regulators' responsibilities/power to the supranational level, on the other hand. This dilemma reflects the essence of another dilemma—between the post-crisis principles of international banking regulation and the specifics of national regulatory policy [Dzhagityan, 2016, p. 90], which demonstrates obstacles and risks of the Mini-Basel III format (Table 3). Until the regulatory dilemma of the EAEU is resolved, the diversity of regulatory regimes, being a source of different potential and capabilities of the banking sectors, along with unequally available/applicable regulatory tools in ensuring financial stability, will depreciate the outcome of integration, delaying the creation of a banking union. In these circumstances, the risks of weaknesses in integration are fraught with opportunity cost and disproportions within the transition to an EAEU single financial market, which, along with external negative factors, will be a barrier to strengthening regional economic cooperation and achieving financial stability.

[8] At the end of 2022, inflation was: in Armenia—8.3%, in Belarus—12.8%, in Kazakhstan—20.3%, in Kyrgyzstan—14.7%, and in Russia—11.9%. The world average inflation for the same period was 8.8%.

Table 3. Obstacles and Risks of a Mini-Basel III Framework

Obstacles	**Risks**
Lack of a concept for bringing together the mechanisms of banking regulation and supervision of the EAEU member states[9]	Higher exposure of the EAEU member states' financial sectors to shocks and crisis development, which is due to: – discrepancy between the EAEU financial markets infrastructure and the potential for financial intermediation; – volatility of exchange rates of EAEU member states' domestic currencies; – lack of coordination between the macrofinancial authorities of the EAEU member states in minimization of the risks and the consequences of crises; – a higher degree of interconnectedness of the EAEU national economies amid the fragmentation and asymmetries of national financial markets; – dependence of the EAEU national economies on the dynamics of the world economy; – different extents of openness of the EAEU national financial markets and, accordingly, different approaches to risk management and risk minimization; and – the unpredictability, extent, and consequences of economic sanctions and, accordingly, additional costs for adapting national financial sectors to the sanctions environment
Lack of a concept for mutual admission of credit institutions to the EAEU member states' financial markets	Lack of tested tools for assessing the consequences of economic sanctions, including those for EAEU member that which are not sanctioned
Lack of a concept of mutual recognition of licenses in the EAEU member states' banking sectors[10]	Varying extent of regulatory adaptation of banks to the Mini-Basel III format and risks of regulatory inconsistency[11]
Lack of harmonized requirements for financial regulation and supervision in the EAEU	Disproportionality of assets of leading banks and the banking sectors of the EAEU member states
Lack of authority/forum on coordination of the EAEU's national regulators' policy and actions pertaining to developing measures and decision-making mechanisms for supranationalization of banking regulation	Risks of administrative pressure and regulatory capture as part of the EAEU's regulatory convergence process
Lack of a concept of EAEU financial consumer protection rights	Risks of EAEU regulatory arbitrage in case of lack of the full-fledged Mini-Basel III mechanism
Lack of a concept of delegation of the EAEU national regulators' responsibilities to the supranational financial markets regulator	Strong "Chinese factor" in the EAEU member states located in Central Asia, which may result in a different concept of banking regulation and supervision being applicable to them[12]

Source: Compiled by the authors.

[9] The concept of an EAEU single financial market does not include the issues of financial regulation and supervision.

[10] The standardized license is the first step toward mutual recognition of licenses of financial institutions in the EAEU. However, the standardized license applies to the establishment/acquisition of a subsidiary only (and not a branch). As of the date of the submission of this article, the agreement on a standardized license in the banking and insurance sectors is in draft form.

[11] Here we posit that minimum capital adequacy of banks that actively participate in the integration processes should exceed minimum capital adequacy for other banks in order to achieve a higher level of their stress resilience.

[12] According to Russian experts, it would be beneficial to prioritize China-EAEU interaction rather than bilateral cooperation between China and each of the EAEU member states, which is traditional for China's foreign economic policy [EAEU-China Economic Trade Cooperation Agreement, 2018].

Based on the combination of factors that determine the contemporary concept, mechanism, and standards of EAEU member states' banking regulation, we identified three interrelated sources of systemic risks (Table 4). At the same time, the multidimensional specifics of systemic risks and their threat to financial stability will require additional efforts by regulators to identify and minimize them; otherwise, their critical mass may become an obstacle to the Mini-Basel III framework and, accordingly, to achieving the full-scale functionality of the EAEU single financial market.

Table 4. Classification of Systemic Risks Associated With Transition to the Mini-Basel III Format

Sources of Systemic Risks	Characteristics of Systemic Risks
1. Quantitative standards of banking regulation and supervision	1.1. Differences in quantitative parameters of applied banking supervision standards[13]
	1.2. Regulatory ease applied by regulators due to sanctions[14]
	1.3. Difference in phasing-in of banking supervision standards[15,16]
	1.4. Differences in the quantitative parameters of the macroprudential policy tools and their phase-in (see Table 1)[17]
2. Qualitative aspects of banking regulation and supervision	2.1. Lack of a coherent concept of a systemically important bank[18]
	2.2. Lack of an agreed concept and mechanism of bank resolution
	2.3. Lack of an agreed concept and mechanism for the orderly liquidation of banks subject to a decision on their insolvency/bankruptcy
	2.4. Lack of an agreed concept of banks' bail-in
	2.5. Lack of an agreed concept of consolidated banking supervision applicable to banking groups/holdings
	2.6. Differences in deposit insurance schemes
3. Other sources of systemic risks	3.1. Lower level of banking assets to GDP ratio[19]
	3.2. Transition of financial reporting in Russia from International Financial Reporting Standards (IFRS) to Russian Accounting Standards (RAS)[20]
	3.3. Higher level of volatility of the EAEU member states' domestic currencies

Source: Compiled by the authors.

A variety of systemic risks associated with different regulatory regimes poses a threat to the development of the EAEU financial market and, largely, to imbalances of the Eurasian integration. Economic sanctions and the growing isolation of the Russian banking sector further aggravate uncertainty and riskiness in the EAEU financial sector. In this regard, single supervisory requirements of the Mini-Basel III framework would help optimize the operating model of banks, make their performance more consistent with strategy, and enhance investor confidence.

[13] Thus, the minimum capital adequacy requirements range from 8% in Russia to 12% in Armenia and Kyrgyzstan; minimum leverage level ranges from 3% in Russia and Belarus to 6% in Kyrgyzstan; short-term liquidity ratio ranges from 45% in Kyrgyzstan to 100% in Russia and Belarus.

[14] Currently, regulatory ease is applied mainly by the Central Bank of the Russian Federation as part of temporary support measures due to sanctions, including, among others, the following:

- reduction of loan loss reserve requirements;
- restrictions on banks' disclosure of their financial statements;
- ease of liquidity standards for systemically important banks, when a decrease below 100% is not considered a violation of prudential standards; and
- zeroing out the capital surcharge requirements for systemically important banks, starting from 1 January 2023, and subsequent gradual restoration to 1% by 2028, starting from 1 January 2025 [Bank of Russia, 2022].

[15] Due to Russia's obligation to implement Basel III standards and recommendations as a member of the Basel Committee on Banking Supervision (BDBS) and their selective implementation by the remaining EAEU member states that are not members of the BCBS. For example, the capital surcharge for systemic importance has been used in Belarus for several years, introduced in Armenia in 2023 only, while in Russia it was temporarily cancelled since the beginning of 2023. Liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) were introduced in Kazakhstan in the second half of 2021, while by that time they had already been applied in supervisory practice in Russia and Belarus; moreover, in Russia these standards apply only to systemically important banks, and in Belarus and Kazakhstan—to all credit institutions.

[16] This factor affects the EAEU banking sector competition and is one of the key prerequisites for banks in their abuse of operations based on Trans-Eurasian regulatory arbitrage.

[17] For example, the countercyclical capital buffer was introduced in Russia in 2016, in Belarus—in 2018, and in Armenia and Kazakhstan—in 2019; in Kyrgyzstan this standard is still absent. The debt burden indicator for consumer loans has been introduced in all EAEU member states except Armenia.

[18] Thus, the category of systemically important banks in Kyrgyzstan includes banks whose deposits and/or loans exceed 8% of the total amount of deposits and/or loans in the country's banking sector. The criteria for systemic importance of banks in the remaining EAEU member states are generally based on the criteria established by the Financial Stability Board for global systemically important banks.

[19] The level of credit funding for EAEU economies ranges from a minimum of 51% in Kazakhstan and Kyrgyzstan to 84% in Belarus, to 90% in Russia, and to about 100% in Armenia. The lower level of loans to the economy has the following consequences: in the event of a crisis, an increase in lending volumes may lead to an increase in non-performing loans and, accordingly, to an increase in the level of systemic risks, while shortage of lending may lead to a decrease of banking sector profits stemming from a decreased amount of charged interest that could result in a lower-than-expected amount for capital replenishment as one of the stress resilience factors of banks and the banking sector.

[20] The transition from IFRS to RAS may cause a decrease in investor confidence which may result in shortage of liquidity in the Russian financial market.

This would ultimately increase lending capacity for the benefit of integration processes [Dzhagityan, 2017b] and secure fair competition. In a broader sense, Mini-Basel III is the most reliable choice to resolve the EAEU's regulatory dilemma, without which efforts to improve the efficiency of financial intermediation will not yield the tangible outcome, while efforts toward financial stability may incur additional costs and could be delayed. Nevertheless, despite the advantages of the single regulatory mechanism, systemic risks that are fraught with regulatory convergence may slow the transition to Mini-Basel III, which could be further aggravated by the EAEU national banking sectors' specifics and interests (Table 5).

Table 5. Scenarios of the Mini-Basel III Implementation

Scenario 1	Full-fledged version of Mini-Basel III	The expected benefits from Mini-Basel III's implementation exceed the current benefits from the EAEU member states' regulatory mechanisms	Scenario 1.1	Sanctions could expedite transition to the Mini-Basel III framework
			Scenario 1.2	Sanctions may force EAEU member states' regulators to implement Scenario 2
Scenario 2	Limited version of Mini-Basel III	The benefits of EAEU member states' regulatory mechanisms and the expected benefits of Mini-Basel III's implementation are about the same	Scenario 2.1	Sanctions may encourage EAEU member states' regulators to implement Scenario 1
			Scenario 2.2	Sanctions may force EAEU member states' regulators to implement Scenario 3
Scenario 3	Moving away from the Mini-Basel III concept	The benefits from EAEU member states' regulatory mechanisms exceed the expected benefits from Mini-Basel III's implementation	Scenario 3.1	Sanctions may encourage EAEU member states' regulators to implement Scenario 2
			Scenario 3.2	Sanctions may force EAEU member states' regulators to implement Scenario 4
Scenario 4	Rejection of the Mini-Basel III concept	Economic sanctions and their consequences will require principally different regulatory measures in the context of EAEU-wide integration		

Note. For scenarios of a Mini-Basel III under sanctions see Table 2, above.

Source: Compiled by the authors.

The implementation of scenarios 1–3 amid possible inconsistency of regulatory convergence may urge regulators to focus on predominantly general objectives not related to Mini-Basel III, for example, regional financial stability. However, given the differences in the EAEU's national financial sectors, efforts toward financial stability amid different regulatory regimes may not produce the desired outcome. What is more, they may contribute to the abuse of regional regulatory arbitrage, which will further exacerbate systemic risks and further complicate regulatory convergence in the EAEU.

Different regulatory regimes and the lack of reliable tools for minimization of systemic risks may indeed discourage EAEU member states from moving toward the Mini-Basel III framework. However, its ability to generate synergetic effect may outweigh "regulatory pessimism" given that materialization of synergy would reduce the costs of national regulators associated with a single supervisory policy and facilitate a faster and less costly achievement of financial stability compared with the environment of different regulatory regimes, as was shown by regulatory supranationalization in the EU. At the same time, the feasibility of Mini-Basel III cannot but depend on capability frontiers of national regulators in minimization of systemic risks, including raising the efficiency of risk identification to a level that would facilitate decision-making at the supranational level as well benefit EAEU-wide financial stability. Removal of restrictions on regional capital flow will inevitably lead to a higher level of interconnectedness of EAEU banks, which, under different regulatory regimes, may exacerbate risks. This is unambiguous evidence in favour of the Mini-Basel III framework as the only alternative to maintain financial risks at a level that would not detract value from economic integration and, therefore, would positively contribute to regional financial stability. In these circumstances, proper coordination between national and supranational banking regulation mechanisms will positively contribute to understanding the extent and limitations of the EAEU national regulators' functional responsibilities, as well as to what extent they will be ready to delegate their power to the supranational level, which is a necessary and sufficient condition for the full-fledged Mini-Basel III framework aiming regional financial stability and a lower level of systemic risks.

Conclusion

The development of an EAEU single financial market is one of the strategic objectives of regional economic integration. It requires consistent approaches by the EAEU member states' financial regulators to the shaping of a Eurasian banking regulation and supervision mechanism, the soundness of which will depend on the extent of convergence of the national regulatory mechanisms. Since regulators have already selected and implemented some of the Basel III standards, such convergence could be based on a Mini-Basel III framework.

Different regulatory regimes put limits on financial integration, while the higher level of exposure of the EAEU financial sectors to shocks and crisis developments exacerbates systemic risks. This is another circumstance favouring the transition to Mini-Basel III as a consolidated regulatory platform that would decisively contribute to financial stability, which is the key for the future EAEU banking union. Further, a single regulatory area will help mitigate the risks of regulatory arbitrage, thereby reducing concentration of risks in jurisdictions with relatively loose regulatory standards. The full-fledged Mini-Basel III regulatory regime will also make it possible to optimize regulatory policy costs facilitated by the single approach to regulation and the EAEU's single financial market regulatory authority.

Despite the advantages of the proposed Mini-Basel III framework in terms of financial stability and a lower level of systemic risks in the EAEU, a number of factors may still slow down the processes of regulatory supranationalization, including sanctions. At the same time, currently implemented measures toward the single regulatory area may not fully contribute to the reduction of risks of the different regulatory regimes.

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