Transnational Regulation and the Global Financial Crisis 2007-2010.
Caroline Bradley[*]

On Monday September 13th 2010 the front page of the New York Times carried a story with the headline "Regulators Back New Bank Rules to Avert Crises".[1] The story began: "The world's top bank regulators agreed Sunday on far-reaching new rules intended to strengthen the global banking industry and shield it against future financial crises".[2] The title of my lecture includes the words "transnational regulation", and whereas it is pretty clear that the financial markets have transnational aspects we're not generally used to thinking about regulation as transnational. Regulation and the jurisdiction of regulators are surely domestic matters? The words transnational regulation seem to imply a set or sets of binding rules which apply across territorial boundaries. And there is no transnational regulation of the financial markets in that sense - or is there?

Since 9/11 we have seen significant efforts to freeze bank accounts of suspected terrorists and we have a complex system with the UN Security Council at its apex which produces lists of names and restricts the activities of financial institutions and some of their customers - this is an example of transnational regulation if you like, and the UN Security Council's resolutions are as a formal legal matter binding on UN Member States - but although the system raises important issues it's not what I want to discuss today. For my purposes - thinking about what we might describe as transnational financial regulation - regulation of activities such as banking, securities, insurance, and shadow banking we can note that there is no single set of binding international rules for the regulation of financial institutions and markets and no single international regulator, nor even multiple international regulators for different financial sectors.

On 14 September 2007 (three years ago today) the Bank of England announced that it would be providing financial support to a UK bank based in the North East of England called Northern Rock..[3] The run on Northern Rock which occurred that week was the first run on retail

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[*] Professor of Law, University of Miami School of Law, PO Box 248087, Coral Gables, FL, 33124, cbradley@law.miami.edu. The paper is available at http://blenderlaw.umlaw.net/

[1] Jack Ewing & Sewell Chan, *Regulators Back New Bank Rules to Avert Crises*, New York Times, p 1, col 1 (Sep. 13, 2010).

[2] *Id.*

[3] Tripartite Statement by HM Treasury, Bank of England and Financial Services Authority, Liquidity Support Facility for Northern Rock plc (Sep. 14, 2007) http://www.bankofengland.co.uk/publications/news/2007/090.htm

deposits of a UK bank since the time of Queen Victoria.[4] Northern Rock had been forced to ask the Bank of England for support because it was unable to raise funds in the financial markets. The bank, a former mutual building society which converted to bank status in 1997,[5] specialized in mortgage lending,[6] had increased its lending during the early part of 2007,[7] and was more reliant than other UK banks on the securitization market as its source of funds to make mortgage loans.[8] Northern Rock originated mortgage loans, packaged them together and used them as collateral to raise money which could be used to make new mortgage loans: this is the "originate to distribute" model of bank lending[9] which has become one of the foci of debate since the crisis.

I begin with this example in part because the Bank of England's announcement was made three years ago today, but Northern Rock is a good illustration of how financial markets changed during the late 20th and early 21st centuries and of some aspects of the global financial crisis. Northern Rock started off as a local mutual building society - people who wanted to buy their own homes clubbed together to support each others' efforts, taking turns to borrow money and receiving a share of the interest generated by the loans. But by the late 20th Century Northern Rock converted, as did many other building societies, into a bank. Ten years later, the bank was in trouble. Northern Rock's funding problems in September 2007 were caused by a "global shock to the financial system" from the US sub-prime crisis.[10] So Northern Rock illustrates a shift from locally sourced mortgage funding to mortgage funding sourced in international financial markets.

In one sense, Northern Rock's problems illustrate the transnational nature of the crisis, as a lack of confidence in securities backed by mortgage assets spread from the US to the UK. Nonetheless, a UK Parliamentary committee blamed the Board of Northern Rock for the bank's difficulties:

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[4] Treasury Select Committee, Fifth Report: The Run on the Rock HC 56-I (Jan 26, 2008) at p 3.

[5] *Id.* at p. 11.

[6] At end 2006, "89.2% of its assets were residential mortgages". *Id.* at 12.

[7] *Id.* at 14.

[8] *See, e.g., id.* at 13-14 (describing a shift in Northern Rock's funding strategies over time and stating that 22.4% of Northern Rock's liabilities and equity at the end of 2006 were retail deposits, whereas other banks' retail deposits represented over 40% of their liabilities and equity).

[9] The Run on the Rock, supra note 4 at 12-13.

[10] The Run on the Rock, supra note 4 at 15.

> "The high-risk, reckless business strategy of Northern Rock, with its reliance on short- and medium-term wholesale funding and an absence of sufficient insurance and a failure to arrange standby facility or cover that risk, meant that it was unable to cope with the liquidity pressures placed upon it by the freezing of international capital markets in August 2007. Given that the formulation of that strategy was a fundamental role of the Board of Northern Rock, overseen by some directors who had been there since its demutualisation, the failure of that strategy must also be attributed to the Board."[11]

The responsibilities of Board Members for the management of risks in a domestic bank based in the UK would seem to be a domestic matter for UK bank regulation. But the transmission of risks across borders which the Northern Rock example illustrates is an international, rather than a purely domestic issue. And Northern Rock's problems raised issues which have become components of the international debate about how to regulate financial markets in the wake of the crisis. Under what circumstances should governments step in to rescue financial institutions in difficulty (or how do we fix the too-big-to-fail problem?[12] (Northern Rock was nationalized by the UK Government in 2008).[13] How can prudential regulation of financial institutions address issues of liquidity as well as of credit risk?[14] (The UK's Financial Services Authority had allowed Northern Rock to manage its credit risk for the purposes of capital adequacy under the Basel II advanced internal ratings based approach, but the Basel capital adequacy standards did not address liquidity risk.) [15] How can anyone trust in the integrity of the financial markets?[16] (We now know that Northern Rock was misrepresenting its

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[11] The Run on the Rock, supra note 4 at 19.

[12] *See, e.g.*, Gert Wehinger, *The Turmoil and the Financial Industry: Developments and Policy Responses*, OECD 96 Financial Market Trends 1, 12 (2009) ("Credible bankruptcy procedures also applicable to large ('too big to fail') institutions could perhaps help to contain banking crisis at an early stage without overly widespread contagion effects.")

[13] The Northern Rock plc Transfer Order 2008, SI 2008 no 432 at http://www.legislation.gov.uk/uksi/2008/432/pdfs/uksi_20080432_en.pdf .

[14] See, e.g., Basel Committee on Banking Supervision, Consultative Document, International Framework for Liquidity Risk Measurement, Standards and Monitoring (Dec 2009) at http://www.bis.org/publ/bcbs165.pdf .

[15] The Run on the Rock, supra note 4 at 24-5.

[16] See, e.g., Financial Services Authority, The Turner Review: A Regulatory Response to the Global Banking Crisis, 28 (Mar. 2009) at http://www.fsa.gov.uk/pubs/other/turner_review.pdf ("The complexity and opacity of the

mortgage arrears during 2007.)[17]

Thinking about Northern Rock doesn't really help us to address other big issues raised by the financial crisis. For example, Northern Rock was not involved in cross-border banking as were Glitnir, Landsbanki, and Kaupthing, Icelandic banks which offered attractive interest rates to depositors based in the UK and the Netherlands who were stunned to realize that when the banks collapsed their deposits were not protected as they would have been had they invested in Dutch or British banks.[18] The EEA financial regulatory structure did not harmonize deposit guarantee schemes, and unwary depositors were caught unawares.

Northern Rock doesn't force us to think about the shadow banking problem: that regulation of the financial sector developed in a context where banks were different from other institutions that were involved in the financial markets. Northern Rock was a bank and was regulated as a bank. But AIG was an insurance company which took on credit risk - the risk of non-payment - a risk which traditionally was borne by banks but which insurance companies and others took on by entering into credit default swap transactions.[19]

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structured credit and derivatives system, built upon a misplaced reliance on sophisticated mathematics, which, once irrational exuberance disappeared, contributed to a collapse in confidence in credit ratings, huge uncertainty about appropriate prices, and a lack of trust that published accounting figures captured the reality of emerging problems."); US Treasury, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation, 2 (Jun. 17, 2009) at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf ("We must act now to restore confidence in the integrity of our financial system.")

[17] *See, e.g.*, FSA Bans and Fines Former Northern Rock Finance Director £320,000 for Misreporting Mortgage Arrears Figures, FSA/PN/126/2010 (Jul. 27, 2010) at http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/126.shtml.

[18] *See, e.g.*, House of Commons, Treasury Committee, Banking Crisis: The Impact of the Failure of the Icelandic Banks, HC 402 (Apr. 4, 2009) at http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/402/402.pdf.

[19] *See, e.g.*, Congressional Oversight Panel, The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy, 9 (Jun. 10, 2010) at http://cop.senate.gov/documents/cop-061010-report.pdf ("The rescue of AIG distorted the marketplace by transforming highly risky derivative bets into fully guaranteed payment obligations. In the ordinary course of business, the costs of AIG.s inability to meet its derivative obligations would have been borne entirely by AIG.s shareholders and creditors under the well-established rules of bankruptcy. But rather than sharing the pain among AIG.s creditors . an outcome that would have maintained the market discipline associated with credit risks . the

As of late 2010 we are waiting to see whether the financial crisis will generate a broad sovereign debt crisis: Greece has already implemented an austerity program to fend off its own crisis .[20]

So, the global financial crisis raised large numbers of issues - the details of the issues and of attempts to address them are really beyond the scope of my lecture today. I now want to focus on transnational regulation before and in the wake of the crisis.

Transnational Regulation Before the Crisis

For many years, regulators have worked with their counterparts in other jurisdictions to develop standards for financial regulation.[21] Securities regulators have worked together in the International Organisation of Securities Commissions (IOSCO),[22] insurance supervisors work through the International Association of Insurance Supervisors (IAIS), and central banks and bank regulators form the Basel Committee on Banking Supervision.[23] These groups are essentially collaborative, technocratic networks of regulators with the power to develop non-binding recommendations, principles and standards. It is the Basel Committee which has produced the new capital requirements I referred to at the beginning of the lecture. As a formal matter the principles and standards produced buy these bodies are not legally binding.

However, although the principles and standards are not legally binding as such, states whose regulators participate in their articulation may feel obliged to implement them

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government instead shifted those costs in full onto taxpayers out of a belief that demanding sacrifice from creditors would have destabilized the markets. The result was that the government backed up the entire derivatives market, as if these trades deserved the same taxpayer backstop as savings deposits and checking accounts.”)

[20] *See, e.g.*, IMF, Debt Managers Agree "Stockholm Principles" to Help Manage Sovereign Risk and High Levels of Public Debt in an Environment of Elevated Uncertainty, Press Release No. 10/331 (Sep. 9, 2010) at http://www.imf.org/external/np/sec/pr/2010/pr10331.htm .

[21] *See, e.g.*, Anne Marie. Slaughter, A New World Order, 36 (2004) (describing regulators as “the new diplomats.”)

[22] *See* http://www.iosco.org/

[23] *See* http://www.bis.org/bcbs/index.htm .

domestically. And states which depend on the IMF's[24] financial resources will be subject to the IMF's examination of their economies, including their bank regulatory systems.[25] The global financial crisis has increased demand for funds from the IMF. The IMF's interest in monitoring the financial soundness of its members, especially of its borrowers, gives it an interest in regulation as a mechanism for promoting financial stability. In response to criticism, the IMF has recently been working to address some of the concerns about its role by emphasizing transparency as an accountability mechanism.[26]

The principles and standards generated by these networks of regulators are often drafted in language that seems vague or even meaningless. For example, IOSCO's Objectives and Principles of Securities Regulation state that :

> Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.[27]

The Basel Capital Adequacy Accord and subsequent amendments are less vague, although they still leave significant discretion in implementation to the domestic policy makers who implement them.

Before moving on we should note that the development of transnational co-operation between regulators is not just a matter of regulators deciding that they need to co-operate across territorial boundaries in order to be more effective at home, but involves a recognition of the impact of regulation on the competitiveness of financial firms. Financial firms which are subject

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[24] The IMF is a treaty-based international organization which was founded in 1944 to govern the international monetary system to assure exchange rate stability and encourage IMF members to do away with exchange restrictions. The Articles of Agreement of the International Monetary Fund are at http://www.imf.org/external/pubs/ft/aa/index.htm .

[25] *See, e.g.*, IMF, Iceland: Financial System Stability Assessment—Update, IMF Country Report No. 08/368 (Dec. 2008) available at http://www.imf.org/external/pubs/ft/scr/2008/cr08368.pdf .

[26] *See, e.g.*, IMF, Transparency is Key to Accountability (Jan. 11, 2010) at http://www.imf.org/external/np/exr/cs/news/2010/cso110.htm .

[27] IOSCO, Objectives and Principles of Securities Regulation, 5 (June 2010) at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD329.pdf .

to relaxed regulation in their home state may benefit from a competitive advantage with respect to firms based in jurisdictions with more demanding regulatory regimes. Governmental support for financial firms may function as a subsidy. The original Basel Accord which was introduced in 1988 provided for states to impose capital adequacy requirements on international banks, even if those states addressed risks to financial stability in other ways (such as through governmental guarantees). The Accord was agreed after the US and the UK announced they would apply stringent capital adequacy requirements to foreign banks doing business in their jurisdictions.[28]

This example with respect to the genesis of the original Basel Accord illustrates that the interests of private firms have an impact on regulation - at the transnational level as well as at the domestic level.

Thus whereas the multi-level governance model of regulation focuses on the idea of levels of regulation I prefer to think about intersections between different spheres of regulation: intersections between governmental and non-governmental or private spheres; between the spheres of expertise and of politics; and between the domestic and foreign or international spheres. These spheres are interconnected. Governmental authorities work together across territorial borders. There is some overlap between the private sphere and the sphere of expertise, and the market-based sphere of expertise is transnational, rather than being entirely domestic.

Before the crisis financial firms had considerable success in persuading governments and the networks of regulators to defer to a large extent to the expertise of the private sector. I chose to use the example of IOSCO's reference to the use of self-regulation for this reason - before the crisis the language of this principle read that the "regulatory regime should make appropriate use of Self-Regulatory Organizations".[29] When the crisis hit, the idea of self-regulation seemed suddenly less attractive. For example, in late 2008 Christopher Cox, then Chairman of the SEC, said that it had become "abundantly clear that voluntary regulation does not work".[30] The

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[28] *See, e.g.*, Stavros Gadinis, *The Politics of Competition in International Financial Regulation*, 49 HARV. INT'L L. J. 447, 500-503 (2008).

[29] IOSCO, Objectives and Principles of Securities Regulation, i (Feb. 2008) at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD265.pdf .

[30] Sec. & Exch. Comm'n, Press Release, Chairman Cox Announces End of Consolidated Supervised Entities Program (Sept. 26, 2008) *available at* http://www.sec.gov/news/press/2008/2008-230.htm . See also, e.g., Sec. & Exch. Comm'n, Office of Inspector General, SEC's Oversight of Bear Stearns and Related Entities: Consolidated-Supervised Entity Program, Report No. 446-A (Sept 25, 2008) *available at* http://www.sec.gov/about/oig/audit/2008/446-a.pdf . Contrast Chairman Cox' statement with the SEC's July 2008 New Guidance Release on SRO rule filings, expanding the range of SRO rule changes which would become immediately effective and stating that "Self-regulation, with oversight by the Commission, is a basidc premise of the Exchange Act." Sec. & Exch. Comm'n, Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed by Self-Regulatory

language of the IOSCO Objectives and Principles was amended to reflect this new nervousness about self-regulation - the 2010 version backtracks from the earlier exhortation to make appropriate use of self-regulation and merely refers to the possibility that the regulatory system will involve self-regulation.

In another example of public reliance on private regulation, Basel II (from which Northern Rock benefitted as I mentioned earlier) allowed regulators to permit sophisticated banks to use their own models for credit risk.. Adair Turner has argued forcefully since the crisis began that everyone put too much faith in these models:

> Mathematical sophistication ended up not containing risk, but providing false assurance that other prima facie indicators of increasing risk (e.g. rapid credit extension and balance sheet growth) could be safely ignored. [31]

The crisis disturbed the complacency with which policy-makers viewed self-regulation in the financial markets. But the private sector reacted by developing new self-regulatory principles and practices. Industry groups have focused on the securitization process, for example by developing guidelines for limiting reliance on credit ratings,[32] and addressing issues of transparency.[33] ISDA, the International Swaps and Derivatives Association, has developed protocols for novations of credit derivatives and interest rate transactions to address backlogs.[34]

Industry groups have actively negotiated and lobbied over changes to the financial regulatory structure and rules. They have done so with the knowledge that circumstances have changed, and earlier habits of deference to industry views have been disrupted. For example, SIFMA - the Securities Industry and Financial Markets Association - a trade group formed after the merger of the Securities Industry Association and the Bond Market Association, recently

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Organizations, 73 Fed. Reg. 40144, 40144 (Jul. 11, 2008).

[31] Turner Review, supra note 16, at 22.

[32] European Fund and Asset Management Association, European Securitisation Forum & Investment Management Association, Asset Management Industry Guidelines to Address Over-Reliance upon Ratings (Dec. 11, 2008).

[33] *See, e.g.*, Industry Initiatives to Increase Transparency: Issuer and Investor Transparency Initiatives (June 2008) at http://www.europeansecuritisation.com/Communications/Archive/Current/Issuer%20and%20Investor%20Transparency%20Initiatives.pdf.

[34] *See* http://www.isda.org/isdanovationprotII/isdanovationprotII.html.

submitted a 71 page response to the SEC's proposals for new regulations on issues of asset backed securities.[35] The response included this passage:

> SIFMA's members have directly experienced the pain of the recent financial crisis and the collapse of the structured finance markets, and are acutely sensitive to what is at stake as both government and the private sector work to rebuild these vital markets. There is a long way to go.

Trade associations like SIFMA and ISDA lobby and negotiate not just with US based regulators and politicians but also with regulators and legislators in other jurisdictions and with the European Commission and the Basel Committee. That they do so is important, because they are in a position to exert influence on the development of rules of financial regulation at all levels: they negotiate about the development of high level principles at the supranational level and again when the principles are implemented within domestic legal systems either during the legislative process or in the administrative rule-making process or sometimes both.

Since the crisis, and the attention to regulation which it has provoked, trade associations have needed to be more circumspect in how they address policy-makers (for example, as I have said already, they need to deal with some scepticism about self-regulation), and how they interact with their members. Trade associations are showing new sensitivity to the concerns of their members that they should pay more attention to member interests. ISDA recently surveyed its members to see what they would like it to do differently.[36]

Two broad brush strategies have been used effectively in the past: trade associations argue that regulation should not interfere too much with the market and that regulations should be harmonized across jurisdictions so as not to give too much of a competitive edge to firms based in less regulated jurisdictions. These strategies are still visible. For example, SIFMA's recent submission on the SEC's proposals on asset backed securities includes the following comments:

> Some of the proposed changes clearly would benefit investors and contribute to the recovery of the ABS markets. In other cases the proposed changes could stifle markets by imposing costs that exceed their benefits, or by imposing compliance

[35] SIFMA, Re: Asset-Backed Securities, Release Nos. 33-9117; 34-61858; File No. S7-08-10 (Aug. 2, 2010) at http://www.sifma.org/assets/0/232/234/124802/385a54e5-59fb-4f0a-b43b-3353efde5f7a.pdf

[36] See, e.g., Moving forward in response to ISDA's Member Survey, in ISDA News, Issue 5, 2010 at http://www.isda.org/newsletters/Issue5-2010/_access/Issue5-2010.pdf.

burdens that may be extremely difficult to satisfy.[37]

I have written about the imbalance between industry groups and non-industry groups in the past. SIFMA and ISDA have significant resources in money and person-power that are not available to non-industry groups (and there is much less of a popular groundswell around financial regulation than around issues of environmental regulation). In a world where supranational standards are vague and leave significant discretion in implementation to domestic legislators and regulators, there is some scope for non-industry groups to influence the rules which affect them. But if the new transnational standards are more concrete and allow for less discretion in implementation, there will be less scope for adjustment at the point of domestic implementation. And it isn't at all easy to imagine how one might challenge transnational standards - there is, after all, so far no harmonized supranational administrative law.[38] Courts have found ways to allow people who are listed as suspected terrorists, and whose assets are blocked as a result, to enforce their fundamental rights, but this is a long way from allowing individuals to challenge supranational standards.[39]

Although supranational standard-setting may seem to take on the form of administrative processes, it also operates at a more fundamental policy-setting level.[40] And even where supranational standard-setters develop highly technical standards, those standards may embed policy assumptions, and they may have significant impacts on the lives of citizen-voters around the world. The generation of supranational standards may be intended to prevent national governments from making policy choices which diverge from the standards, and may in fact

[37] *Id.*

[38] *See, e.g.*, B. Kingsbury, N. Krisch, and R. B. Stewart, *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROB. 15, 16 (2005) (noting "an accountability deficit in the growing exercise of transnational regulatory power.")

[39] EU courts have stated that EU and Member State authorities which implement Security Council resolutions must ensure that EU fundamental rights are respected. See Yassin Abdullah Kadi and Al Barakaat International Foundation v Council and Commission, Joined Cases C-402/05 P and C-415/05 P 3 C.M.L.R. 41 (2008).

[40] For example, The Basel Committee on Banking Supervision develops technical standards for capital adequacy but has also set out what it regards as the core necessary elements of banking regulation. See BIS, Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision (Oct. 2006) *available at* http://www.bis.org/publ/bcbs129.pdf and BIS, Basel Committee on Banking Supervision, Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version (Jun. 2006) *available at* http://www.bis.org/publ/bcbs128.pdf .

preclude such divergent choices (consider the example of the original Basel Accord) .

The supranational standard-setters have recently been increasing the transparency of their work, formalizing their procedures, and developing practices for consulting on proposed standards, and even establishing consultation policies.[41] Some commentators have reacted by arguing that the multi-level features of transnational standard-setting may in fact enhance accountability and legitimacy.[42] I am more sceptical. Transnational standard setters engage in public consultation as a concession rather than as a matter of obligation: they are not required by any binding rules to carry out consultations at all or in any particular way. As a corollary of this lack of obligation, stakeholders do not have meaningful rights to be consulted. Even the EU is concerned to ensure that its interests are taken into account in the transnational standard-setting process.[43]

We should also note that the development of meaningful supranational standards for financial regulation has been dominated by the developed economies. The processes for developing supranational standards of financial regulation are not inclusive, and tend to privilege the wealthiest countries. Although the Basel Committee's recent expansion of its membership shows some sensitivity to this issue, it is still a very select group. From its inception in 1974 until very recently the membership of the Basel Committee on Banking Supervision included only the G10 countries:[44] Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden the United Kingdom, and the United States. In 2009 the Basel Committee twice

[41] See, e.g., IOSCO, Executive Committee, *IOSCO Consultation Policy And Procedure*, (Apr. 2005) at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD197.pdf .

[42] *See, e.g.*, Michael S. Barr & Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 EUR. J. INT'L L. 15, 17 (2006).

[43] *See, e.g.*, Decision of the European Parliament and of the Council Establishing a Community Programme to Support Specific Activities in the Field of Financial Services, Financial Reporting and Auditing, O J No. L 253/8 (Sep. 25, 2009) at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:253:0008:0016:EN:PDF. Recital number 3 states: "In a global economy, there is also a need to converge standards between jurisdictions and develop international standards under a transparent and democratically accountable process. It is therefore important that the Community play a role in the international standardsetting process for financial markets. To ensure that the interests of the Community are respected and that global standards are of high quality and compatible with Community law, it is essential that the interests of the Community are adequately represented in that international standard-setting process."

[44] *See* http://www.bis.org/bcbs/history.htm .

announced that it was expanding its membership. In June of 2009 the Basel Committee said that:

> The newly expanded membership will enhance the Committee's ability to carry out its core mission to strengthen global supervisory practices and standards. It will also help to more effectively implement the necessary reforms of the international financial system.[45]

The Basel Committee now includes: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.[46]

Transnational Regulation and the Crisis: The G20 and the IMF

The global financial crisis demonstrated the transnational nature of financial market activity, and seemed to persuade governments to commit to an intensified co-ordination of financial market regulation. In a declaration in November 2008, the G20 countries stated that:

> Regulation is first and foremost the responsibility of national regulators who constitute the first line of defense against market instability. However, our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability.[47]

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[45] BIS, Press Release, The Basel Committee Broadens its Membership (Jun. 10, 2009) available at http://www.bis.org/press/p090610.htm (announcing invitation to join the Committee to Argentina, Indonesia, Saudi Arabia, South Africa, Turkey, Hong Kong and Singapore); BIS, Press Release, Expansion of Membership Announced by the Basel Committee (Mar. 13, 2009) available at http://www.bis.org/press/p090313.htm (announcing invitation to join the Committee to Australia, Brazil, China, India, Korea, Mexico and Russia).

[46]See http://www.bis.org/bcbs/history.htm .

[47] G 20, Declaration: Summit on Financial Markets and the World Economy (Nov. 15, 2008) at http://www.g20.org/Documents/g20_summit_declaration.pdf .

Subsequent declarations reinforced this commitment to co-ordination,[48] including a review of existing harmonized standards,[49] the introduction of new harmonized regulatory standards,[50] and the development of new structures for addressing systemic risks.[51]

At the same time, the crisis meant that financial regulation (often treated as a technocratic sphere) came to be seen as a matter of significant domestic political interest. For example, politicians, regulators and private sector groups recognized that citizen-voters were offended by the fact that bankers, who were seen as having caused the crisis and whose institutions were bailed out by taxpayers, nevertheless had contractual rights to large bonuses while non-bankers suffered increased rates of mortgage foreclosure and unemployment.[52] Market and regulatory

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[48] *See, e.g.*, G20, Declaration on Strengthening the Financial System, London (Apr. 2, 2009) at http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf. Cf. Elliott Posner, Making Rules for Global Finance: Transatlantic Regulatory Cooperation at the Turn of the Millennium, 63 Int'l Org. 665, 669 (2009) (describing an institutionalization of transnational co-operation in financial regulation after 2002).

[49] *See, e.g.*, BIS, Basel Committee on Banking Supervision, Consultative Document, Proposed Enhancements to the Basel II Framework, 1 (Jan. 2009) *available at* http://www.bis.org/publ/bcbs150.pdf ("The Basel Committee has finalised its proposals for enhancing the Basel II framework in the area of securitisation and more specifically for dealing with resecuritisations. These enhancements are intended to strengthen the framework and respond to lessons learned from the financial crisis.")

[50] *See, e.g.*, *id.* at 2 ("once recovery is assured, prudential regulatory standards should be strengthened. Buffers above regulatory minima should be increased and the quality of capital should be enhanced. Guidelines for harmonisation of the definition of capital should be produced by end 2009. The BCBS should review minimum levels of capital and develop recommendations in 2010")

[51] G20, Declaration on Strengthening the Financial System, *supra* note 48, at 1 ("We have agreed that the Financial Stability Forum should be expanded, given a broadened mandate to promote financial stability, and re-established with a stronger institutional basis and enhanced capacity as the Financial Stability Board (FSB).")

[52] *See, e.g.*, Productivity Commission, Executive Remuneration in Australia, Productivity Commission Inquiry Report No. 49, xv (Dec. 19, 2009) *available at* http://www.pc.gov.au/__data/assets/pdf_file/0008/93590/executive-remuneration-report.pdf ("A catalyst for this inquiry was concern that executive pay had got out of hand. This perception was fuelled by practices in financial institutions abroad that were seen as a key contributor to the global financial crisis (GFC). Further, while local shareholder value plummeted in 2008 as a

failures in the financial markets[53] were acknowledged to have imposed externalities on those outside the financial markets.[54] These developments led to debates about the extent to which the financial markets provide value to the real economy.[55]

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result of that imported crisis — with some companies and sectors being propped up by taxpayers — executive pay seemed to emerge unscathed, crystallising a view that executives were being rewarded for failure (after having been rewarded for success)."); FSA, Reforming Remuneration Practices in Financial Services, CP 09/10 (Mar. 2009) at http://www.fsa.gov.uk/pubs/cp/cp09_10.pdf ; The Conference Board, The Conference Board Task Forceon Executive Compensation (Sep. 2009) at http://www.conference-board.org/pdf_free/ExecCompensation2009.pdf.

[53] *See, e.g.*, Financial Services Authority, The Turner Review: a Regulatory Response to the Global Banking Crisis, 22 (Mar. 2009) *at* http://www.fsa.gov.uk/pubs/other/turner_review.pdf (identifying excessive reliance on particular risk management techniques as a factor contributing to the crisis :"Central to many of the techniques was the concept of Value-at-Risk (VAR), enabling inferences about forward-looking risk to be drawn from the observation of past patterns of price movement. This technique, developed in the early 1990s, was not only accepted as standard across the industry, but adopted by regulators as the basis for calculating trading risk and required capital, (being incorporated for instance within the European Capital Adequacy Directive)").

[54] *See, e.g.*, Financial Crisis Inquiry Commission, Preliminary Staff Report, Shadow Banking and the Financial Crisis, 41 (May 4, 2010) at http://www.fcic.gov/reports/pdfs/2010-0505-Shadow-Banking.pdf ("..many financial firms were crippled, and some only survived with substantial government assistance. Their capital was depleted and many of their revenue channels were extinguished or impaired by the decline in financial activity. This condition severely restricted their capacity to provide funding to consumers, businesses, and governments, reinforcing reductions in real economic activity around the world and magnifying the ensuing recession.")

[55] *See, e.g.*, Adair Turner, What Do Banks Do, What Should They Do and What Public Policies Are Needed to Ensure Best Results for the Real Economy? Speech, CASS Business School (Mar. 17, 2010) at http://www.fsa.gov.uk/pubs/speeches/at_17mar10.pdf . *Cf.* SOMO, EU Financial Reforms Newsletter (April 2010) at http://somo.nl/dossiers-en/sectors/financial/eu-financial-reforms/newsletter-finance/april_2010/view ("The financial sector has the potential to serve the real economy, to improve sustainability and to help people in need, for instance, through credit and investments. However, recent financial crises have shown that the financial industry primarily serves itself. The financial sector has become so powerful that some say we "live in financial times". It is therefore important to seize the momentum of the ongoing financial reforms to truly transform the financial sector so it

Because the financial crisis was and is global, governments stated publicly that they accepted that regulatory solutions should be the products of global as well as domestic processes.[56] As I have said, governments of the G20 countries made public commitments to strengthen international co-operation with respect to financial stability, and prudential regulation. They also agreed to work together in other areas, including the supervision of hedge funds and credit rating agencies. More than merely agreeing to increased co-operation, however, the G20 committed to "implement international financial standards (including the 12 key International Standards and Codes)".[57] And they agreed to participate in mutual assessment to ensure this implementation.[58]

The language of public statements about the reform of financial regulation by groups such as the G20, and by the International Financial Institutions and supranational regulatory networks would tend to suggest that there is a genuine transnational commitment to effective regulation of the financial markets. On the other hand, implementation of the transnational commitment is to be carried out in multiple levels of fora, which are less transparent to citizen-voters than domestic legislatures, and where well-resourced financial firms and their trade associations can participate actively in the negotiation of the new standards.[59]

In some ways the global financial crisis seems to have created new opportunities for the IMF. An international lending institution that had suffered from critiques from the left (conditionality) and the right (suspicion of global governance, for example the failed proposals for a sovereign debt restructuring mechanism) the IMF had been involved in a long process of

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serves the real economy, the environment and the interests of the most vulnerable within Europe and especially within developing countries. ")

[56] *See, e.g.*, G20, Declaration on Strengthening the Financial System (Apr. 2, 2009) at http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf.

[57] G20, Declaration on Strengthening the Financial System (Apr. 2, 2009) at http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf.

[58] G 20, Communiqué: Meeting of Finance Ministers and Central Bank Governors, United Kingdom (Nov. 7, 2009) at http://www.g20.org/Documents/2009_communique_standrews.pdf .

[59] *Cf.* Caroline Bradley, *Financial Trade Associations and Multilevel Regulation*, in Ramses Wessel, Andreas Follesdal & Jan Wouters eds., MULTILEVEL REGULATION AND THE EU: THE INTERPLAY BETWEEN GLOBAL, EUROPEAN AND NATIONAL NORMATIVE PROCESSES (2008).

reform of its own governance.[60] The IMF responded to the G20 declarations with an assessment of how it could help with the mutual assessment process. [61] As a formal matter, the IMF stated that its role would constitute "technical advice" rather than "surveillance", but that:

> Even though the envisaged G-20 assessment process constitutes technical advice, it could be used to inform surveillance, in that the information obtained and the analysis undertaken could be used as inputs for bilateral and multilateral surveillance. [62]

So the sort of standards which are developed by bodies such as the Basel Committee, which are from a formal legal perspective not binding on anyone, seem set to become closer to binding from a practical perspective. For me this makes issues about how the standards are constructed more salient, so I will next look briefly at the Basel Committee's recent announcement..

Transnational Regulation and the Crisis: the Basel Committee on Banking Supervision

The Basel Committee's September 2010 announcement reads in part:

> At its 12 September 2010 meeting, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced a substantial strengthening of existing capital requirements and fully endorsed the agreements it reached on 26 July 2010. These capital reforms, together with the introduction of a global liquidity standard, deliver on the core of the global financial reform agenda and will be presented to the Seoul G20 Leaders summit in November.
> The Committee's package of reforms will increase the minimum common equity requirement from 2% to 4.5%. In addition, banks will be required to hold a capital conservation buffer of 2.5% to withstand future periods of stress bringing the total common equity requirements to 7%. This reinforces the stronger definition of

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[60] See, e.g., IMF Executive Board Discusses Governance Reform Public Information Notice (PIN) No. 09/98 (Aug. 4, 2009) at http://www.imf.org/external/np/sec/pn/2009/pn0998.htm .

[61] IMF, The G-20 Mutual Assessment Process and the Role of the Fund (Dec. 2, 2009) at http://www.imf.org/external/np/pp/eng/2009/120209a.pdf .

[62] *Id.*

> capital agreed by Governors and Heads of Supervision in July and the higher capital requirements for trading, derivative and securitisation activities to be introduced at the end of 2011. [63]

The Basel Committee's work is most interesting from my perspective because of all the supranational international standards we have, some of the Basel Committee's work is (at least on the surface) quite concrete. This announcement contrasts with the IOSCO principle on self-regulation because it seems to have content - there is to be an increased minimum common equity requirement for banks. The percentage figures in the announcement refer to the relationship between capital and risk-weighted assets (loans and other transactions to which the bank is a party).

However, the concreteness is apparent rather than real. In practice domestic regulators have always had a significant amount of discretion in the implementation of the Basel rules. And Yves Smith comments that what is striking about Basel III is that there is no progress on harmonization of rules for valuation of assets, no accounting harmonization for capital adequacy purposes, and no reduction of reliance on credit rating agencies. [64] And the new rules won't fully kick in until 2019.

Some press reports suggest that the new requirements will require banks to raise more capital, [65] others that they will result in a flight to government bonds.[66] This would provide something of a subsidy of the debt of at least some sovereigns but it would not help to increase lending. Vince Cable, the UK's business secretary warned banks not to use the new rules as an excuse to limit credit.[67]

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[63] Group of Governors and Heads of Supervision Announces Higher Global Minimum Capital Standards (Sep. 12, 2010) at http://www.bis.org/press/p100912.htm .

[64] Yves Smith, This Is Basel III??, Roubini Global Economics (Sep. 13, 2010) at http://www.roubini.com/financemarkets-monitor/259617/this_is_basel_iii .

[65] Julia Kollewe & Graeme Wearden, Basel Iii: the Main Points (Sep. 13, 2010) at http://www.guardian.co.uk/business/2010/sep/13/basel-iii-the-main-points.

[66] Brian Kelly, More on Basel III: Finding the Path of Least Resistance, Seeking Alpha, (Sep. 14, 2010) at http://seekingalpha.com/article/225100-more-on-basel-iii-finding-the-path-of-least-resistance.

[67] Jill Treanor, Basel III: Vince Cable Warns Bankers to Unlock Flow of Credit (Sep. 14, 2010) at http://www.guardian.co.uk/business/2010/sep/13/basel-3-bank-lending-cable .

So, Basel III : slow in development. Slow in implementation, not as ambitious as it might have been, and used as an example of excessive interference with the business of banking. Not that capital adequacy regulation is simple: it isn't. Concrete rules (Basel I) invite gaming and may limit the provision of credit in undesirable ways and a more flexible self-regulatory approach (aspects of Basel 2) risk encouraging excessively risky behaviour.

Transnational Regulation and the Crisis: the EU and the US (convergence and competition)

The EU and the US are both examples of structures of multi-level governance (federal/quasi-federal entities). And they host large financial markets and large financial institutions. Regulators in the EU and the US are participants in the work of the Basle Committee and IOSCO, and the EU[68] and US[69] have welcomed the Basel III announcement. At the same time, the EU and the US have also been involved in their own local processes for reform of financial regulation. The US enacted the Dodd-Frank Act this summer, although many of the details of the new rules will only be apparent as regulations are drafted and put out for comment..[70] The EU is in the process of revising its structures for financial regulation and has adopted and proposed a number of different measures.[71]

In some areas, the EU's new rules illustrate convergence with rules in place in the US. For example, in September 2007, at the time of the run on Northern Rock, some deposit guarantee schemes in Europe, including that in the UK, were co-insurance schemes which did not guarantee 100% of a depositor's moneys up to a financial limit as was the case in the US.[72]

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[68] See, e.g., EU to adopt new Basel Rules in 2011 (Sep. 14, 2010) at http://www.euractiv.com/en/financial-services/eu-adopt-new-basel-rules-2011-news-497736 .

[69] Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, U.S. Banking Agencies Express Support for Basel Agreement (Sep. 12, 2010) at http://www.fdic.gov/news/news/press/2010/pr10206.html .

[70] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (Jul. 21, 2010).

[71] *See, e.g.*, Financial Reform: Where do we stand? (Sep. 10, 2010) at http://ec.europa.eu/news/economy/100910_en.htm .

[72] European Commission, Review of the Deposit Guarantee Schemes Directive (94/19/EC), 4 (Jul. 14, 2005) at http://ec.europa.eu/internal_market/bank/docs/guarantee/consultationpaper_en.pdf ("Eleven

By October 2008 the European Commission was proposing eliminating co-insurance as a feature of European deposit guarantee schemes,[73] and a new directive achieved this in 2009. [74]

At the same time, policy-makers in the EU and the US are conscious that they are developing domestic (and regional) regulation for markets which are international and in which many of the participants are subject to international and not merely domestic competition. The EU is currently discussing how to regulate hedge funds: some wish only to allow EU registered hedge funds to operate in the EU, whereas others argue for broader access to the European market.[75]

Final Thoughts

Transnational regulation - yes, we do have transnational regulation of the financial markets in the sense that there is a transnational conversation about how to regulate the international financial markets and in the sense that the effects of financial regulation (or non-regulation) in one jurisdiction are felt in other jurisdictions around the world.

I am currently researching public consultation as a component of transnational standard-setting. In practice, public participation in consultations by transnational financial standard-setters is limited.[76] There are a number of reasons for this: transnational consultations on standards are framed in a way that makes the views of non-experts seem irrelevant, and they are not designed to be visible and/or accessible. For example, the Basel Committee/IADI's

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Member States have co-insurance schemes, where depositors are not reimbursed for the full amount, but must bear 10% of the loss.")

[73] Proposal for a Directive of the European Parliament and of the Council amending Directive 94/19/EC on Deposit Guarantee Schemes as regards the coverage level and the payout delay, COM (2008) 661 (Oct. 15, 2008).

[74]Directive 2009/14/EC OJ No. L 68/3 (Mar. 13, 2009).

[75] *See, e.g.*, Barnier Speaks out on Hedge Funds, EU Budget Reform (Sep. 14, 2010) at http://www.euractiv.com/en/priorities/barnier-speaks-out-hedge-funds-eu-budget-reform-news-497731.

[76] *See, e.g.*, Barr & Miller, *supra* note 42, at 26 ("The role of the broader public was relatively muted, which reflected in part the technical nature of the Basel Committee's work and the fact that for most public-interested organizations, the connection between banking standards and broader social concerns was not pronounced.")

"Consultative Document" on Core Principles for Effective Deposit Insurance Systems did not contain requests for comments, or even any indication as to where comments could be sent.[77] Transnational standard-setters have not adopted standard practices with respect to publicizing the results of their consultations, and incorporating the results of consultations into announcements of final standards. The transnational standard setters do not necessarily even seek to communicate with potential respondents in their own languages: the BIS publishes some documents in German, Spanish, French and Italian as well as in English, but English is the dominant language. Different bodies publicise the results of their consultations in different ways.

We don't yet exactly have a transnational system of regulation, but we do have an imperfect combination of public and private processes which I think do produce examples of transnational regulation.

[77] *See* Basel Committee on Banking Supervision & International Association of Deposit Insurers, Consultative Document: Core Principles for Effective Deposit Insurance Systems (Mar. 2009) *available at* http://www.bis.org/publ/bcbs151.pdf . Contrast e.g., IOSCO, Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies,
Consultation Report, 3 (May 2010) at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD319.pdf (identifying 3 possible means of communicating views on the document).