

The reform of the International Financial Architecture (IFA) after the global crisis

- *Introduction:* financial law and financial crises
- 1. Initiatives taken so far with a view to strengthening the IFA and IFSSs (International Financial Standards)
- 2. The new IFA (Overview, G-20, IMF, FSB, BCBS)
- 3. Outlook regarding contents and implementation of IFSSs
- *Conclusion:* towards a crisis-resistant IFA ?

Introduction: financial law and financial crises

- Financial law as a child of crises
 - Development of modern banking regulation and supervision after the 1929 crisis
 - Creation of Basel Committee (BSBS) after the Herstatt affair 1974 (euromarkets)
 - Creation of Financial Stability Forum (FSF) after the Tequila and Asian crises 1999; concept of IFA
 - Reform of IFA under the aegis of G20 following global crisis 2008-2009: London summit 2 April 2009: major step

Introduction: financial law and financial crises

- Outbreak of a global crisis despite existing IFSs aiming at eliminating systemic risk
 - Some IFSs may even have contributed to the outbreak and spreading of crisis
 - Basic prudential rules have been disregarded

1. Initiatives taken so far with a view to strengthening the IFA and IFSs [1]

- Revival of the **G-20** as the main forum for reforming the IFA
- Creation of 4 WGs at the G-20 Washington summit 14 Nov. 2008:
 - Enhancing sound regulation and strengthening transparency
 - Reinforcing international cooperation and promoting financial integrity in financial markets
 - Reforming the IMF
 - The World Bank and other Multilateral Development Agencies

1. Initiatives taken so far with a view to strengthening the IFA and IFSs [2]

- Detailed Action Plan of the **G-20** Washington summit (some 50 measures)
- Progress Report of 14 March 2009
- IFA based on reformed IMF and enhanced FSF under the guidance of the G-20
- Expansion of FSF to include all G-20 countries and enlargement of BCBS

1. Initiatives taken so far with a view to strengthening the IFA and IFSs [3]

- **G-20** London summit 2 April 2009: a substantial reform of the IFA
- *Leaders' Statement*, 2 main elements:
 - Economic (tackling the crisis): restoring growth and jobs, resisting protectionism and promoting global trade and investment, ensuring a fair and sustainable recovery for all
 - Financial (preventing another crisis): strengthening financial supervision and regulation, strengthening global financial institutions

1. Initiatives taken so far with a view to strengthening the IFA and IFSs [4]

- **G-20** *Declaration on Strengthening the Financial System* (London summit):
 - new Financial Stability Board (FSB)
 - International cooperation (IMF, WB, OECD, FSB, BCBS, FATF, standard-setters) + action against non-cooperative jurisdictions (including tax havens)
 - International framework for prudential regulation (building up buffers, mitigate procyclicality...)
 - General scope of regulation (comprehensive + macro-prudential supervision...)
 - Specific aspects to be covered (hedge funds, rating agencies, derivatives, executive compensation...)

1. Initiatives taken so far with a view to strengthening the IFA and IFSs [5]

□ **UN Commission of Experts** on reforms of the international monetary and financial system (chair: J. Stiglitz).

Recommendations published 19 March 2009 include

- global reserve system, reform of IFIs
- Financial Products Safety Commission
- comprehensive application of financial regulation, including on derivatives trading and rating agencies
- enhanced and expanded FSF to be made accountable
- groundwork for a Global Financial Regulatory Authority

1. Initiatives taken so far with a view to strengthening the IFA and IFSs [6]

- **Group of Thirty working group** (chair: P. Volcker) published on 15 Jan. 2009 a report *Financial Reform – A Framework for Financial Stability* with 18 recommendations including
 - supervision of all systemically significant financial institutions regardless of type, including private pools of capital
 - improving quality and effectiveness of prudential regulation and supervision (including international coordination)
 - Strengthening of governance, risk management, capital and liquidity standards (mitigating procyclical effects)
 - Restoring confidence in securitized credit markets, rating agency reforms, oversight of Credit Default Swaps and OTC markets, transparency of structured product markets
 - Resolution mechanism for defaulting financial institutions

2. The new IFA

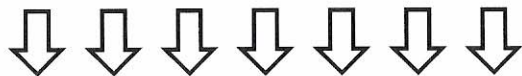
2.1 Overview

- Based on 3 dissimilar entities (with different membership):
 - G-20 as informal political steering group
 - reformed IMF with increased resources and focus on surveillance and implementation of IFSs
 - a new Financial Stability Board (FSB) (as a successor to the Financial Stability Forum, FSF) overseeing standard-setting bodies (SSBs) and coordinating the IFSs-setting process

IMF
INTERNATIONAL ORGANIZATION
192 MEMBER COUNTRIES
*Implementation of IFSs
(ROSCs, FSAPs, Art.IV)*

G-20
INFORMAL POLITICAL STEERING GROUP
19 COUNTRIES+EU
Overall political guidance

FSB
INTERNATIONAL BODY ESTABLISHED BY G-20
24 COUNTRIES+4 IFIs+6 SSBs
Oversight and Coordination of standard-setting process



NATIONAL JURISDICTIONS
Incorporation in domestic regulation and practice



STANDARD-SETTING BODIES
BCBS IOSCO IAIS
CGFS CPSS IASB
IMF WB
Elaboration of IFSs

Graph 2: Synoptic table of membership in the G-20, FSB and BCBS

FSB	G-20			EU ¹	BCBS
BIS	IMF ²	<i>[G-7]³</i>	["BRIC"]	Argent.	ECB
OECD	WB	<i>Canada</i>	Brazil	Austral.	
		<i>D</i>	Russia	Indon.	
BCBS		<i>F</i>	India	Korea	
IASB		<i>I</i>	China	Mexico	
IAIS		<i>Japan</i>		Saudi Ar.	
IOSCO		<i>UK</i>		S. Africa	
		<i>USA</i>		Turkey	
CGFS					
CPSS					
EUR.COMM.		<i>HK SAR</i>		<i>Netherl.</i>	<i>Belgium</i>
		<i>Spain</i>		<i>Switzerl.</i>	<i>Luxemb.</i>
		<i>Sing.</i>			<i>Sweden</i>

¹ Council Presidency

² Including chairs of IMFC and Development Committee for the G-20

³ G-10 countries are in *italics* (G-7 plus Belgium, the Netherlands, Sweden and Switzerland)

Reminder: legal nature of IFSs

- Recommendations of experts, «*soft law*»
- Neither international treaties, nor European directives
- ≠ domestic soft law, no threat of legislative intervention
- ≠ customary law, but relevant for interpretation and closing gaps of legislation
- Bearing on regulations, codes of conduct, administrative practice, aimed at national legislators (not directly at financial intermediaries)
- « Voluntary » implementation by national authorities on the basis of official incentives (FSAPs, ROSCs, peer pressure...) and market incentives
- Growing recognition under international law (UN, WTO)

Reminder: contents of IFSs [1]

Twelve key standards defined by FSF

1. Code of Good Practices on Transparency in Monetary and Financial Policies IMF
2. Code of Good Practices on Fiscal Transparency IMF
3. Special Data Dissemination Standard/General Data Dissemination System IMF
4. Insolvency and Creditor Rights World Bank
5. Principles of Corporate Governance OECD
6. International Accounting Standards (IAS) IASB
7. International Standards on Auditing (ISA) IFAC
(International Federation of Accountants)

Reminder: contents of IFSs [2]

8. Core Principles for Systemically Important Payment Systems CPSS
Recommendations for Securities Settlement Systems CPSS/IOSCO
9. The Forty Recommendations of the Financial Action Task Force / 9 Special Recommendations Against Terrorist Financing FATF
10. Core Principles for Effective Banking Supervision BCBS
11. Objectives and Principles of Securities Regulation IOSCO
12. Insurance Core Principles IAIS

2. The new IFA

2.2 The G-20

- The **G-20**, informal political forum established in 1999 (enlargement of G-7)
 - No seat, no permanent staff, rotating chair, « troika » of past, current and designated chairs to ensure continuity
 - Low profile during the first 10 years (one yearly meeting of finance ministers and c.bank governors)
 - Claim for representativeness, membership issues
 - Further « leaders summits » ? after the Washington (14 Nov. 2008) and London (2 April 2009) summits
 - Next meetings: September 2009 in New York; November 2009 in Scotland (finance ministers)

2. The new IFA

2.3 Role of the IMF [1]

- IMF, a fully fledged international organization (created in 1944 to monitor international monetary system):
 - substantial increase of resources (from 250 to 750 billion USD through NAB + new SDR allocation of 250 billion USD)
 - greater influence of emerging market economies (revision of quotas)
 - overarching institution for macro-financial supervision
 - focus on surveillance through ROSCs, FSAPs and Art. IV surveillance [→implementation of IFSs]
 - early warning exercises (together with FSB)

2. The new IFA

2.3 Role of the IMF [2]

□ The **IMF**

- Relationship with G-20 and FSB
IMF more representative than G-20 ?
- Enhanced surveillance as a new mission for the IMF ? (35 years after the end of the BW system; previous attempts: capital flows, SDRM « Krueger initiative »)
- Need for amendment of Articles of Agreement? FSAP to become compulsory?
- Revision of quotas; reinforcement of Executive Board; [Council at ministerial level?]

2. The new IFA

2.4 The FSB [1]: legal status

- Financial Stability Board(FSB): a « legal UFO » with a partly undefined legal status
 - Created in 1999 by G-7 as the Financial Stability Forum to coordinate standard-setting bodies (itself not a standard-setting entity)
 - Legitimacy (« ownership »): broader membership since March 2009
→ membership to be reviewed periodically
 - No supervisory authority, no institutional powers or sanctions, but *commitment of members to implement IFSs and undergo FSAPs and peer reviews*
 - Legal status unclear, no legal personality under private or under international law
External representation?

2. The new IFA

2.4 The FSB [2]: mandate

1. Original mandate:

- assess vulnerabilities affecting the financial system
- identify and oversee action needed to address them
- promote coordination and information among authorities responsible for financial stability

2. Broadened mandate (in addition to 1):

- monitor and advise on *market developments*
- advise on and monitor *best practice in meeting regulatory standards*
- joint *strategic reviews* of the policy development work of SSBs (to ensure: timeliness, coordination, focus on priorities, addressing gaps)
- set guidelines for and support *supervisory colleges*
- contingency planning for *cross-border crisis management* (particularly for systemically important firms)
- (with IMF) conduct *Early Warning Exercises*

2. The new IFA

2.4 The FSB [3]: organization

- Chairperson: oversees Steering Committee, Plenary and the Secretariat
- Steering committee (appointed by Chair)
- Plenary: decision-making organ (meets twice per year). Voting rights?
- Permanent secretariat based in Basel (Switzerland): to be expanded (~20 persons)
- Infrastructure provided and staff hosted by BIS; immunities deriving from BIS immunities
- Standing Committees: (1) Vulnerabilities Assessment; (2) Supervisory and Regulatory Co-operation; (3) Implementation of Standards and Codes; more as necessary
- Future funding and financial autonomy?

2. The new IFA

2.4 The FSB [4]: reporting and some other issues

□ Reporting:

- FSB reports to IMFC (IMF) and G-20 (fin.min.+c.bk gov.) on build-up of risks and action needed
- SSBs will report to the FSB without prejudice to their existing reporting arrangements or independence
- FSB and IMF will intensify their collaboration each complementing the other's role

□ Some other issues:

- Accountability (« technocracy », « democratic control »)
- Formal adoption of IFSs; legal remedies ? liability ?
- Technical expertise / flexibility and speed / efficiency following enlargement ?
- Transparency, procedural rules, consultation process

2. The new IFA

2.4 The FSB [5]: division of labor with IMF

- Division of labor betw. IMF and FSB:
 - Surveillance of the global financial system → responsibility of IMF
 - Elaboration of IFSs and policies, coordination across various IFS setting bodies → principal task of FSB → IMF participates and provides inputs as member of FSB
 - Implementation of IFSs and policies → national authorities → assessment by IMF through ROSCs, FSAPs and Art. IVs
 - Early warning exercises → cooperation betw. IMF (macro-financial and systemic risks) and FSB (financial system vulnerabilities)

2. The new IFA

2.5 The BCBS

- BCBS created 1974 by G-10 central bank governors, most prominent international financial standard-setting body; enlargement in March and June 2009
 - undefined legal status, no legal personality (« international administrative law », « transgovernmental network »)
 - infrastructure, staff: hosted by BIS, Basel, Switzerland
 - Reporting lines? Member of FSB
 - Need for organisational rules and enhanced infrastructure ? Governing body ?
 - Efficiency with wider membership ?

3. Outlook regarding contents and implementation of IFSs [1]

- Overview of proposals:
 - General principle: all financial (1) *intermediaries*, (2) *markets* and (3) *products* irrespective of type must be subject to appropriate regulation and supervision *in all jurisdictions*
 - Not only institution by institution, but also systemic (« macro-prudential »)
- Some specific areas for regulation:
 - higher capital and liquidity requirements (including overall leverage ratio)
 - accounting rules (mitigating « fair value » and procyclicality)
 - hedge funds
 - rating agencies
 - credit default swaps and derivative products

3. Outlook regarding contents and implementation of IFSs [2]

- Prudential vs. governance standards
 - Following failures in prudential regulation and supervision, shift towards governance issues not directly linked to the outbreak of the global crisis, but politically sensitive
 - 3 examples:
 - Sound compensation practices
 - Non-cooperative (smaller) jurisdictions (in particular « tax havens »)
 - G-7 initiative promoting integrity in financial markets (Tremonti)

3. Outlook regarding contents and implementation of IFSs [3]

□ Implementation and sanctions

- Official and market incentives
- Blacklisting (FATF, OECD, UN)
- Measures taken by national jurisdictions (e.g. conditions imposed upon foreign financial entities for accessing domestic market or on domestic entities for transactions with certain jurisdictions)
- G-20 calls for a tool-box of effective counter-measures with regard to non-cooperative jurisdictions
- Compatibility with international (public) law including WTO rules ?

Reminder: Implementation of IFSs Assessment by IMF and WB [1]

- **Reports on Observance of Standards and Codes (ROSCs)** produced jointly by IMF and WB
- provide summary assessments of an economy's progress in observing standards on
 - data dissemination
 - fiscal transparency
 - auditing and accounting
 - insolvency and creditor rights systems
 - corporate governance
 - financial sector

Reminder: Implementation of IFSs Assessment by IMF and WB [2]

□ Financial Sector Assessment Programs (FSAPs)

- joint evaluation by IMF and WB
- cover financial sector standards (BCBS, IOSCO, IAIS, CPSS)

□ Participation and publication of ROSCs and FSAPs is voluntary (≠ Art. IV Surveillance)

- most countries have made them public
- ROSCs are available on www.imf.org or www.worldbank.org
- commitment of FSB members to implement IFSs and undergo FSAPs and peer reviews

Conclusion: towards a crisis-resistant international financial system?

- London summit: multilateral approach
- A landmark in the consolidation of the IFA
- However:
 - Non-existence of an international financial authority (financial regulation, prudential supervision and jurisdiction): not realistic
 - Multiplicity (and diversity of legal status) of entities involved in defining IFSs
 - Critical aspect: effective implementation; IFSs as binding rules ?
 - Potential regulatory and supervisory gaps or overregulation ?
 - Monetary aspects (inflation, deficits) might become more important in the aftermath of the crisis