Lessons from the crisis

- Institutions and market structures
  - Power of financial contagion in integrated global financial markets

- Policy analysis
  - Market-based financial regulatory models do not adequately monitor and control systemic risks

- Policy implementation
  - Outdated regulation can exacerbate externalities
  - Failure in UK, US and other G10 supervisors to give sufficient attention to safety and soundness issues
The Effectiveness of UK-style ‘light-touch’ Principles-based Regulation?

• ‘The United Kingdom’s experiment in a strategy of light touch regulation to attract business to London away from New York and Frankfurt ended tragically. That should be a cautionary note for other countries deciding whether to try to take advantage of the rise in standards in the United States’

*Timothy Geithner, US Secretary of the Treasury, 6 June 2011*

US regulatory and supervisory practices were suspect as well

• In 2003, then-Vice Chairman of the Federal Reserve Roger W. Ferguson praised

  the truly impressive improvement in methods of risk measurement and management and the growing adoption of these technologies by mostly large banks and other financial intermediaries.’

  *(The Future of Financial Services - Revisited, 8 Oct 2003)*

• Alan Greenspan believed in ‘self-regulation.’

  *It is critically important to recognize that no market is ever truly unregulated, . . . The self-interest of market participants generates private market regulation. Thus, the real question is not whether a market should be regulated. Rather, the real question is whether government intervention strengthens or weakens private regulation.’*

  ‘Government Regulation and Derivative Contracts’ (Feb 1997)
Global reform agenda –
*macro-prudential supervision*

- Global consensus on need for more effective, better coordinated macro- and micro-prudential regulation and supervision
- Oversight of systemic risk has to be globally co-ordinated
- Systemic risk oversight bodies: international, regional, national
  - Global: Financial Stability Board (FSB)
  - EU: European Systemic Risk Board (ESRB)
  - UK: Financial Policy Committee of Bank of England
  - USA: Federal Stability Oversight Council
  - Switzerland: systemic risk oversight committee (FINMA and Swiss National Bank)
  - France: Council on Financial Regulation and Systemic Risk
Supervisory Structure – the US experience

- Multiple regulators justified as creating ‘checks and balances’ to keep agencies ‘from becoming arbitrary or inflexible’.
- The current structure provides banks with a method . . . of shifting their regulator, an effective test that provides a limit on the arbitrary position or excessively rigid posture of any one regulator. The pressure of a potential loss of institutions has inhibited excessive regulation and acted as a countervailing force to the bias of a regulatory agency to overregulate. - Alan Greenspan (1994)
- Some US regulators (OTS and OCC) were funded by industry assessments from institutions they regulated. As a result, the larger the number of institutions that chose these regulators, the greater their budget.


- Light-touch regulation and supervision of Financial Holding Companies
- Intent was to eliminate excessive or duplicative regulation across a FHC’s subsidiaries and across financial sectors
- However, Fed Lite ‘made it difficult for any single regulator to reliably see whole picture of activities and risks of large, complex banking institutions.’ Ben Bernanke, evidence before the FCIC
- Complex regulatory and institutional structure made it difficult for anyone regulator, including the Fed, to identify excessive risks and unsound practices building up in non-bank subsidiaries of financial holding companies, such as Citigroup and Wachovia.
Dodd-Frank Act 2010 –
Financial Stability Oversight Council

- 15 members – Membership – FRB, FDIC, Treasury, SEC, OCC, CFTC, & FHFA
- Identify gaps in regulation and provide a forum for discussion of cross cutting issues
- Coordinate macro-prudential systemic views of other regulators
  - Identify institutions’ practices and markets that create potential systemic risks
  - Synthesize perspectives of various functional regulators
- Federal Reserve Board – main systemic risk regulator of financial institutions (Financial Holding Companies) with excess of $50 billion assets.
  - Authority to recommend firms that will be subject to Tier 1 FHC supervision
  - Systemic regulator (FRB) required to consult with the council in setting prudential standards for Tier 1 FHCs.
- Issues:
  - Agencies serve as check and balance to systemic regulator?
  - How agencies discharge responsibilities in globalised financial markets and adequately coordinate with other national/EU authorities?

G20 and Financial Stability Board Initiatives

- The G20 Washington Action Plan and the London & Pittsburgh Summit Statements on strengthening the financial system
- FSF’s April 2008 and 2009 Reports
- FSB principles for cross-border cooperation on crisis management
- G-20/FSB protocol to establish colleges for all major cross-border financial institution
- Basel Committee membership increased to 20 (Australia, Brazil, China, India, Korea, Mexico and Russia)
- Macro prudential to complement micro prudential regulation
The Financial Stability Board: *in brief*

- FSB (global systemic risk)
- FSB – G20 mandate to promote global financial stability
- Members: developed countries and large developing countries
  - national financial authorities (central banks, regulatory and supervisory authorities and ministries of finance) international financial institutions
  - standard-setting bodies
  - committees of central bank experts
- FSB mandate includes
  - Assessing vulnerabilities, and identifying and overseeing action needed to address them;
  - Collaborating with the IMF to conduct early warning exercises
- FSB soft institutional structure and no binding powers
- Flexibility/speed evident in response to crisis in 2009
- Impact?
  - Obligations on members
  - FSB members produce almost 90% of world GDP: leading by example
  - Peer reviews
  - Implementation & follow up
  - Transparency
  - “Naming and shaming”
- Accountability and legitimacy concerns?

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European System of Financial Supervision
What role for international law?

- Financial globalisation requires international standards/rules - how voluntary?
- What international legal relevance?
- The governance gap in international norm setting and the challenge for efficient international financial regulation – the dominance of the G10/G20?
- What supervisory structure for global governance

European Commission ‘Augur’ project
What global financial regulation will look like in 2025?

- G20/FSB/IMF regime – build on existing international regime – ‘muddling through’
- Regional groupings of states – EU, NAFTA, Mercosur, Asian groupings
- A return to the primacy of nation states
- Further consolidation of the existing international regime through the creation of a World Financial Organisation

What institutional structure of international financial regulation/supervision?