

THE DODD-FRANK WALL STREET REFORM ACT'S TURN TO INTERNATIONAL LAW

This panel was convened at 3:30 pm, Wednesday, April 9, by its moderator, Yesha Yadov of Vanderbilt Law School, who introduced the panelists: Michael Barr of the University of Michigan Law School; Christopher Brummer of Georgetown University Law Center; Jonathan Macey of Yale Law School; and David Zaring of the University of Pennsylvania's Wharton School.*

GLOBAL ADMINISTRATIVE LAW AND THE POST-CRISIS FINANCIAL ORDER

By Michael S. Barr[†]

The global financial crisis caused widespread harm not just to the financial system, but also to millions of households and businesses, and to the global economy.¹ The crisis revealed substantive, fundamental weaknesses in global financial regulation, and raised serious questions about whether national regulators and the international financial regulatory system could ever be up to the task of overseeing global finance. The Bretton Woods institutions (the International Monetary Fund, the World Bank, and the World Trade Organization) were never really equipped to deal with the growing complexity, breadth, and size of the global financial system, and instead left rulemaking and supervision largely to the domestic arena. The cross-border rules that were developed—essentially by national regulators and the international standard-setting bodies that took root in this global institutional lacuna in the 1980s—proved woefully ineffective. Despite strategies to increase the accountability and legitimacy of these hybrid standard-setting bodies,² the rules failed substantively, and overwhelmingly. Global finance, and a “soft-law” architecture left unchecked by a decades-long regulatory race to the bottom, proved weak in the face of global financial institutions and crushed the real economy.

The failure of the pre-crisis regulatory architecture to manage the financial system at the global level raises two fundamental questions: First, how can we build an effective international financial architecture with more than one architect? And second, how can we foster a global regulatory architecture that is legitimate and accountable—one that reflects our most basic values?

The rubric of global administrative law (GAL) provides a useful framework for thinking about how to answer these questions. Specifically, it provides a way of thinking about how we might embed in the international regulatory architecture procedural values that are consistent with the normative justifications for this architecture.³ At the most basic level, we want global institutions that are effective—meaning that they establish norms that are treated by national actors as obligation, that there are systems in place to monitor compliance

* Professors Brummer and Zaring did not submit remarks for the *Proceedings*.

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¹ My remarks on this panel are drawn from my article, *Who's in Charge of Global Finance?*, 45 *Geo. J. INT'L L.* 971 (2014).

² See generally Michael S. Barr & Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 *EUR. J. INT'L L.* 15 (2006).

³ See Benedict Kingsburg et al., *The Emergence of Global Administrative Law*, *LAW & CONTEMP. PROBS.* (Summer/Autumn 2005).

with these obligations, and that these obligations are enforced.⁴ Effective global institutions will help produce rules and other mechanisms that work at a substantive level and that can prevent the significant harm the financial system can do to the real economy when it fails. We also need global institutions that are legitimate, in the sense that the decisionmaking criteria and processes they use are seen as normatively correct, and in the sense that the outcomes produced by these mechanisms respond substantively to the public's interests and values. Finally, we ought to demand accountability. At its most basic level, the international system requires accountability of its organs to national governments, but global administrative law suggests a deeper commitment to public accountability, for example, through transparency, public engagement in decisionmaking, and initiatives to embed global rule-making in national processes of public accountability, such as notice and comment rule-making.

There is important interplay between these values. Even where an institution lacks formal accountability to nations through treaty authorization, for instance, robust GAL mechanisms (for example, strong forms of due process and review, or high levels of responsiveness to notice-and-comment rule-making) nevertheless might foster a sense of legitimacy, increase the substantive efficacy of outputs, and encourage adoption by state or private-sector actors.⁵ Conversely, an organization might represent an unusually broad set of interests but have difficulty producing effective rules widely adopted by national actors. An array of subsidiary values, such as transparency, can also contribute to institutional legitimacy and accountability.⁶ On an institution-by-institution basis, the configuration of these values—the degree to which each value is embedded in the procedures and underlying structure of an international organization—is often highly variable, particularly when measured against institutional mission. Assessing the extent to which the international financial regulatory architecture “embodies” a set of democratic values thus requires an understanding of what the different institutional actors are designed to do, the sources of their authority, how they might relate to one another, and the type of lawmaking in which they are engaged.

My article, *Who's in Charge of Global Finance?*, traces the evolution of the international financial regulatory architecture and evaluates each phase of this evolution in terms of institutional efficacy, legitimacy, and accountability. It begins with a brief analysis of two key pre-crisis phases in the development of our current global financial architecture, the birth of the Bretton Woods institutions and the rise of the so-called “networks”—the international standard-setting bodies, such as the Basel Committee on Banking Supervision and International Organization of Securities Commissions that first began to develop cross-border rules in the 1980s.

In the third phase—the emerging post-crisis regulatory framework—contradictory trends have emerged: the international financial order is more political and more inclusive, and at the same time, its norms have hardened. Although this hardening means that minimum standards have become more difficult to avoid, in some sense races to the top have replaced races to the bottom (at least for the moment), and nations have reasserted their authority to raise standards unilaterally within their own countries and to apply—aggressively—these standards extraterritorially. In this third phase, the Group of Twenty (G-20) nations take

⁴ See W. Michael Reisman, *The Concept and Functions of Soft Law in International Politics*, in 1 ESSAYS IN HONOUR OF JUDGE TASLIM OLAWALE ELIAS 135, 135 (Emmanuel G. Bello & Bola A. Ajibola eds., 1992).

⁵ Benedict Kingsbury & Lorenzo Casini, *Global Administrative Law Dimensions of International Organizations Law*, 6 INT'L ORGS. L. REV. 319, 354 (2009).

⁶ Megan Donaldson & Benedict Kingsbury, *The Adoption of Transparency Policies in Global Governance Institutions: Justifications, Effects, and Implications*, 9 ANN. REV. L. & SOC. SCI. 119, 121 (2013).

center stage as the world's economic and financial decisionmakers, and the Financial Stability Board becomes the platform through which the macro-prudential blueprints of the G-20 are implemented, in part by directing and coordinating the work of the standard-setting bodies. My article then explores the interactions between these bodies and the older Bretton Woods and standard-setting institutions. Finally, the article assesses the merits of the current regulatory order and identifies key reforms aimed at strengthening the efficacy, legitimacy, and accountability of this new system before concluding with thoughts about the prospect for—and the necessity of—continued reforms over the next decade.

On a substantive level, global reform efforts to date have made the financial system safer, perhaps significantly so, but there remain real questions about whether the financial system is safe enough. Much of the reform agenda remains a work in progress, from capital standards to regulation of derivatives and other financial markets, to the mechanisms necessary to wind down immense cross-border firms that get into financial distress. Amnesia about the causes and consequences of the breakdown of the financial system may slow or even reverse reforms taken to date, just when we need to be pushing harder to complete the task. The next misunderstood financial innovation—asset boom, increase in leverage, or explosion in hot money—may find the world still globally mis-coordinated and unprepared. That is why the stakes are so high for getting the international financial architecture right.

Ultimately, the strength of these reforms cannot be judged absent the next crisis. But if the post-crisis reforms are to endure, the system must shift from the task of emergency response to the project of governance, a project that will require more institutional clarity and more sensitivity to the concerns of legitimacy and accountability, both globally and nationally. Conceptually “easy” answers—a treaty-based World Financial Organization, centralized adjudication, a global financial supervisor, and resolution authority, to name a few—are neither politically feasible nor normatively desirable. Instead, we are left with a messier, more iterative, less satisfying, but more realistic task: to continue to make progress on making the global financial system safer, fairer, and, one would hope, more focused on meeting the pressing needs of households and business in the real economy.

CROSS-BORDER INSOLVENCIES OF FINANCIAL INSTITUTIONS: AN OBTAINABLE GOAL? / A GOAL WORTH OBTAINING?

*By Jonathan Macey**

The development of a harmonized system for resolving the failures of large, international financial institutions is considered by academics and policy-makers to be critical to reducing systemic risk and reducing the probability that the insolvency of a major bank will lead to a global economic collapse. Reaching agreement on how to develop this harmonized system for financial institutions with significant transnational assets and liabilities has proved elusive thus far. Commentators in favor of a more international and less parochial approach to resolving bank failures can point to a number of extremely high-profile events that demonstrate the manifest unfairness of resolving bank failures on an individual basis. The bankruptcies of Lehman Brothers and the Bank of Credit and Commerce International (BCCI) are two of many such examples.

In these remarks I will make two principal observations. First, both the United States and creditors of failed banks that settle international transactions in the United States unequally

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benefit under the current ring-fence system¹ of non-cooperation, and have no reason to change. Second, a more promising approach that would enjoy broad international cooperation would be to rank all the creditors of failed banks, with highest priority given to particularly deserving small retail creditors.

The typical resolution process when these institutions fail has four components. First, regulators pronounce the bank to be insolvent and appoint a receiver to take control of it. Second, the receiver structures a resolution, ranging from liquidation, to arranging for a merger with a more financially sound financial institution, to selling the bank. Third, the receiver marshals the bank's assets and collects on all its items of potential value. Lastly, the receiver determines the validity and priority of claims against the bank, and uses its assets to pay the valid claims. If those claims exceed the value of bank assets, as they typically do, the receiver pays creditors in the order of priority prescribed by law (paying deposits first, ordinary non-deposit claims second, and subordinated debt last). A decision to coordinate or cooperate on the resolution of a failed financial institution is made on a case-by-case basis by regulators, who have total discretion in this regard.

By way of illustration, I explore the failures of the Lehman Brothers and BCCI. When Lehman Brothers failed, it was a global firm with over seven thousand legal entities in more than forty countries. Hoping to avoid a Chapter Seven liquidation of its broker-dealer units, Lehman filed a Chapter Eleven petition for its holding company, and kept its broker-dealer subsidiaries out of bankruptcy until it had moved all of the customer accounts. Mere hours before the company declared bankruptcy on September 15, 2008, as Lehman Brothers sank deeper into insolvency, employees transferred approximately eight billion dollars from its London brokerage affiliate to the firm's New York accounts. This "transfer left Lehman's London affiliate with essentially no funds; there weren't even sufficient resources to pay employees,"² and illustrates how quickly assets can be repatriated to the United States when trouble starts. With BCCI, there was an even more egregious example of unfairness. The Federal Reserve Bank of New York had inside information regarding when BCCI would be shuttered by foreign regulators. This information was used to benefit the U.S. creditors of BCCI, to the detriment of non-U.S. creditors, with U.S. creditors being paid in full. Additionally, the U.S. government collected an "exit fee" of over two hundred million dollars from BCCI assets through a fine levied by the Federal Reserve Board, while thousands of economically underprivileged depositors both in the United Kingdom and Southeast Asia received only a fraction of what they were owed.

This maneuvering demonstrates the unfairness of ring-fencing, which is what is now done when large institutions fail. It ensures that local creditors receive preferential treatment over foreign creditors, generates unfair results, and is generally criticized as poor global citizenship. Moreover, ring-fencing is inconsistent with best practices in international law. The small-scale initiative that I suggest focuses on classes of creditors of failed financial institutions rather than on geography. A general goal of bankruptcy policy is to achieve an orderly

¹ Ring-fencing describes the practice of cordoning off and freezing the assets and liabilities of a failed company in a particular jurisdiction, and then treating those assets and liabilities separately from the company's assets and liabilities in other jurisdictions.

² Christine Cumming & Robert Eisenbeis, *Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required?*, Federal Reserve Bank of New York, Staff Report No. 457, at 12 (July 2010), www.newyorkfed.org/research/staff_reports/sr457.pdf.

resolution of a failed economic enterprise and to deter the “race for assets”³ among creditors in order to promote “equality of distribution among similarly situated creditors.”⁴ My approach builds on the simple premise that some creditors, regardless of where they are located, deserve more sympathy than others. This approach would not require the United States or any other country to abandon totally a ring-fence approach in resolving an insolvent financial institution. Rather, I envision each of the various jurisdictions involved agreeing to make good-faith sacrifices in order to generate a fairer, more equitable outcome. Specifically, my approach would allow any jurisdiction involved in the resolution process for a failed global financial institution to identify any “particularly deserving creditors” in its jurisdiction to the regulators in the other involved jurisdictions.

The spectacular failures of BCCI and Lehman provide a useful indication of who the losers and who the winners in international, multiple-jurisdiction bank failures are likely to be. I suggest that a more promising strategy to achieve a greater degree of coordination, and fairness, among regulators when global financial institutions fail would be to frame the debate in terms of favoring the particularly deserving uninsured small creditors of such an institution. The interests and characteristics of this group, albeit inchoate, will be both more salient and more compelling than vague appeals to such abstract virtues such as international comity and cooperation.

³ Morris Macey, *Preferences and Fraudulent Transfers Under the Bankruptcy Reform Act of 1978*, 28 EMORY L.J. 685, 685 (1979). Another goal of bankruptcy law, at least under the reorganization provisions in Chapter 11 of the U.S. Bankruptcy Code is to give debtors a “fresh start” in business after reorganizing their businesses and resetting the terms of their obligations to creditors. U.S. bankruptcy law has been criticized as being too lenient on companies. Other countries have been similarly censured, particularly France, whose insolvency process is generally considered to tilt too much towards companies and jobs, and to afford too little influence to the creditors of failed companies. In Britain, insolvency usually results in liquidation. Despite these differences, all countries share the public policy goal of efficiently resolving the debtor’s estate. *European Bankruptcy Laws: Out of Pocket*, ECONOMIST (Dec. 30, 2008), <http://www.economist.com/node/12855376>; Michelle White, *The Costs of Corporate Bankruptcy: A U.S.-European Comparison*, in JAGDEEP BHANDARI & LAWRENCE WEISS, CORPORATE BANKRUPTCY 467 (1996).

⁴ *Id.*