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Emerging Public International Banking Law? Lessons from the Law of the Sea Experience

Barbara C. Matthews*

"The time has come," the Walrus said,
"To talk of many things:
Of shoes–and ships—and sealing-wax—
Of cabbages and kings."[1]

I. INTRODUCTION

The aftershocks of last year's financial sector implosion continue to reverberate. Policymakers, lawmakers, and regulators coming together under the umbrella of the Group of Twenty (G20)[2] seek to create new standards and structures to address weaknesses at the global and national levels so as to

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1 Lewis Carroll, *Through the Looking Glass and What Alice Found There* 56 (California 1983). The poem tells the tale of a Walrus and a Carpenter that lure young oysters away from home so they can be eaten up in a picnic by the sea.

2 The Group of Twenty consists of: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the US, the UK, and the EU. In addition, the International Monetary Fund, the World Bank, the Chair of the International Monetary & Finance Committee, and the Chair of the Development Committee hold seats at the table. Observers include informal international regulatory standard setters such as the Basel Committee on Banking Supervision.

prevent further economic dislocations in financial markets around the world.[3] They draw on history's lessons from past financial crises to help guide their policy responses.

This Article suggests that another discipline—the law of the sea and its subsequent codification into treaty-based law during the twentieth century—holds important lessons for the development of global financial intermediation activity and its regulation at the international level. The three main lessons are:

1. The path towards codified global consensus is neither linear nor inevitable. In fact, the controversies generated by the law of the sea codification process during the twentieth century suggest that more reliable and pragmatic arrangements based on customary international law are needed in the financial context.
2. Some level of codification and sovereignty sharing are inevitable and necessary when cross-border economic and political activity reaches a critical mass.
3. In particular, credible and durable global standards require real, predictable, and accepted enforcement mechanisms in order for institutional stability that can support growth enhancing cross-border economic activity to evolve.

Absorbing these lessons will help policymakers build a more resilient global structure that can deliver confidence and economic growth—two components that remain missing from today's environment.

The body of law known as the law of the sea spans the centuries and, like its namesake, is vast. This Article does not attempt to describe all aspects of that body of law, nor does it attempt to address all modern political controversies associated with it. Instead, this Article focuses on the evolution from economic need to customary international law to codification in order to draw lessons for today's normative efforts regarding finance and economics at the global level. One key controversy merits immediate attention, however.

During the twentieth century, the law of the sea had been criticized as having a democratic deficit because the customary standards articulated in treaty-based codifications deprived modern and newer nation-states from participating

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3 G20 Final Communiqué ("London Communiqué"), *The Global Plan For Recovery and Reform*, ¶ 4 (London Apr 2, 2009), online at www.g20.org/Documents/final-communique.pdf (visited Nov 21, 2009) ("We have today therefore pledged to do whatever is necessary to: restore confidence, growth, and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform our international financial institutions to overcome this crisis and prevent future ones; promote global trade and investment and reject protectionism, to underpin prosperity; and build an inclusive, green, and sustainable recovery. By acting together to fulfill these pledges we will bring the world economy out of recession and prevent a crisis like this from recurring in the future.").

in the standard-setting process.[4] Some might suggest that therefore the law of the sea does not provide the best example for modern global normative processes. This Article does not opine on the merits of the democratic deficit debate regarding the law of the sea. This Article instead asserts that the modern global normative process in the financial sector area composed of the G20 and its observers (the international regulatory standard-setters) make irrelevant the democratic deficit argument raised by law of the sea critics because all relevant standard-setters are global in their constituency.[5] The Article focuses on the process of developing global international law frameworks and, for this purpose, the law of the sea discipline is both helpful and instructive.

II. SHOES AND SHIPS

The discipline we know today as "public international law" in the non-war context is rooted in economic activity arising from ocean exploration for commercial and state purposes and the need for certainty in the delineation of rights and responsibilities among increasingly strong and centralized "modern" nation-states.[6] Hugo Grotius, his intellectual colleagues, and his successors created a conceptual framework allocating rights and responsibilities of sovereigns with overlapping interests and jurisdictions in an atmosphere of heady globalization, intense technological innovation, and intense competition among emerging nation-states whose wealth and power were growing as their global trading activities increased.[7] The tools for this first era of globalization

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4 See Bernard H. Oxman, David D. Caron, and Charles O. Berderi, eds, *The Law of the Sea: U.S. Policy Dilemma*, 127–144 (ICS 1983).

5 That is, the G20 is a representative body of the world's largest economies to which effectively all other global groups now report, regardless of their compositional arrangements. This Article leaves for another day the issues of whether the various international regulatory standard setters are sufficiently accountable democratically to merit their normative role and whether they have sufficient credibility to continue generating global standards. The latter is particularly true in the regulatory space, where not all global regulatory groups (particularly the Basel Committee) are global in its membership. It may also be true of global groups composed of private sector entities (for example, the International Accounting Standards Board).

6 "[O]ther causes were at work which were to make it impossible for the world to accept the absence of bonds between state and state, and to bring them into more intimate and constant relations with one another than in the days when their theoretical unity was accepted everywhere. Among these causes may be mentioned (1) the impetus to commerce and adventure caused by the discovery of America and the new route to the Indies . . . [the new discipline of international law] proclaimed that [nation-states] were bound to one another by the supremacy of law." J.L. Brierly, *The Law of Nations: An Introduction to the International Law of Peace* 6–7 (Oxford 6th ed 1963).

7 This Article does not attempt to address the arguments raised over the centuries about whether this growing economic power was morally appropriate and what the remedies should be today for abuses during the colonization period. For present purposes, it suffices simply to state the fact that this era of globalization generated unparalleled economic growth in an environment of

were the sea-lanes and the ships that carried people and goods between countries for commercial purposes.[8]

Greater familiarity with deep-sea currents and advances in ship construction and navigation generated increased private (albeit state-sponsored) commercial activity subject to tax and royalty arrangements from the relevant crown. These private actors and their state sponsors shouldered risks still known to sailors today: storms, navigational uncertainties, delays, and pirates.[9] Clarity regarding rights and responsibilities among states sponsoring economic activity was needed in order to encourage people to risk their lives on the high seas for material gain. Moreover, that clarity required strong international cooperation and consensus in order to ensure that the standards would be honored by independent economic and military agents of many different countries crossing the oceans in increasing numbers.

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substantial technological innovation and gave rise to the need for a legal framework to govern interactions among state and non-state actors in a new sphere. Modern commitments to democratic decision-making govern today's normative activities at the global level. For more details on the role that global ocean exploration played in generating economic growth and technological innovation during the fifteenth and sixteenth centuries, consider Dava Sobel, *Longitude* (Walker 1995); Fernand Braudel, *The Wheels of Commerce* (Harper & Row 1982); Benn Steil and Manuel Hinds, *Money, Markets & Sovereignty* (Yale 2009).

8 Consider Sobel, *Longitude* (cited in note 7); Braudel, *The Wheels of Commerce* (cited in note 7); Steil and Hinds, *Money, Markets & Sovereignty* (cited in note 7). Recently, some have asserted that fifteenth century China also launched global exploration and potentially commercial activities, a full seventy years prior to the European expeditions. Consider, Gavin Menzies, *1421: The Year China Discovered the World* (Random House 2002). However, even if the claims of Chinese circumnavigation are correct, the fact is that the Chinese leadership in the fifteenth century turned sharply inwards and avoided international engagements, thus precluding participating in international normative processes for a few hundred years. Paul Kennedy, *The Rise and Fall of Great Powers: Economic Change and Military Conflict from 1500 to 2000* 7–9 (Knopf Doubleday 1989) (noting in particular that the Chinese expedition of 1433 was the last of the line, and three years later an imperial edict banned the construction of seagoing ships). Substantial evidence also exists that the Arab nations conducted serious and ongoing commercial relationships using the sea-lanes in the Indian Ocean and, during the Middle Ages, the Mediterranean. Braudel, *Wheels of Commerce* at 120–125 (cited in note 7) (describing the merchants of the Indian Ocean and the East Indies). See also Jacques Gernet, *A History of Chinese Civilization* 326 (Cambridge 1982) ("Progress in navigational techniques made the expansion of maritime activity possible, but the underlying reasons for this expansion were connected with political circumstances and the development of the mercantile economy."). However, any customary standards developed among Arab, Chinese, and Indian subcontinent seafarers did not evolve into the global standards we know today as the law of the sea. Similarly, the vast trading empires conducted by the Incan and Aztec empires did not generate global standards. The equal participation of all nations in global normative processes is a welcome twentieth century contribution to standard-setting, despite its obvious weaknesses and challenges.

9 See generally Sobel, *Longitude* (cited in note 7).

Even as scientists, astronomers, and mathematicians sought to identify reliable tools for increasing the precision and clarity in navigation,[10] legal scholars simultaneously sought to articulate common standards for allocating rights and responsibilities of nations sponsoring those sailing ships in global commerce. Their thinking has defined navigational and other international legal disciplines to this day, extending up to outer space and down to the depths of the sea floor.[11]

The jurisprudential thinking developed by these scholars balanced each nation's need to access the oceans with the security and economic needs of individuals and states to allocate rights and responsibilities fairly.[12] The key components include:

- The concept of a global commons, or "high seas," which cannot be "owned" by any sovereign and through which rights of free transit would be undisputed;[13]
- The concept of "universal jurisdiction" in which certain criminal acts conducted on the high seas can be adjudicated by any state or aggrieved actor;[14]

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[10] Id.

[11] Lauren Morello, *US Pushes for Law of the Sea Ratification as New Arctic Mapping Project Begins*, NY Times (July 29, 2009), online at http://www.nytimes.com/cwire/2009/07/29/29climatewire-us-pushes-for-law-of-the-sea-ratification-as-89174.html (visited Nov 21, 2009). The US is the only major industrialized nation that has not ratified the Law of the Sea. The Law of the Sea governs navigation rights and addresses species protection and other environmental issues.

[12] This thinking itself evolved from a much older body of law: the Lex Mercatoria. See Steil and Hinds, *Money, Markets & Sovereignty* at 33 (cited in note 7) ("Yet the history of law in the Western world, going back to ancient Greece, shows clearly it is not possible to separate the activity of private exchange from the evolution of law and the evolution of thought about law . . . it is specifically in dealings with foreigners that it was necessary for law to develop which was independent of any ruler's will. Good law was always old law, and old law is what emerged by dint of its consistency with what people came to expect as just behavior from others."). What was revolutionary about the thinking associated with the law of the sea was that it extrapolated well-known jurisdictional and state-limiting context to the oceans and then declared large portions of physical territory (the high seas) exempt from sovereign territorial ownership and jurisdiction.

[13] UN Convention on the Law of the Sea ("UNCLOS III"), Part VII, Arts 87.1 and 89 (Article 87.1 states that the high seas are open to all States, whether coastal or landlocked, and lists the freedoms available on the high seas. Article 89 says that no State may validly purport to subject any part of the high seas to its sovereignty). See also Brierly, *Law of Nations* at 304–316 (cited in note 6) (discussing jurisdiction on the high seas); Oxman et al, *Law of the Sea*, 19–22 (cited in note 4) (discussing national jurisdiction).

[14] Brierly, *Law of Nations* at 311 (cited in note 6) ("The Convention contains comprehensive provisions concerning 'piracy' and 'hot pursuit' which constitute the first attempts to formulate authoritative statements of law on these matters."). Those acts considered to be direct violations of the law of nations by individuals and for which universal jurisdiction exists are: piracy, slavery, and hot pursuit. With respect to hot pursuit, arrest on the high seas is permitted "when a coastal state has good reason to believe that the ship has broken its laws . . . [with respect to] customs,

- The concept that the Home State (the ship's flag country) governs the ship and its interactions with foreigners on board those vessels;[15]
- The concept that even when foreign flag vessels have the right of free transit within such "contiguous zones," the port (Host) state can impose conditions, standards, and taxes on foreign flag vessels seeking to use port services and trade with local business;[16]
- The concept that sovereign states have legitimate economic interests in contiguous areas.[17]

These concepts evolved and were enforced as "customary international law" for centuries.

The concept most intriguing in the financial context is that a body of law has existed for hundreds of years that permits Home states to project their sovereignty beyond their territory for certain limited purposes. Those purposes are: ensuring that the ships chartered under the Home country flag are seaworthy when they depart the Home port and are engaged in legal commerce;[18] ensuring that the Home state's laws and rules govern all who board the ship on the high seas;[19] ensuring some minimum harmonization of standards that *all* ships are entitled to enforce on the high seas against other actors with respect to activities that can damage all participants (for example, piracy); and submitting to foreign jurisdiction when the ship reaches a foreign port and

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fiscal, immigration, or sanitary regulation for the protection of which the contiguous zone was established." Id at 314.

15 Id at 310–311 ("The Convention recognizes the right of every state to sail ships under its own flag and to determine the conditions for the grant of its nationality to ships, for the registration of ships in its territory and for the right to fly its flag . . . a 'genuine link' must exist between the state and the ship and that in particular the state must effectively exercise its jurisdiction and control over ships of its flag in administrative, technical, and social matters . . . ships on the high seas are subject to the exclusive jurisdiction of one state only and that the state whose flag they are entitled to fly.").

16 For an abridged evolutionary history of these concepts from the sixteenth to the mid-twentieth century, see Brierly, *Law of Nations* at 194–221 (cited in note 6) (discussing maritime territory, the continental shelf, and territorial air space).

17 Id at 216 ("The Convention recognizes that over the continental shelf, as so defined, the coastal state possesses *ipso jure*, without any act of occupation or proclamation, '*sovereign rights for the purpose of exploring it and exploiting its natural resources*.' It deliberately refrains from granting full territorial sovereignty over the continental shelf because of a fear that this might be but a short step to sovereignty over both the waters and air space above it; and to hammer the point home it expressly declares that the coastal state's rights over the continental shelf do not affect the legal status of the superjacent waters as high seas or that of the airspace above the high seas.").

18 UNCLOS III, Part VII, Art 94.3 (Article 94 states that every state shall take such measures for ships flying its flag as are necessary to ensure safety).

19 UNCLOS III, Part VII, Arts 92, 94 (Article 92 states that ships shall sail under the flag of one State only and shall be subject to its exclusive jurisdiction on the high seas).

foreign territorial waters. In addition, the law of the sea makes clear that warships of one country may not board foreign flag vessels on the high seas except to address piracy, slavery, unauthorized broadcasting, a ship without a nationality, and operations without a flag.[20]

This balance of rights and responsibilities among Home/flag states and Host/coastal port states is familiar to banking law experts, even if no formal treaties have yet evolved to articulate that balance in the international banking supervision context. The legal concepts in both disciplines with regard to the rights and responsibilities of Home and Host states are broadly the same at the two territorial points. In the banking arena, Home country regulators are responsible for consolidated supervision of the holding company, both with respect to setting normative standards and enforcement of those standards. They are responsible for ensuring that the banking organization is "seaworthy" when it expands abroad. Host country regulators have the authority to grant or deny access to their banking markets to foreign banks, based on an assessment of whether the foreign bank applicant might pose a threat to the stability and credibility of the local banking market. Host country regulators are authorized to enforce those standards on local operations of foreign banks.

These norms evolved into clearly defined "Minimum Standards" the substance of which was progressively articulated by banking supervisors from the Group of Ten[21] countries from the early 1970s to the early 1990s.[22] The initial effort to obtain international consensus on these Home and Host responsibilities arose in response to a global banking crisis. In 1974, a German bank (Herstatt) was closed by local regulators before it had paid out a substantial number of contracts in the foreign exchange market in New York. The bank's failure to make payments wreaked havoc on the foreign exchange market

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20 UNCLOS III, Part VII, Art 110.

21 The Group of Ten consists of: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK and the US. These are also the original members of both the Board of Governors of the Bank for International Settlements and the Basel Committee on Banking Supervision (although the leadership of both these entities has recently expanded to include additional countries). They have not issued a communiqué since October 23, 2007. All past communiqués can be found online at www.bis.org (visited Nov 21, 2009). It seems highly likely that their relevance may be waning as the Group of Twenty with its more global membership gains momentum and credibility.

22 For example, the US implemented the substance of the Basel Minimum Standards in 1991 as the Foreign Bank Supervision Enhancement Act, largely in reaction to the supervisory gaps discovered following the failure of a major, criminal, cross-border bank: the Bank of Credit and Commerce International ("BCCI"). However, the implementation was undertaken without reference to the Basel standards or to other global supervisory developments. *Foreign Bank Supervision Enhancement Act, Implications for Foreign and Domestic Banks*, 58 BNA Banking Report 1001 (1992).

globally. The Basel Committee on Banking Supervision was created under the auspices of the Bank for International Settlements to increase cross-border supervisory cooperation and to delineate clear allocations of rights and responsibilities between Home and Host states.[23] As with the law of the sea, the underlying expectation was that global financial market integration was both desirable and would continue to grow. The policy goal was to find ways to generate greater clarity regarding overlapping sovereign jurisdiction, which in turn would facilitate the prudent flow of economic activity across borders.

A modern expansion of this thinking can be found in proposals for complex, cross-border banks to create "living wills" or separately capitalized subsidiaries to facilitate their closure in the event that the bank encounters financial difficulty.[24] This stream of work also suggests the limits of engagement and political will. The proposed approaches would attempt to *avoid* the need for government intervention and cross-border "burden-sharing" associated with the wind-up of a global financial institution with obligations in multiple jurisdictions. The stated goal is to require financial firms to have plans in place for liquidation of positions and possibly the creation of separately capitalized subsidiaries so that winding-up activities can be undertaken without government intervention. If this work stream goes forward, it potentially represents an effort to avoid the difficult issues associated with overlapping jurisdictions by placing the first responsibility on the financial firms themselves. It remains to be seen whether such plans can be legally enforced in a wide range of jurisdictions with different legal traditions. It also remains to be seen whether they can be implemented in an economically sensible manner that does not undermine global commerce.

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23 Consider Michael P. Malloy, International Banking: Cases, Materials, and Problems (Carolina Academic 1998). See also Joseph J. Norton, Comment on the Developing Transnational Network(s) in the Area of International Financial Regulation: The Underpinnings of a New Bretton Woods II Global Financial System Framework, 43 Intl Lawyer 175, 182 (2009) ("From this beginning, we have, in the mid-1970s, the random and reactive formation of the informal Basel Committee by the G-10, which introduced the bank regulators and supervisors of major Western nations into the equation.").

24 "Work is ongoing to implement the FSF Principles for Cross-border Cooperation and Crisis Management. Schedules for firm-specific cross-border contingency planning discussions have been set out and will take place in 2009 and first half of 2010. The FSB Cross-Border Crisis Management Working Group is preparing a list of the main elements to be included in contingency planning discussions, including a template for 'de-risking' plans to be prepared by the firms. De-risking plans will cover the options the firms would need to consider to exit risky positions and scale back their activities, in an orderly fashion and without government intervention." *Progress Report on the Actions to Promote Financial Regulatory Reform Issued by the US Chair of the Pittsburgh G20 Summit* ("Pittsburgh Progress Report") 3 (Sep 25, 2009), online at www.pittsburghsummit.gov/documents/organization/129866.pdf (visited Nov 21, 2009).

Viewed in a more positive light, the work stream could also be construed as an effort by policymakers to continue supporting cross-border financial market activity without getting bogged down in tedious and likely controversial negotiations on how losses could be shared across finance ministries in crisis countries—a negotiation that could likely take years. These proposals could also be seen conceptually as an extension of the Host/Home state authorities' legitimate efforts to ensure the reliability and safety of their docking stations and harbors by imposing clear standards on the ships that enter their jurisdiction, including restrictions on the means by which waste disposal occurs while in the Host port.

Growing cross-border financial market activity also increases the opportunities for criminals to evade a broad number of Home and Host laws. The banking analog for high seas piracy can be found in the anti-money laundering paradigm, which assumes that an otherwise innocent financial institution is being used to commit crimes against its will and internal policies. Thus, the Financial Action Task Force (FATF) was created to facilitate standard setting with respect to anti-money laundering standards and to facilitate cross-border cooperation when law enforcement officers are in "hot pursuit" of suspected criminal elements. As with the "hot pursuit" standard in the law of the sea, a state may pursue suspected wrongdoing in its territory (and other territories) subject to certain procedural safeguards.

A number of important differences exist between the law of the sea and banking law today. The most important differences relate to the doctrine of the high seas and universal jurisdiction. There is no part of the financial landscape today that is viewed by the law as a "global commons" to which all nations and private parties should have a right of equal and unfettered access. However, the G20 process and the global but informal institutional arrangements it is creating suggest that a comparable concept may be emerging globally. All countries share a common interest and collectively may exercise authority over the conduct of national economic, financial, and monetary policy due to the disastrous spillover effects associated with negligence and mismanagement at the national regulatory level.

A global commons may not exist in the private financial space, but a global common interest may exist in policing that space. The G20 heads of state and government have held three summit meetings (November 2008; April 2009; September 2009) to address a broad range of financial and economic policy issues arising from the credit meltdown. They have made it clear through their commitment to free trade and various central bank support mechanisms for different portions of the credit and transactions market that they seek to keep the modern lines of commerce and finance (including use of derivative financial instruments and alternative investment vehicles) open and functioning. "We believe that the only sure foundation for sustainable globalization and rising

prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions."[25] At the same time, however, they want to ensure that those financial institution vessels are governed by appropriately vigorous minimum standards regarding their operations.[26]

The G20 wants to keep the modern lanes of global finance open to all appropriately regulated credit vessels that seek to sail the open seas in search of growth-enhancing opportunities,[27] and it wants to tighten the enforcement regime against tax evaders,[28] adding to the universe of bad actors subject to international coordination on "hot pursuit" matters. Its goal then is directly

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25 London Communiqué at ¶ 3 (cited in note 3). That support was recently underscored by the European Central Bank's decision in May 2009 to purchase covered bonds issued in Europe. Those bonds, like securitization instruments, structure payouts to investors based on an underlying pool of assets (usually mortgages or public sector debt). However, unlike securitization instruments, they are guaranteed by the issuer's balance sheet. The Financial Times reports that issuance activity regarding sovereign bonds "roared" following the ECB's endorsement of this type of derivative instrument. David Oakley, *Europe's Revival in Covered Bonds Boosts Lending*, Financial Times 20 (Sept 2, 2009), online at http://www.ft.com/cms/s/0/bc9aaf24-9726-11de-83c5-00144feabdc0.html (visited Nov 21, 2009). Since the ECB announced its plans to buy 60 billion pounds in covered bonds, the market has roared back to life.

26 See London Communiqué at ¶ 4 (cited in note 3) ("We have today therefore pledged to do whatever is necessary to: restore confidence, growth, and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform our international financial institutions to overcome this crisis and prevent future ones; promote global trade and investment and reject protectionism, to underpin prosperity; and build an inclusive, green, and sustainable recovery.").

27 "We will fight protectionism. We are committed to bringing the Doha Round to a successful conclusion in 2010." Pittsburgh Communiqué, *Leaders' Statement: The Pittsburgh Summit*, Preamble ¶ 28 (Sep 24–25, 2009), online at http://www.pittsburghsummit.gov/mediacenter/129639.htm (visited Nov 21, 2009). See also London Communiqué at ¶ 3 (cited in note 3) ("We believe that the only sure foundation for sustainable globalization and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions."); G20 Declaration, *Summit on Financial Markets and the World Economy* ("Washington Declaration"), ¶ 12 (Nov 15, 2008) ("Recognizing the necessity to improve financial sector regulation, we must avoid over-regulation that would hamper economic growth and exacerbate the contraction of capital flows, including to developing countries."), online at www.g20.org/Documents/g20_summit_declaration.pdf (visited Nov 21, 2009).

28 See Washington Declaration at ¶ 9 (cited in note 27) ("Promoting Integrity in Financial Markets: We commit to protect the integrity of the world's financial markets by bolstering investor and consumer protection, avoiding conflicts of interest, preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperative jurisdictions. We will also promote information sharing, including with respect to jurisdictions that have yet to commit to international standards with respect to bank secrecy and transparency."). See also London Communiqué at ¶15 (cited in note 3) ("In particular, we agree . . . to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information.").

analogous to the policy priorities that established the canon of expectations and doctrines that we now know as the law of the sea.

The analogy of course is not perfect. A "global commons" concept is unlikely to evolve and is undesirable with respect to the granting of credit or financial intermediation conducted among private parties, even if some of those parties currently operate under substantial government ownership and influence. One significant cause of the current crisis is found in areas either not regulated or not sufficiently regulated by governments. In particular, the fraud and abuse in the US mortgage underwriting business generate understandable cries for greater government regulation, even if the enforcement of preexisting laws and regulations in multiple jurisdictions would have done much to decrease the scale and scope of the crisis.

By articulating common political priorities for the direction that global regulatory policy should take, the G20 is effectively engaging in the same activity that policymakers undertook in the early days of the law of the sea: ensuring vessels (today's financial intermediaries) are "seaworthy" and subject to jurisdiction at all times. However, practical limits exist on how far a Home state can exert its jurisdiction. In addition, overly ambitious or aggressive Host state regulation could undermine the cross-border flow of finance and investment activities that support global economic growth. This Article asserts that various informal and pragmatic solutions are being floated by G20 Leaders in an effort to avoid debilitating and acrimonious negotiations on these sovereign jurisdictional overlaps between Home and Host states.

If a global common interest emerges to justify common standards, it will most likely first focus on transparency and access to data rather than adjusting sovereign interests in entities subject to Home and Host state jurisdiction. As noted above, cross-border resolution issues are not likely to be addressed in a common manner soon. However, the vast streams of transaction, counterparty, and risk exposure data held by financial institutions and their data providers cross boundaries and oceans literally at the speed of light. The communications networks that link the providers and users of financial information globally create the twenty-first century analog to sea-lanes. Global financial policymakers do not seek to nationalize or appropriate those communication mechanisms created by private parties. They do not even seek to control the data itself. Instead, they are declaring a global common interest in acquiring copies of that data and access to the data streams in order to create "early warning" mechanisms that can help regulators and international policymakers prevent new crises.[29] In modern democratic societies with access to 3G networks, XBRL

[29] See London Communiqué at ¶ 15 (cited in note 3) ("In particular, we agree . . . that the FSB should collaborate with the IMF to provide early warning of macroeconomic risks and the actions

technology,[30] fiber optic cables and social media, pressures to make more information available publicly will also increase. Jurisdiction over that data is unlikely to lose its territorial nexus in the short run.[31] Thus, the global commons interest is likely to emerge with respect to the full stream of anonymous transactions data designed to protect individual privacy and proprietary secrets while increasing market transparency.[32]

Such data collection and sharing currently occurs in a more limited manner within the IMF and the BIS, and this has been the case for decades. The novelty here is that the G20 seeks to increase the scale and scope of information gathering and sharing in two ways. First, it is empowering the IMF to provide policymakers with "early warning"[33] mechanisms so that crises can be averted going forward. Second, it is endorsing the creation of "colleges of regulators"[34]

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needed to address them; to reshape our regulatory systems so that our authorities are able to identify and take account of macro-prudential risks; to extend regulation and oversight to all systemically important financial institutions, instruments, and markets . . ."). None of these mandates can be implemented without substantial and new data streams flowing into financial regulators, the FSB, and the IMF. In addition, a broad range of regulatory proposals in the US and the EU would also significantly expand the kind of market data provided to national regulators responsible for oversight of hedge funds, private equity funds, and derivatives dealers.

30 See, for example, *An Introduction to XBRL*, online at www.xbrl.org (visited Nov 21, 2009). XBRL stands for eXtensible Business Reporting Language. It creates identifying tags for individual data points, which are computer readable. It "enables automated processing of business information by computer software, cutting out laborious and costly processes of manual re-entry and comparison. Computers can treat XBRL data 'intelligently': they can recognize the information in a XBRL document, select it, analyse it, store it, exchange it with other computers and present it automatically in a variety of ways for users. XBRL greatly increases the speed of handling of financial data, reduces the chance of error and permits automatic checking of information" by anyone with the technology, including individual investors, analysts and financial regulators.

31 See Asaad Siddiqi, Welcome to the City of Bytes? An Assessment of the Traditional Methods Employed in the International Application of Jurisdiction over Internet Activities—Including a Critique of Suggested Approaches, 14 NY Intl L Rev 43, 104 (2001) ("the traditional territorial jurisdiction approaches will indeed survive the internet's exponential growth.").

32 See Pittsburgh Progress Report at ¶ 29 (cited in note 24) ("The use of macro-prudential tools will require that authorities expand data collection on the financial system. The IMF and FSB have launched a joint initiative to identify and address data gaps and will submit a report outlining priorities and work plans to G20 Finance Ministers and Central Bank Governors in November."). See also id at ¶ 28 ("Aside from the work to address procyclicality noted elsewhere, the FSB and its members are developing quantitative tools to monitor and assess the build-up of macro-prudential risks in the financial system. These tools aim to improve the identification and assessment of systemically significant components of the financial sector and the assessment of how risks evolve over time.").

33 See id at ¶ 4 ("The initial 'dry run' Early Warning Exercise (EWE) was presented to the International Monetary and Financial Committee (IMFC) meeting in Washington on 15 April 2009. The next iteration of the EWE will be jointly presented to the IMFC meeting in October.").

34 See id at ¶ 6 ("Supervisory colleges have now been established for more than thirty large complex financial institutions identified by the FSF as needing college arrangements. The FSB Standing

so that regulators can meet and share information with respect to specific financial intermediaries in an effort to identify systemic vulnerabilities. None of these functions can occur without the creation of substantially broader common data reporting and substantially expanded data sharing arrangements across borders.

This does not mean to suggest that the data sharing process is easy. Crafting protocols for generating apples-to-apples data sets is laborious and tedious. Even when technically sound methods for generating globally consistent data sets can be crafted, they inevitably involve significant costs associated with changing IT structures and/or requiring all reporting entities to generate new data fields and reporting streams. In some instances, major differences in legal and political cultures can create serious impediments to crafting globally agreed upon standards, particularly in the real estate sector where countries in the civil law tradition rely on land registries to collect data on mortgage markets in substantially different ways than common law countries where mortgages are specific as to both property and person.[35] As difficult and costly as the process may be, the G20 and its constituent parts are firmly committed to increasing and enhancing global data collection.

At what point do global political activities coalesce into actual international law? This issue has troubled scholars for centuries. The process of customary law evolving into positive, codified law has been eloquently described by John Chipman Gray as follows:

> Just as in the history of particular societies there are periods when the differentiation between law and morality is in the process of becoming rather than actually being realized—periods when a something which is to become positive law is being slowly differentiated from positive morality—so in relation to the society of nations today there is a body of rules in which a distinction is being established and developed between rules which must be obeyed, if certain penalties are not to be incurred, and rules which are merely the expression of international comity and good will. Rules of the former class . . . are law in becoming—law struggling for existence, struggling to make itself good . . . If the nations who have united to establish the [the International Court of Justice] unite to declare that they will join in carrying out its decrees by force, if necessary, then the rules will

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Committee on Supervisory and Regulatory Cooperation, working with standard setters to set out good practices among supervisory colleges, will report to the G20 ahead of the Finance Ministers and Governors meeting (November 7–8, 2009).'").

[35] I am indebted to Ted Truman for reminding me of the difficulties and costs associated with effecting these kinds of changes. In addition to his experience in this area with the BIS Euro-Currency Standing Committee (now the Committee on the Global Financial System), I have had personal experience in crafting common data sets and collection processes when working with financial engineers to craft and participate in the Quantitative Impact Surveys that formed the basis for the Basel 2 regulatory capital framework.

> become Law in the strictest sense and each of the nations parties to the establishment of the court will have legal rights and legal duties.[36]

Custom has nonetheless been accepted as a basis for international law in the Statute of the International Court of Justice.[37] It has been described as:

> A usage felt by those who follow it to be an obligatory one . . . Evidence that a custom in this sense exists in the international sphere can be found only by examining the practice of states; that is to say, we must look at what states do in their relations with one another and attempt to understand why they do it, and in particular whether they recognize an obligation to adopt a certain course.[38]

The development and use of customary international law is not limited to Western legal systems and can be found in most domestic legal systems around the world, ancient and modern.[39] In the international context, state practice can provide concrete evidence that a given international norm is viewed as having domestic effect, in addition to treaties and formal domestic legislation.

Two key components merit special attention here. First, customary international law does not require an international enforcement structure—quite the opposite. It relies on local or domestic structures to use local legislation enforcement structures to implement an international standard. Second, the focus is on the implementation conduct of the states, not on the identity of the articulating agent. This is consistent with the evolution of the law of the sea in particular, where international conferences and conventions to articulate standards are a relatively new development. This analogy is particularly useful in the financial context, where the vast majority of global standard setters (in fact, all but the Bank for International Settlements and the Bretton Woods institutions) lack legal personality.[40]

The vantage point of history makes it relatively easy to see the evolution of state practice in the law of the sea context. States increasingly had an interest in

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36 John C. Gray, *The Nature and Sources of Law* 131–32 (Gaunt 2d ed 2000).

37 Statute of the International Court of Justice (1945), Art 38, 59 Stat 1055 (stating that the Court shall apply international custom, as evidence of a general practice accepted as law).

38 Brierly, *Law of Nations* at 59–60 (cited in note 6).

39 Alan Watson, *The Evolution of Law* 43–44 (Johns Hopkins 1985) ("Customary law is not all of a piece. It operates, for example, among wandering small groups, temporarily settled tribes, rather small permanent communities, and so on right into economically developed modern Western societies where there is also much status law."). See also, John P. Dawson, *The Oracles of the Law* (Michigan 1968).

40 The EU in this context is not an "international standard setter." It does have a limited international legal personality, but in this context it is more directly analogous to national legislators and regulators because EU Member States retain many sovereign functions particularly at the global level. For example, the EU is an equal member of the G20 together with its larger Member States, but it does not have a voting seat at the IMF or the Basel Committee.

abiding by and enforcing common standards in the interest of letting commerce flow. It was relatively straightforward to obtain official endorsement of an international standard because the rise of the administrative state had not yet expanded the scope of instrumentalities and agents authorized to act for the state in some capacity.

The situation in finance is more muddled. Global financial supervisory standards emerge after closed discussions among regulators that represent the supervisory interests of their Home jurisdiction. It is unclear whether all participants in the process are authorized to bind their respective nation-state during global negotiations. For example, in the US, the Constitution grants the authority to enter into international agreements to the executive branch,[41] and not all financial regulators are part of executive branch agencies.[42] Moreover, all financial regulators are prohibited from applying domestically any global regulatory standards without first going through a public "notice and comment" process.[43] The status of the global regulatory standard-setters themselves could also be fairly called into question, as they have no legal personality.[44] One could also reasonably question whether individual European countries (particularly those within the eurozone and subject to the Maastricht Treaty) have the authority to negotiate international agreements internationally or whether instead the European Commission should represent the EU eurozone Member States in international discussions.

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41 US Const Art II (giving the President the power, by and with the advice and consent of the Senate, to make treaties).

42 The Securities and Exchange Commission and the Commodity Futures Trading Commission are technically part of the Legislative Branch of government and they exercise congressionally delegated authority. The Federal Reserve is a completely independent entity.

43 Administrative Procedures Act, 5 USC § 553 (1946). Note that this is part of the controversy associated with the Basel Committee's new regulatory capital standard for banks (Basel 2). Implementation of a new regulatory capital framework for banks negotiated internationally over a number of years stalled in the US in 2003 in part over allegations that the Federal Reserve and other independent federal banking regulators had inappropriately finalized the regulatory standard without complying with the APA.

44 Norton, 43 Intl Law 175 at 181 (cited in note 23) ("Further, we have no formal international financial regulations notwithstanding an increased need for international collaboration: what we have are international standard-setting and a few evaluation/assessment/enforcement tools . . . . Some even may conjecture that this 'soft' international law/regulation represents an incipient form of global administrative law (GAL). But, at the end of the day, what comes out of the international 'sausage-grinder' still are domestic policies, regulations, and administrative practices, shaped to varying degrees by the GFRNs but to be implemented and enforced by domestic regulators."). See also Daniel K. Tarullo, *Banking on Basel: The Future of International Financial Regulation* 2 (Peterson 2008) (Box 1.1: "The (Basel) Committee has no formal legal existence or permanent staff, and the results of its activities do not have the force of international law."). See also Lawrence Boulle, *The Law of Globalisation* (Bond 2008).

A closer look at the most established global standard-setters in the financial arena demonstrates disparate state practice on the question of whether, for example, the Basel Committee's regulatory capital standards for banks are considered customary international law. In Europe, the Basel standard has been transposed into EU law practically verbatim each time the Basel Committee has issued the standards and its updates.[45] In the US, the original Basel Accord and the subsequent "Specific Risk Amendment" were incorporated into US federal banking regulations.[46] More recent state practice in Europe and the US does not support an argument that the Basel regulatory capital standard specifically represents customary international law. The Basel 2 framework generated opposition from two US federal banking regulators (the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency), significant political opposition articulated through various Congressional hearings and a bill (never passed) designed to deprive the Federal Reserve of the ability to negotiate future international agreements without a formal US position. The new capital framework has not yet been implemented in the US even though it was implemented in Europe in 2006, and it is unclear whether the US will actually implement the new framework.[47]

The US does not seem to be at risk for efforts to compel implementation of Basel 2 based on a customary law argument. International law recognizes the rights of a "persistent objector" to avoid being subject to an emerging rule. This recognition reflects the gradual process by which customary international law evolves, predicated on the practical recognition that not all states will endorse a new standard immediately. In Europe, recent efforts by the European Commission to amend the Capital Requirements Directive (CRD) without

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45 The original Basel Accord was implemented through the Capital Adequacy Directive. The updated Basel 2 framework was implemented through the Capital Requirements Directive ("CRD").

46 12 CFR Part 208(A); 12 CFR Part 208(E); 12 CFR Part 225(A); 12 CFR 225(E) (paraphrased from the statutes). Consider, Board of Governors of the Federal Reserve System, *Application of Market Risk Capital Requirements to Credit Derivatives*, SR 97-18 (June 13, 1997), online at http://www.federalreserve.gov/boarddocs/srletters/1997/sr9718.htm (visited Nov 21, 2009). This letter provides a good history of the US implementation history for the Basel Committee's regulatory capital requirements and the application of those requirements to a then expanding universe of financial instruments. It also provides guidance on how credit derivatives held in the trading account should be treated under the market risk capital requirements by state member banks and bank holding companies.

47 The US banking regulators have committed to implement Basel 2 in the past, and the G20 leaders included a commitment to implement Basel 2. However, the G20 leaders also agreed to create a global leverage ratio which establishes an alternative minimum standard for setting regulatory capital independent of all risks present on a bank's balance sheet except traditional leverage. These two regulatory capital frameworks are therefore conceptually at odds with each other and it is unclear whether both can be implemented as minimum capital standards.

waiting for global consensus to emerge on the details suggests strongly that the Basel Committee standard increasingly is not viewed as customary international law, even among its strongest supporters in the EU.

These considerations enhance the importance of the G20's actions when seeking to determine whether certain standards are considered customary international law. As Brierly noted decades ago, "it is possible even today for new customs to develop and to win acceptance as law when the need is sufficiently clear and urgent."[48] The need to move forward quickly with internationally agreed normative standards that can deliver stability to the financial system drives G20 heads of state and governments to empower the Financial Stability Board, the International Monetary Fund (IMF) and the Bank of International Settlements (BIS) to generate standards and then assess implementation against those standards. Important constitutional differences among these entities generally and between the IMF and the BIS are discussed in greater detail in Section V below.

Importantly, the G20 is creating a process by which standards articulated by informal groups that have no legal personality (for example, Financial Stability Board (FSB); Basel Committee; International Organization of Securities Commissions) are recognized and applied, if not "ratified," by formal, treaty-based international organizations (IMF; BIS) and political groups (G20). This adds a layer of legitimacy to the informal global normative process and provides positive evidence of the intent to rely on the standards generated by the global policy groups as binding international law. It does not, however, create a common enforcement mechanism.

The structure here is important, albeit convoluted. The FSB consists of: finance ministries, central banks, and independent financial supervisors from all G20 countries; *plus* the European Central Bank, the European Commission, the IMF, the World Bank, the Organization for Economic Cooperation and Development (OECD), and the BIS; *plus* the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the BIS's Committee on the Global Financial System, the International Accounting Standards Board, and the International Association of Insurance Supervisors.[49] This collection of entities includes a private sector group (IASB), two BIS committees in addition to the BIS itself, and national authorities.

One could reasonably question whether a group of this size with substantially different internal mandates and priorities is capable of reaching solid decisions. The author's experience in working with very large and political

48 Brierly, *Law of Nations* at 62 (cited in note 6).

49 See *Links to FSB Members,* online at http://www.financialstabilityboard.org/members/links.htm (visited Nov 21, 2009) (listing all the members, including those cited).

groups suggests that individual projects will be handed to a small group of "experts" whose conclusions will be endorsed by the broader political group. While this is a pragmatic way to address difficult technical issues within large groups, it suggests that the global decision-making process regarding individual issues could become more difficult to track and potentially less transparent over time. It will also increase the pressure on the "informal" global standard setters such as the Basel Committee to deliver standards that can be implemented and enforced consistently at the national level. Political endorsement by the G20 may provide an elegant way to achieve this goal short of long-running treaty negotiations, thus avoiding some of the political pitfalls that emerged in the process of trying to codify the law of the sea.

The G20 has specifically mandated that "the FSB should collaborate with the IMF to provide early warning of macroeconomic and financial risks and the actions needed to address them."[50] In other words, the G20 is creating a path by which informal standards can gain the force of law by incorporating the work of informal bodies into formal treaty-based entities with real authority to act at the global level.

We are watching the development of customary international law proceed at a pace rarely seen before in history. Regardless of the view on the underlying substantive standards that are emerging, the process itself is impressive. The question then becomes: how are those standards enforced? As has been noted, "many treaties and other international declarations are merely empty promises if nations do not actually enforce them."[51]

III. SEALING WAX

Customary practice and gentlemen's agreements function only up to a point. In any given group, some parties will always seek to push the envelope of acceptable behavior while others will overtly disregard norms and violate agreed standards for personal or political gain. This dynamic exists also in the international law context. Dispute avoidance and dispute resolution are key reasons for attempting the arduous process of negotiating an international agreement or treaty. It becomes unavoidable when cross-border enforcement issues start generating friction.

Again, the law of the sea provides informative guideposts. By the mid–twentieth century, coastal states sought to exert greater economic rights over their contiguous sea areas even as technological developments were stretching

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50 London Communiqué at ¶ 15 (cited in note 3).

51 John O. McGinnis, The Comparative Disadvantage of Customary International Law, 30 Harv J L & Pub Pol 7, 10 (2006).

these states' effective boundaries above and below the water level. Harnessing the early twentieth century optimism regarding global treaty-making processes, the global community then embarked on a series of conventions to codify the customary law of the sea into treaty-based law with clear allocations of rights and responsibilities as well as dispute resolution standards for states to adjudicate differences of opinion.[52]

Early efforts at codification, including the UN Convention on the Law of the Sea I and the UN Convention on the Law of the Sea II, were relatively uncontroversial. They undertook to translate old-fashioned understandings of the territorial sea doctrine—delimited traditionally by the distance that a cannon ball could travel—into modern quantifiable standards (territorial sea = three miles from shore). Difficulties began in earnest with the third convention, the UNCLOS III, which pushed the boundaries beyond accepted custom. UNCLOS III attempts to establish a new international tribunal separate from the International Court of Justice to hear disputes among ratifying parties. It also seeks to create a new mechanism for sharing economic wealth gathered from the deep-sea bed, with a new international administrative body and adjudicative system. The US still has not ratified the treaty, and it is unclear when ratification might occur, especially since increased potential economic resources may now be available under the Arctic Sea.

The experience here is a mixed bag for the G20 and the financial world. On the one hand, greater clarity and precision in the terms of the law of the sea have on average decreased disputes and ensured free passage of vessels and trade. Updated understandings of relative rights and responsibilities with respect to contiguous areas and the continental shelf have also minimized the potential for disputes. However, the controversies associated with extending the treaties to cover issues not yet settled by customary law generate cautionary lessons for those anxious to proceed quickly to formal international agreements in the financial area.

The need for greater clarity on rights and responsibilities in the cross-border financial sector is clear, particularly with respect to failed institutions. The failure of large cross-border financial firms generates challenges for national regulators. Local retail depositors and/or customers will seek recompense from their local or national authorities, not the Home country. Local policymakers are

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52 See Brierly, *Law of Nations* at 207 (cited in note 6) (noting that, in 1945, the Truman proclamations concerning the continental shelf and the conservation of fisheries had a distinctly unsettling effect on state practice in regard to coastal waters). A basic description of the UNCLOS history and ratification status can be found online at www.continentalshelf.org (visited Nov 21, 2009).

very aware that "unhappy depositors are unhappy voters."[53] National treasuries must bear the fiscal burden of a significant financial bailout, which tends to dictate tax and borrowing policies for many years to come. The counterparties of the failed financial firm potentially face serious shortfalls, as the failed institution cannot meet its pre-agreed contractual commitments. Further, corporate clients of the firm face constrained access to credit (and constrained financial job creation and economic growth). Finally, all market participants face significantly increased legal and political risk as payment on the failed firm's contractual obligations becomes subject to the idiosyncratic decisions of a bankruptcy judge and/or local government administrators.

The same underlying issues that stalled the law of the sea treaty are likely to generate the same significant challenges and controversy in the financial market context today of sovereignty and burden sharing. National governments are unlikely to want to cede authority over their local capital markets to foreign or international tribunals, particularly if the non-domestic entity is likely to take decisions that could have a significant adverse impact on the national fiscal accounts. UNCLOS III has foundered in the US due to the delegation of authority afforded to the tribunal created to settle disputes, particularly those with respect to the redistributive economic rights associated with the deep-sea bed.

Similar issues hover around the G20 process today, making it unlikely that formal arrangements for dispute resolution and financial regulation administration will emerge quickly. Two key categories of issues, burden sharing/dispute resolution and cross-border regulatory authority, demonstrate the challenge associated with formalizing enforcement standards in the finance context, particularly before the underlying normative standards have been agreed.

A. Burden Sharing and Dispute Resolution

Burden sharing and dispute resolution are not new issues for international bankers.[54] While the scale of the problem currently before us is unprecedented,

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[53] Barbara C. Matthews, The Second Banking Directive: Short-term Choices and Long-Term Goals, 2 Duke J Comp Intl L 89, 118 (1992).

[54] The challenge of cross-border insolvency is also familiar to corporations involved in international business. Banks present special challenges and so they are the focus of the present article. For a review of issues that can arise with respect to cross-border insolvencies for non-financial entities, see Paul J. Omar, *Insolvency Laws: An Anglo-French Comparison*, 39 Intl Law 107 (2005) (examining the rules in France and the UK). For a US-EU comparative assessment, see Jonathon L. Howell, *International Insolvency Law*, 42 Intl Law 113 (2008) (discussing international insolvencies, Section 304 of the Code, the development of a unified insolvency doctrine, the Model Law, and the European Insolvency Regulation, and the recently enacted Chapter 15).

policymakers and bankers have seen this problem in the recent past.[55] Not only did they have Bank Herstatt to unwind in the 1970s, but the Latin American debt crisis generated the largest bank failures of its day (notably, Continental Bank). More recently, the closure of the criminal Bank of Credit and Commerce International (BCCI) in London generated policy debate on the urgent need for an international insolvency regime for large global banks.[56] Nothing was done.

In the current crisis alone, financial firms in Iceland, Germany (IKB; Sachsen), the UK (Lloyds Bank; Northern Rock; Royal Bank of Scotland) and the US (most notably, Bear Stearns, Lehman Brothers, and AIG) have all failed or have been taken over by Home state governments to forestall catastrophic financial system failure. In addition, a mutual fund administered by a French bank (BNP Paribas) failed and the bank halted trading in its shares at the beginning of the crisis in August 2007. The ripple effects across financial market counterparties, corporate clients, and retail customers have been significant. This Section discusses the cross-border impact of financial firms' failures on customers and governments.

Affected customers routinely and appropriately seek restitution from governments for their losses when financial institutions of all kinds (not just banks) fail. They have varying degrees of success. Success is usually strongly correlated with the availability of any residual cash or assets left inside their domestic jurisdiction. Can depositors, investors, and customers obtain restitution from foreign governments/regulatory authorities or parent entities abroad after a financial firm has collapsed? This issue is currently being litigated in two different contexts.

First, Spanish investors have also sought (unsuccessfully so far) restitution from the US for losses resulting from investment with scam artist Bernard Madoff. Some negotiated solution is possible. Fraud-based enforcement actions

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55 For a good summary of this history, see Lawrence Baxter, The Internationalization of Law: The "Complex" Case of Bank Regulation, forthcoming in William Van Caenegem and Mary E. Hiscock, eds, The Internationlisation of Law; Legislating, Decision-Making, Practice and Education (Edward Elgar 2010) (characterizing the emerging pattern of international banking regulation).

56 See *Reducing the Risks of International Insolvency; A Compendium of Work in Progress* (Group of Thirty 2000) (noting that the financial crises of the mid-1990s underscored the need for a global dialogue on the financial stakes presented by cross-border insolvencies). The *Compendium* is intended to be a complete and accurate portrait of the ongoing efforts of major international financial institutions and organizations, both public and private, in the area of insolvency reform. See also *International Insolvencies in the Financial Sector: Study Group Report* (Group of Thirty 1998) (arguing that the Asian financial crisis demonstrated the need for stronger national insolvency laws and heightened awareness of the dangers of cross-border insolvency). This report examines the issues surrounding cross-border insolvency in the financial sector, and makes recommendations for regulators, administrators, legislators and financial firms.

against other hedge funds and investment funds in the US may generate increased interest by investors to seek restitution as well.

Second, in the case of the Lehman Brothers failure, payouts will be assessed by the judicial system because the firm entered into bankruptcy administration in September 2008 in two different jurisdictions: New York and London. Administration procedures will continue for years as the two relevant bankruptcy courts attempt to sort out which contractual obligations will be paid in which geographical location from which pools of assets. The conflicts of law discipline will doubtless be stretched in the process.

Regardless of which authorities ultimately are responsible for paying claims, the point remains the same: national treasuries and central banks remain responsible for maintaining financial system stability and ensuring that key counterparties and customers do not bear the burden of a financial firm's failure. It is a tall order with significant implications for taxation and public debt overhangs. These are profoundly political decisions taken by national authorities knowing full well that unhappy depositors make unhappy voters.

Devising a cross-border dispute and insolvency resolution system that generates certainty of outcome for financial market participants (including consumers) while respecting national sovereign priorities to protect taxpayer funds is proving to be challenging at best. Therefore, while a cross-border resolution authority solution would be desirable, it seems highly unlikely to evolve either as custom or more formal arrangements in the near future at the global level. As noted in note 25, the G20 itself seeks to mandate private sector solutions with the hope of minimizing the risk of fiscal payouts and bailouts in the future.

The unique cross-border nature of the EU[57] makes it conceptually possible for policymakers to consider crafting a joint burden-sharing framework, at least with respect to financial firms headquartered in the eurozone. Policymakers in Brussels made this issue a priority following the onset of the financial crisis in 2007,[58] but progress has stalled. EU member states are reluctant to make

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57 For a good description of the overlapping and unique legal authorities created within the EU structure (and their implications for international engagements), see Charles T. Kotuby, Jr, *External Competence of the European Community in the Hague Conference on Private International Law: Community Harmonization and Worldwide Unification*, 15 NY Intl L Rev 99 (2002) (addressing the new Community competence stemming from Articles 61 and 65, and the approach that the Community has taken to utilize conflict of law as an integrating tool).

58 In October 2007, EU finance ministers and central bank governors sitting in Council formation agreed to negotiate amongst themselves a Memorandum of Understanding ("MoU") that would include, among other things, "common practical guidelines for crisis management to reflect a common understanding of the steps and procedures that need to be taken in a cross-border situation." They also identified in Annex I "Common Principles for Cross-Border Financial Crisis Management." Council of the European Union press release 13571/01 (Luxembourg, Oct 9,

commitments to bail out depositors or counterparties in other countries ex ante, particularly when the full scale of potential liabilities is unknown and while the public finances in EU member states continue to deteriorate.

Two commentators recently proposed the creation of a temporary EU-level authority to facilitate disposition and administration of toxic assets from European bank balance sheets. The proposal is far less ambitious than establishing a permanent process for resolving cross-border insolvencies. And yet it is not gaining much political traction since the establishment of such an entity as proposed would require that the EU-level authority hold "bank equity and other assets purchased by national governments in the restructurings on account for them." It would also contemplate ex ante capital allocation agreements among state participants and greater transparency about the State's own banking systems. [59]

If the EU cannot make arrangements to share the financial burden across borders when they have pre-existing treaty obligations to share sovereignty and support a common currency,[60] how can the more loosely organized G20 create burden-sharing mechanisms? Some possible emerging tools are discussed in the last Section of this article.

B. Cross-Border Regulatory Authority

A basic tenet of international law is that a nation-state's jurisdiction and authority are located in its territory. This authority cannot be exercised beyond its territory without impinging on the rights and obligations of other nation-states. However, the world is more complex than this principle suggests. As noted, the law of the sea delineates the many places where a coastal state's authority may extend beyond its three-mile territorial sea. The main areas where jurisdiction expands beyond the territory relate to economic interests above, within, and below the sea as well as with respect to foreign flag vessels seeking to navigate, dock, and undertake commerce with the coastal state. With respect to the latter category, Host state jurisdictional overrides can be justified based on the need to protect the local populace and to respect local territorial authority.

2007). The text of the MoU is not publicly available. However, a March 2009 presentation by an IMF staff member available publicly concludes that the "MoU and ECOFIN crisis management principles not of obvious help" in addressing cross-border resolution issues. The presentation is available online at www.imf.org/external/np/seminars/eng/2009/eurfin/pdf/fontey.pdf (visited Nov 21, 2009). One likely source of weakness: relative responsibilities for allocating fiscal burdens are not spelled out in the publicly available Council documents.

59 Adam S. Posen and Nicolas Veron, *A Solution for Europe's Banking Problem*, Peterson Institute Policy Brief PB09-136, 8 (June 2009).

60 See, for example, Treaty of Rome, 298 UN Treaty Ser 11 (1957); Maastricht Treaty, 31 ILM 247 (1992).

As noted earlier in this Article, international supervisory bodies were created over the last thirty years to facilitate cross-border coordination and cooperation among financial regulators. The increased rate and significance of cross-border financial flows across the Atlantic Ocean,[61] passage of the Sarbanes-Oxley Act during the early part of this decade,[62] and the aggressive use of "equivalency" requirements by the EU for access to European capital markets,[63] created an intense political debate about whether and how Home country supervisors could conduct onsite or other inspections beyond the territorial limits of the Home state. For the past decade, financial supervisors particularly at the transatlantic level have been struggling with how to safeguard their local systems knowing that they must rely on other supervisors for daily oversight of increasingly complex financial activities and risk exposures.[64] This has generated debate over regulatory jurisdiction and authority, with the terms "mutual recognition,"[65] "equivalence,"[66] "substituted compliance,"[67] and

61 See Daniel S. Hamilton and Joseph P. Quinlan, eds, *Deep Integration: How Transatlantic Markets are Leading Globalization* (Johns Hopkins and the Centre for European Policy Studies 2005). See in particular Chapter 9 on the transatlantic regulatory policy debates during the earlier pre-crisis part of this decade.

62 Id at 126 (the issue regarding auditor oversight results from the passage of the Sarbanes-Oxley Act in the US).

63 Id at 126–27 (discussing various equivalence agreements). See also Directive 2004/109/EC, Art 23(4), OJ L390/38 (Dec 31, 2004) (requiring the European Commission to determine whether non-EU accounting standards are "equivalent" to EU standards created in that directive. Failure to issue an equivalence determination results in securities offered by companies in non-conforming countries to be barred from the EU after a transition period.).

64 The US-EU Economic Relationship: What Comes Next?, Hearing before the US House of Representatives Financial Services Committee, Domestic & International Subcommittee (June 8, 2005) (this hearing will allow the members of the subcommittee to hear from industry witnesses in highlighting areas of improvement needed in the US-EU dialogue in trade convergence and access to capital); The US-EU Regulatory Dialogue: The Private Sector Perspective, Hearing before the US House of Representatives Financial Services Committee, Domestic & International Subcommittee (June 17, 2004) (hearing from those who are not official parties to the dialogue between financial regulators on both sides of the Atlantic); The US-EU Regulatory Dialogue and its Future, Hearing before the US House of Representatives Committee on Financial Services (May 13, 2004) (evaluating the US-EU dialogue on the EU's financial services action plan and its implications for America's financial services industry over the past two years).

65 Mutual recognition in the EU prohibits Member States from barring entry/free passage of goods of services produced in another EU member state so long as the goods or services were produced lawfully in the Home State, even if those Home laws are different and generate technically different goods and services than might otherwise be permitted in the receiving Host state. See EU Council Resolution of Oct 28 1999 on Mutual Recognition, OJ C141 (May 5, 2000).

66 Directive 2003/71/EC of the European Parliament and of the Council (Nov 4, 2003) (amending Directive 2001/34/EC, Art 20) (on the prospectus to be published when securities are offered to the public or admitted to trading); Commission Regulation (EC) No 809/2004 (Apr 29, 2004) (implementing Directive 2003/71/EC of the European Parliament and of the Council as regards

"extraterritoriality" thrown around with increasing abandon. In all cases, regulatory authorities seek to define areas where it might be appropriate to rely on foreign supervisory authorities without giving away too much sovereignty or rights of action.

The current financial crisis has not eliminated this debate; it has only pushed the debate to the background. In part, this reflects political pragmatism. Regulators in Europe and the US realize they cannot seek to rely on foreign regulatory regimes when confidence in all regulatory regimes is at an all time low, and for good reason. With the possible exception of Canada, no major financial services regulatory system has covered itself in glory.

In Germany, regulators missed growing concentrations of risk and risk management failures at IKB and Sachsen. In the UK, the new and hyper-sophisticated Financial Services Authority (FSA) missed a most basic problem at Northern Rock, namely mismatched maturities between assets and liabilities. The FSA also failed to exercise adequate supervision over the London subsidiary of AIG, which stood at the epicenter of the credit derivatives business. In France, supervisors, compliance officers, and external auditors failed to detect the fraudulent trades conducted by a rogue trader. The positions taken by the trader were of such magnitude that their unwinding had a direct impact on monetary policy decisions made by the Federal Reserve. In the US, all regulatory

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information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements); Directive 2004/109/EC of the European Parliament and of the Council (Dec 15, 2004) (on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC). These legislative texts permit foreign firms to use the EU prospectuses and other disclosures and offering documents if the European Commission and the EU-level regulatory committees such as the Committee of European Securities Regulators ("CESR") determine that such foreign standards are "equivalent" to those established at EU level. The resulting "equivalence determinations" have evolved into highly developed political theater, especially at the transatlantic level. A good example of how convoluted the "equivalence determinations" can become can be found online at www.cesr.eu/popup2.php?id=3481 (visited Nov 21, 2009). Committee of European Securities Regulators, Technical Advice on Equivalence of Certain Third Country GAAP and on Description of Certain Third Countries Mechanisms of Enforcement of Financial Information, CESR/05-230 b (June 2005), online at www.cesr.eu/popup2.php?id=3481 (visited Nov 21, 2009) (holding that certain countries GAAPs are equivalent to IFRS subject to certain requirements).

[67] Howell E. Jackson, *A System of Selective Substitute Compliance*, 48 Harv Intl L J 105 (2007) (examining the Tafara and Peterson Framework); Ethiopis Tafara and Robert J. Peterson, *A Blueprint for Cross-border Access to US Investors: A New International Framework*, 48 Harv Intl L J 31 (2007) (proposing a new framework to apply foreign financial service providers accessing the US capital market). As a practical matter, substituted compliance and mutual recognition generate the same outcome: free entry of foreign items without compliance with local law. The difference is that substituted compliance contemplates that the receiving state reserves the right to require domestic compliance in the event that the sending state fails to exercise appropriate oversight and require compliance at Home.

agencies at the federal and state levels failed to detect major defects in risk management systems and underwriting practices across all parts of the financial system: banks, investment banks, broker-dealers, hedge funds, mutual funds, insurance companies, mortgage originators. This is not the time to ask policymakers and politicians to trust another country's regulatory system, particularly when potentially huge sums of taxpayer funds will be used to redress failings in another country's oversight of its financial system.

And yet, devolving to a Host-state dominated paradigm would be disastrous to economic growth. If hard times continue, Host states could find it difficult to resist domestic political pressure to impose burdensome and discriminatory requirements on the local operations of foreign financial firms. The creation of competitive advantages for local firms would likely be offset by a corresponding decrease in competition and availability of finance for a broad range of economic actors.

As noted earlier in this Article, the G20 rejects on paper the potential growth of mercantilist, protectionist, or autarkic systems. Instead, focuses political attention at the technical level by supporting the creation of "colleges" of supervisors that can share information across borders in a confidential manner so as to create "early warning" systems.[68] These informal, ad hoc activities stretch the boundaries of permissible sovereign activity in reciprocal ways. If all regulators share information with each other, then each regulator simultaneously cedes sovereignty in a manner that is evenhanded. Work in this direction was well underway in the EU, the Basel Committee,[69] and IOSCO[70]

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68 Group of Twenty Leaders Communiqué, 5 (Washington DC Nov 2008), online at http://www.g20.org/Documents/g20_summit_declaration.pdf (visited Nov 21, 2009) (the IMF and the FSF should strengthen their collaboration and conduct early warning exercises); EU Economic and Financial Affairs Council ("ECOFIN") Roadmap of December 4, 2007, 12 (inviting Level 3 Committees to monitor the coherence of the practices of different colelges of supervisors); EU Council Conclusions May 4, 2008; Committee of European Banking Supervisors ("CEBS") and Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS"); *Colleges of Supervisors—10 Common Principles* (Jan 27, 2009), online at http://www.ceiops.eu/media/files/publications/standardsandmore/recommendations/CEBS-CEIOPS-IWCFC-10-principles-colleges-of-supervisors.pdf (visited Nov 21, 2009) (ten common principles are presented as relevant for the banking, insurance and financial conglomerates sector regarding the functioning of the Colleges of supervisors).

69 Basel Committee on Banking Supervision, *Results of the 2008 Loss Data Collection Exercise* (July 2009), online at www.bis.org/publ/bcbs160.htm (visited Nov 21, 2009) ("The 2008 Loss Data Collection Exercise (LDCE) is the first international LDCE to collect information on all four data elements that are used in the Advanced Measurement Approach (AMA) for operational risk in the Basel II Framework—internal loss data, external loss data, scenario analysis and business environment and internal control factors (BEICFs).").

70 International Organization of Securities Commissions, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and Exchange of Information*, International Organizations of Securities Commissions (May 2002), online at http://www.sec.gov/about/

before the crisis. These efforts have gained momentum in the year since the 2008 autumn market meltdown. They also provide an additional concrete example of customary state practice and evolving international law regarding the obligations to increase cross-border transparency in the financial sector, at least among official sector parties.

However, these informal arrangements fail to address the enforcement issue. Even with colleges of supervisors, there is little hope that participants will enforce identified weaknesses with vigor. No obligation exists to compel enforcement. Past experience does not engender confidence that such informal gentlemen's agreements will suffice to enforce standards, particularly if the Host country in question does not agree with the standards or would have to provide significant taxpayer funding to resolve the problem.[71] Clarity, predictability, and certainty of outcome are crucial for the smooth functioning of markets. These elements are lacking in a world where ad hoc groupings of regulators can meet in one formation to discuss and agree on action plans with respect to one financial institution, and meet in a separate formation with different participants to discuss a different financial institution. Joint enforcement actions are not likely to work smoothly where the economic impact of a given enforcement action are spread unevenly. More formal mechanisms for joint law enforcement activities (letters rogatory, for example)[72] are not likely to be useful tools because they take years to negotiate and implement. Financial markets require faster action.

Finally, the history of the law of the sea suggests that more formal treaty-based agreements spelling out enforcement jurisdiction and possibly even joint adjudication procedures are highly unlikely to evolve. Another, more basic, consideration also militates against treaty-based arrangements in these areas. Financial supervision is the purview of largely independent regulators, finance ministries, and sometimes central banks. If formal international agreements or

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offices/oia/oia_bilateral/iosco.pdf (visited Nov 21, 2009). This instrument has its roots in facilitating mutual legal assistance following the September 11, 2001 attacks on the US.

71 To provide a sense of scale, the European Commission estimates that the amount of state support to European banks between October 2008 and July 2009 that has *so far* been approved by the Commission's competition regulator amounts to one-third of GDP for the entire EU. This amount is split between 313 billion Euros in direct capital injections and 2.9 trillion Euros in guarantees. At the individual country level in states hardest hit by the crisis, the proportion is more staggering. For example, Ireland's support for its banking sector represents 231.8 percent of GDP.

72 A "letter rogatory" is "a formal request from a court in which an action is pending, to a foreign court to perform some judicial act . . . in United States usage, letters rogatory have been commonly utilized only for the purpose of obtaining evidence." 22 CFR Part 92, § 92.54 ("'Letters rogatory' defined"), online at http://edocket.access.gpo.gov/cfr_2006/aprqtr/pdf/22cfr92.54.pdf (visited Nov 21, 2009).

treaties are to be negotiated either bilaterally or multilaterally, each nation's diplomatic service will likely take over the negotiations, which could last years. Neither financial market participants nor the affected finance ministries and regulators have an incentive to cede negotiating authority to non-specialists that might not appreciate key structural differences between financial institutions and sectors across jurisdictions and might therefore undertake political horse-trading with respect to arcane regulatory policy concepts.

If reaching agreement on enforcement matters is so difficult, one might reasonably question whether formality is really required. Can the financial system continue to function with customary international law evolving over time as the needs of the market and sovereigns evolve (even during a crisis)? In the short-run, the answer is probably yes, largely because there is no choice. However, in the longer run the inevitable trajectory is towards formality and codification.[73] This Article suggests the glide path is clear. The IMF has the potential to evolve into an enforcement agent at least with respect to data collection and global systemic risk detection; the technical global standard-setters are evolving into articulators of customary international law norms.

IV. CABBAGES

Over the last twenty years, a relatively quiet revolution has occurred in the way that risks are intermediated. That revolution has been global, and has challenged the ability of all financial regulators to keep pace and to exercise their jurisdiction.[74] Financial instruments designed thousands of years ago to help farmers hedge their agricultural commodity risk have been turbo-charged by computing and telecommunications technology.[75] The structure and mathematics supporting modern finance may be complex and flawed. This is not the place to describe in detail the evident flaws in risk management, risk modeling, asset valuation, and underwriting. For purposes of this Article, it is sufficient merely to note that modern risk management and modeling have

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73 See McGinnis, 30 Harv J L & Pub Pol 7 (2006) (cited in note 51).

74 See Group of Thirty: Study Group on Supervision and Regulation, *Global Institutions, National Supervision and Systemic Risk* (Group of Thirty 1997) (the threat of serious disruption to the international financial system is small, but is nonetheless a serious concern).

75 See Roger Lowenstein, *When Genius Failed: The Rise and Fall of Long-Term Capital Management* 233 (Random House 2000) ("Long-Term put supreme trust in diversification—one of the shibboleths of modern investment, but an overrated one. As Keynes noted, one bet soundly considered is preferable to many poorly understood."). Consider Peter L. Bernstein, *Against the Gods: The Remarkable Story of Risk* (Wiley & Sons 1996); Gregory J. Millman, *The Vandal's Crown: How Rebel Currency Traders Overthrew the World's Central Banks* (Simon & Schuster 1995).

permitted formerly illiquid credit risk to become traded.[76] The G20 seeks to find ways to constrain but not eliminate this activity.

Creating a world in which credit can be and is traded across borders creates a web of interrelationships among a broad range of economic actors that no global policy group can untangle without unleashing additional volatility and damage into the financial system. Financial market participants trade credit derivatives alongside other derivatives, debt securities, and equity securities at a scale and with a speed that is difficult to appreciate. Trading houses compete with each other regarding the placement of their servers in relation to the servers at exchanges in order to shave off *nanoseconds* from execution times. These transactions link globally disparate counterparties together not just as counterparties but also as individuals with a stake in the resilience of the system.

The growth of global commerce, denominated in dollars, has also generated significant counterparty credit exposures through trading channels that do not rely on derivatives. Currently, the vast majority of global trade is invoiced in US dollars so that the companies involved in the transaction do not have to assume the cross-currency risk of exchange rate fluctuations between the time that goods are purchased and delivered. Banks that underwrite those transactions thus acquire dollar obligations. In order to fund their dollar-based business, BIS research has shown that European banks became major purchases of US money market mutual fund (MMMF) assets.[77] This is a key example of credit support activities being conducted through trading channels, rather than those of traditional banking. It is a key support function for the global supply chain, and is part of the so-called "shadow banking system." It was not well understood until 2008 that such exposures could be subject to payment interruption similar to those experienced by market participants when Bank Herstatt failed to pay its foreign exchange rate obligations in New York in the early 1970s.

The G20 policymakers recognize that disentangling the web of interrelationships is inadvisable. Their action plan (as with the action plans in various member countries, including the US, and other jurisdictions, like the

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[76] See John B. Caouette, Edward I. Alman, and Paul Narayanan, *Managing Credit Risk: The Next Great Financial Challenge* 354 (Wiley & Sons 1998); Michael K. Ong, *Credit Ratings: Methodologies, Rationale and Default Risk* (RISK 2002); Dwight B. Crane, et al, *The Global Financial System: A Functional Perspective*, 108-109 (Harvard Bus 1995). Consider Michael K. Ong, *Internal Credit Risk Models: Capital Allocation and Performance Measurement* (RISK 1999); *Credit Derivatives: Key Issues* (British Bankers 1997).

[77] Nachiko Baba, Robert McCauley, and Srichander Ramaswamy, *US Dollar Money Market Funds and Non-US Banks*, BIS Quarterly Review 65–70 (March 2009). Patrick McGuire and Gotz von Peter, *The US Dollar Shortage in Global Banking and the International Policy Response* (BIS Working Paper No 291) (October 2009) (discussing European banks' need for US dollar funding), online at www.bis.org/publ/work291.htm (visited Nov 21, 2009).

EU) seeks merely to make a derivative space function with more safeguards and limits. Increased capital requirements for banks and other intermediaries, centralized counterparty clearing arrangements, limitations on large order block execution in so-called "dark pools" and on hedge fund activities, and potential bans on flash trading and short selling (to name but a few of the policy initiatives underway) will change the structure and flexibility of the financial system going forward. One can debate whether increased rigidity in counterparty relationships and the creation of incentives against knowing one's counterparty and relying instead on a clearinghouse are appropriate ways to strengthen risk management. As noted in this Article, the broader point is that the clearly stated goal of the policymakers is to make the system function better, not to outlaw particular instrument types.

If the G20 keeps to these goals in the months and years ahead, global financial market integration can only increase. The number of internationally active intermediaries will shrink as hard times continue to force out competitors. The number of counterparties technically also will dwindle dramatically as a growing proportion of derivatives transactions are required to clear through a central counterparty and, potentially, be traded on a formal exchange. Replacing bilateral counterparty relationships with central clearing means that each financial firm will have only a handful of bilateral central counterparties for its derivatives transactions. Ironically, efforts to eliminate weaknesses associated with faulty and opaque links among bilateral counterparties will create concentrations of credit exposures at a small number of central clearing locations. It could also have the unintended consequence of decreasing the incentives for financial firms to assess the creditworthiness of their counterparties because their relationship going forward will be predominantly with the central counterparty.

The oversight of this smaller group of large central counterparty institutions with cross-border reach and risk exposures will also fall on a shrinking number of countries that host such sophisticated and centralized trading activities. This can only increase the need for policy coordination and enforcement cooperation. As the number of systemic risk institutions shrinks and as their asset sizes grow, regulators from other countries will want assurances not just about "exit strategies" but also about whether and how enforcement actions will occur.

The potential for cross-border differences of view regarding enforcement is great. This risk will be exacerbated if government ownership and capital support in financial firms continues for extended periods. Such relationships will blur further the line between private sector and public sector interests in financial sector health. Attitudes about the appropriate approach for enforcement actions are highly dependent on the local legal system. For example, the US treats certain violations of banking and securities laws as

criminal offenses. The same is not true in Europe or other parts of the world. Where enforcement actions require extradition for prosecution, conflicts and controversy can emerge. In Europe, policymakers favor negotiated solutions where possible. This can complicate regulatory action, particularly in situations where a financial institution needs to be closed quickly.[78] Increased regulatory interaction among supervisors from different regulatory traditions within the colleges may perversely increase friction over operational differences much as the negotiating history of the UNCLOS treaties increased the acrimony and disdain among the negotiating parties over time. The regulatory and political risks that financial firms must now manage will ironically grow exponentially as a direct consequence of increased global cooperation and communication among regulators.

The need for certainty of outcome will generate market pressure for more formal commonly agreed standards at the international level. Modern experience and controversy regarding UNCLOS' proposed international enforcement mechanisms suggests that evolutionary approaches stand the best chance of garnering real engagement and buy-in across borders rather than top-down approaches agreed at international conferences designed to create binding agreements based on wishful thinking rather than actual practice.

V. KINGS

What kind of enforcement arrangements could G20 leaders devise? As noted, formal treaty-based solutions and global adjudicatory processes are likely to be cumbersome, slow, and controversial to implement. Financial markets move too fast for such instruments to be appropriate or realistic. The first three G20 summits suggest that the outlines of emerging customary practice are in the field of enforcement. Those outlines focus on classically sovereign financial authorities to raise and spend funds and emphasize the one international organization that already has the authority to enforce some standards and agreements globally, the IMF.

Two international organizations exist in the financial arena today: the IMF and the BIS. They bring together global finance ministers (IMF) and central bank governors (BIS) in a global setting, also reinforcing traditional splits between finance ministers and their central banking counterparts. The IMF has a broader mandate and formal authority to imposed sanctions on its Members

78 In the US, banks are closed on Fridays after the close of business by the FDIC and reopened on Mondays so as to minimize disruption in the financial system. No similar structure exists in the EU today. As a consequence, European policymakers are more likely to nationalize or make massive capital infusions into large financial institutions because they have no way of administering a cross-border failure inside Europe.

than the BIS. More importantly, the IMF is a full international organization in which participation is governed by treaty, and so it is the focus of this Section. The BIS has a more convoluted history and more limitations, which make it an unlikely candidate to evolve into a G20 enforcement agent, at least with respect to formal sanctioning powers against sovereign states.

The BIS was created to facilitate cross-border payments between central banks by acting as an agent for participating central banks.[79] Its purpose is to "promote the co-operation of central banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international settlements entrusted to it under agreements with the parties concerned."[80] It has no formal authority to exercise oversight or enforcement actions over member central banks. It is best understood as a forum for central banks to compare notes and effectuate payments.

The BIS was created first by a treaty between the governments of Germany, Belgium, France, the UK, Italy, and Switzerland.[81] The US is not a party to this treaty, nor are the other countries that have subsequently joined the BIS. Instead, the US membership is traced to a parallel "constituent charter" which notes that the US and three private commercial banks contributed the start-up capital for the bank.[82] It operates with many of the attributes of an "international organization" as that term is understood in international law with respect to certain immunities, including tax immunity.[83] But it is not an entity to

79 See Board of Governors of the Federal Reserve System, *Fedpoints*, online at www.newyorkfed.org/aboutthefed (visited Nov 21, 2009) ("Established in 1930 in Basel, Switzerland, the Bank for International Settlements (BIS) is a bank for central banks. It takes deposits from and provides a wide range of services to central banks, and through them, to the international financial system. The BIS also provides a forum for international monetary cooperation, consultation, and information exchange among central bankers; conducts monetary, economic, and financial research, and acts as an agent or trustee for international financial settlements."). Because it operates only as agents for central bank principals, the BIS does not appear to be a major participant in the central bank swap arrangements crafted in 2007 to address the onset of the financial crisis. See Maguire and Peter, *US Dollar Shortage* at 19 (cited in note 77) (showing the central bank network of swap lines).

80 Bank for International Settlements, *Statutes of the Bank for International Settlements*, Art 3 (2003) ("The objects of the Bank are: to promote the co-operation of central banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international financial settlements entrusted to it under agreements with the parties concerned."), online at www.bis.org/about/statut.pdf (visited Nov 21, 2009). The original treaty was crafted in 1930 as the Bank was created to facilitate war reparations payments from Germany to England and France.

81 Convention Respecting the Bank for International Settlements (Jan 20, 1930), online at www.bis.org/about/convention-en.pdf (visited Nov 21, 2009).

82 Constituent Charter of the Bank for International Settlements 3 (Jan 20, 1930), online at www.mnb.hu (visited Nov 21, 2009).

83 Id at 4–5.

which the US holds treaty obligations on par with the other international financial institutions, including the IMF.[84] The US is thus a shareholder in the institution, which was created and remains an agent of the central bank members who contribute to its operations. The remainder of this article thus focuses on the IMF.

The IMF treaty makes clear that the international financial institution is responsible not just for promoting international cooperation, but also for providing, among other things, "the machinery for consultation and collaboration on international monetary problems," for facilitating "the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income," and for shortening "the duration and . . . degree of disequilibrium in the international balances of payments of members."[85] In the event that the IMF provides emergency resources to member countries, the Articles of Agreement entitle it to render opinions on local economic policies and require changes.[86] The IMF also has the authority to request, and member states have the obligation to provide to the IMF, a broad range of economic, financial, and clearing arrangement information for the IMF to assess.[87] The "Article IV"

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84 See United States Department of State, Treaties in Force (Jan 1, 2009), online at www.state.gov/s/l/treaty/treaties/2009/index.htm (visited Nov 21, 2009). The treaties establishing the Bretton Woods international financial institutions are included in that compendium. The documents establishing the BIS are not because those documents are neither international agreements nor treaties.

85 IMF Articles of Agreement, Art 1, online at http://www.imf.org/external/pubs/ft/aa/index.htm (visited Nov 21, 2009). The IMF also famously is responsible for promoting "exchange stability" and maintaining "orderly exchange arrangements among members and to avoid competitive exchange depreciation." Id. The foreign exchange component of its authorities has been the subject of much discussion. The implications are left for another article focused on economics.

86 Id at Art V, Section 2a ("The Fund shall adopt policies on the use of its general resources, including policies on stand-by or similar arrangements, and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund.").

87 Id at Art VIII, Section 5 (The fund may require members to furnish it with such information as it deems necessary for its activities). This authority was recently strengthened and expanded by the IMF Board. See IMF Decision No 13182-(04/10), Jan 30, 2004, as amended by Decision Nos 13814-(06/98), November 15, 2006, 13849-(06-108), Dec 20, 2006 and 14107-(08/38), May 2, 2008 ("IMF VIII expansion"). See also IMF Public Information Notice (PIN) No. 4/10 (February 23, 2004); IMF Public Information Notice 6/95 (August 10, 2006); and IMF Public Information Notice (PIN) No. 08/60 (May 27, 2008) ("In addition, in cases of severe deficiencies and where staff have had to construct key data based on limited information, staff should discuss with the authorities specific and prioritized remedial measures, and should report on this discussion . . . In cases of non-provision of data, most Directors agreed that there should be no delay in implementing the formal procedures specified under the 2004 Decision—including the "letter stage" where management notifies the member of its intention to inform the Board of a

reviews and the IMF's Article VIII ability to compel information from member countries have been interpreted liberally over the years and include voluntary assessments of non-client countries under the "Financial Sector Assessment Program."[88]

The IMF is interpreting liberally its G20 mandate to create mechanisms that would permit it to establish "early warning" systems so that risks cannot in the future build up in the financial system. The IMF warned for years of growing global imbalances that effectively were sending "hot money" from China and the Middle East to the US. The IMF's traditional enforcement mechanisms have focused on establishing conditions for the granting of emerging assistance. This ex post arrangement can create incentive problems and make the IMF ineffective in preventing problems when local national interests do not coincide with IMF recommendations. It also faced the challenge that policy prescriptions appropriate in one context might not fit another country's financial situation.[89] Until recently, it had no authority to compel remedial action from non-borrowers.

The IMF is now crafting a range of mechanisms to compel action by member states, regardless of whether they are borrowing from its facilities. Two merit particularly close attention: Article VIII revisions and the Memoranda of Understanding (MoU).

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breach of obligation—once the criteria for moving to the letter stage are met, namely where the data are not provided and the member appears to have the capacity to provide the data.").

88 See International Monetary Fund, *Financial Sector Assessment Program*, online at www.imf.org/external/NP/fsap/fsap.asp (visited Nov 21, 2009):

> "Resilient, well-regulated financial systems are essential for macroeconomic and financial stability in a world of increased capital flows. The FSAP, a joint IMF and World Bank effort introduced in May 1999, aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. Supported by experts from a range of national agencies and standard-setting bodies, work under the program seeks to identify the strengths and vulnerabilities of a country's financial system; to determine how key sources of risk are being managed; to ascertain the sector's developmental and technical assistance needs; and to help prioritize policy responses. Detailed assessments of observance of relevant financial sector standards and codes, which give rise to Reports on Observance of Standards and Codes (ROSCs) as a by-product, are a key component of the FSAP. The FSAP also forms the basis of Financial System Stability Assessments (FSSAs), in which IMF staff address issues of relevance to IMF surveillance, including risks to macroeconomic stability stemming from the financial sector and the capacity of the sector to absorb macroeconomic shocks."

See also International Monetary Fund, *Factsheet on The Financial Sector Assessment Program* (Sep 29, 2009), online at www.imf.org/external/np/exr/facts/fsap.htm (visited Nov 21, 2009) (the focus of FSAP assessments is twofold: (1) to gauge the stability of the financial sector and (2) to assess its potential contribution to growth and development).

89 See Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery*, 260–87 (Brookings 2003).

A. Article VIII Revisions

The IMF in 2004 updated its information gathering activities and, at the same time, created mechanisms to sanction non-deliver of data from countries. In 2008, the IMF Board (composed of finance ministers from around the world) agreed to expand its access to data concerning the economies of its member states. The decision and its amendments enumerate specific actions the IMF Board is authorized to take if a "member has breached its obligation" to deliver information to the IMF.[90] The ultimate sanctions for a recalcitrant member state are: Board censure,[91] prohibition from accessing IMF funding,[92] suspension of voting rights,[93] and expulsion.[94] It seems only expulsion will generate a public disclosure obligation.[95] Less draconian measures are contemplated for countries that provide "inaccurate information" to the IMF.[96]

The data collection is undertaken so that the IMF can execute its surveillance and enforcement duties with good information. The 2008 expansion was undertaken in order to facilitate IMF oversight of the financial sector in addition to the overall macro-economy.[97] A casual comparison on the data points sought by the IMF indicates significant overlap with the data currently collected by another international organization: the BIS. However, a key difference between the two entities beyond their mandates is that one organization has a pre-existing set of mechanisms to enforce its will upon member states (the IMF) whereas the other (BIS) does not.

This IMF sanctioning mechanism provides a potentially powerful enforcement tool for the IMF. Every time the scope of data delivery obligations expands (as it did in 2008), the scope of the enforcement tool expands as well. Most economists would likely view the 2008 expansions as minor changes

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90 2009 IMF VIII expansion at ¶ 11 (cited in note 87) (direct quotation and paraphrasing).

91 Id (issue a declaration of censure against the member).

92 Id at ¶ 14 (declare the member ineligible to use the general resources of the Fund for its breach).

93 Id at ¶ 15 (recommend that the Fund suspend the member's voting and related rights).

94 2009 IMF VIII expansion at ¶ 16 (initiate proceedings for the compulsory withdrawal of the member from the Fund).

95 Id.

96 See id at ¶ 18.

97 International Monetary Fund, *IMF Executive Board Reviews Progress in Members' Provision of Data to the Fund for Surveillance Purposes*, Public Information Notice (PIN) No. 08/60 (May 27, 2008) ("In view of the increasing importance of data on intersectoral positions and exposures, Directors agreed that high priority should be attached to increasing the number of countries that report monetary and financial data . . . expanding the coverage of financial institutions . . . and introducing additional information . . . for assessing financial sector stability."), online at www.imf.org (visited Nov 21, 2009).

designed to reflect shifting economic and financial realities so that the IMF can fulfill its core mandate more effectively. From an economic perspective, this is probably correct. The data collection mechanism itself is far from perfect. For example, it fails to impose data collection requirements on sovereign wealth funds even though such entities are part of the reporting entities and even though their activities can have a material impact on the parent country's fiscal and monetary policies.

It is not clear whether the enforcement mechanisms have been used. The terms of the IMF's tool specifically contemplated public disclosure only in the event that the last step (expulsion) has been reached. Given that the IMF's own data posted on its website have gaps, it is easy to see that Member States have failed to provide all requested data sets on a timely basis. Some commentators estimate "that member countries holding almost 40% of reported total holdings of foreign exchange reserves decline voluntarily to provide the IMF staff information on the currency composition of their reserve holdings even when the IMF staff has promised to control tightly access to such apparently sensitive information and only report it on an aggregate basis . . . only 64 countries, about a third of the total membership, subscribe to the IMF's Special Data Dissemination Standards . . . another 94 members subscribe to the less-exacting General Data Dissemination Standard. Only 27 members do neither."[98]

Past failure to use all available authorities is not necessarily a guide to future performance here. As noted, the G20 and the various entities that report to it are increasing the scope and scale of their data requests. Access to high quality data relevant to financial sector analyses will be key to the IMF's ability to exercise its new "early warning system" responsibilities in a credible manner. Moreover, the urgency of data collection could increase if economies either continue to deteriorate or fail to deliver robust recoveries.

Therefore, this Article asserts that the IMF may have a strong incentive in the near future to use the more formal sanctions for non-delivery of key data sets. In addition to the institutional interests identified here, the IMF and the Financial Stability Board are making quick strides in defining new data streams that will be collected from sovereigns and market participants.[99] The IMF's ability to exercise its expanded "early warning" authorities allocated to it by the G20 may well depend on its ability to receive and process these new data sets. Under these circumstances, the formal procedures to compel data delivery may

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[98] Edwin M. Truman, *The IMF and Regulatory Challenges* (unpublished article) (on file with the Peterson Institute for International Economics).

[99] *The Financial Crisis and Information Gaps*, Financial Stability Board & IMF Report to the G20 Finance Ministers and Central Bank Governors (October 29, 2009), online at www.g20.org (visited Nov 18, 2009).

acquire new importance. Such engagement would represent a departure from the informal political pressure through which the IMF Board can otherwise compel data delivery. Under these circumstances, reliance by the IMF on the previously approved sanctions should serve as a clear litmus test on the trajectory towards customary state practice of permitting an international organization (IMF) to penalize transparency-related transgressions on the part of member states.

Additional research would be needed to determine whether failure to deliver information in the past could be used to establish exceptions based on a "persistent objector" status. Additional research would also be needed to determine whether more effective tools and informal practices exist within the IMF structure or elsewhere to compel data delivery before the sanction mechanisms are triggered. Any such alternative functional operating norms would effectively also establish other customary state practice basis for identifying an emerging international law. For example, since the BIS already collects a good deal of relevant information, and since the BIS and the IMF are now mandated by the G20 to share information in order to craft an early warning mechanism, a potentially broad range of document production responsibilities exist. It is unclear whether these additional data access points would fall within the scope of the IMF Art VIII expansions discussed in this section.

As the G20 and various components of its process establish priorities for enhanced data collect, a close look at which entities are required to collect and/or compel data using legally enforceable means represents a rich area for potential future research as well as state practice. Reporting obligations have been a traditional tool for financial regulators to exercise control over regulated entities. Access to information also creates information asymmetries and expectations by those excluded from the information stream that the recipients of the information will be able to process the information well and use it judiciously. The credibility of the G20 process in creating a more transparent and resilient financial system may very well rest on the IMF's enforcement of its data flow requirements.

B. Memoranda of Understanding

The IMF is experimenting with another novel tool that merits close attention. Four Central European countries that are members of the EU currently have in place programs in which the IMF and the EU provide them with emergency financial support to help those countries address economic weaknesses exacerbated by the financial crisis: Latvia, Hungary, Romania, and

Poland.[100] A fifth country (Iceland) is part of the European Community and is in the process of joining the EU and adopting the euro. In one of these so-called "program countries," Hungary, the IMF has obtained and made public a "statement" by private sector banks with offices in Hungary that they will support their operations in that country rather than create an additional fiscal burden on the Host country.[101] The various Home and Host state regulators were also present at the meeting, but they did not release parallel press documents.

The innovations here are significant. The meeting at which the banks made these commitments and crafted the language of the public statement was jointly chaired by the European Commission (which technically has no enforcement authority over individual entities) and the IMF (which certainly has no authority over private sector entities).[102] Other entities participating in the meeting with no formal authority over the affected banks included the World Bank, the European Investment Bank and the European Central Bank.[103] In addition, the IMF is creating and making public documents that technically have no legal right to be enforced (memoranda of understanding). Moreover, those documents are executed by *private sector entities*, not by their governments, and they are made

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100 As of August 27, 2009, the IMF had provided Stand-by Arrangements support to Latvia in the amount of 1,522 million Special Drawing Rights ("SDRs"), of which only 535 million had been used (422 percent of its quota). Support to Iceland amounted to 1,400 million SDRs, of which 560 million had been used (476 percent of its quota). Support to Hungary amounted to 10,538 million SDRs, of which 7,587 million had been used (731 percent of its quota). Support to Romania amounted to 4,370 million SDR in the first tranche (424 percent of its quota). In addition, Poland was granted a flexible line of credit (13,690 million SDRs).

101 See European Banking Group Coordination Meeting for Hungary, Concluding Statement by Participating Parent Banks (May 20, 2009), online at www.imf.org/external/np/cm/2009/052009.htm (visited Nov 21, 2009). The banks specifically state that it is in their "collective interest and in the interest of Hungary for all of us to reconfirm, in a coordinated way, our commitment to maintain our overall exposure to Hungary." Id at ¶ 5. They also "acknowledge that our subsidiaries in Hungary have been and will continue to adjust to the current challenging economic environment. A need for additional capital cannot be excluded, and will be met as necessary." Id at ¶ 6. They indicate a willingness to "discuss the results of stress tests in a group, as well as bilaterally with Hungarian authorities, and to agree on any necessary further steps based on these discussions." Id at ¶ 7. Finally, the private banks indicate they are "prepared to confirm these commitments, within the framework of the international financial support package, on a bilateral basis with the Hungary authorities, and under report to our home country supervisory authorities, according to European and the respective national regulatory frameworks." Id at ¶ 8.

102 See *Joint IMF, EC Press Release on the European Banking Group Coordination Meeting for Hungary*, IMF Press Release No 09/180 (May 20, 2009), online at www.imf.org/external/np/sec/pr/2009/pr09180.htm (visited Nov 21, 2009).

103 The Maastricht Treaty contemplates that the ECB could one-day exercise supervisory authority within the European area. However, for a range of political reasons, the ECB has chosen not to exercise this authority.

public by a treaty-based international organization in order to provide assurances about the stability of the financial relationship between Home and Host states.[104]

A direct relationship has existed between the IMF and Home country banks in the past, most notably in connection with restructuring of debt from Latin America in the 1980s. But these were negotiations between holders of debt and providers of additional liquidity, executed after problems had developed and agreed to as a condition to finding resolution to a crisis.[105] The agreement with European banks that have operations in Hungary is entirely different. The private sector participants are not negotiating the terms of a debt restructuring. They are providing an open-ended guarantee of support for their legally separate subsidiaries in a crisis country.

Nation-state members' use of the IMF Board to galvanize financial support directly from the private market participants themselves (rather than from the IMF itself) suggests an evolution and potential expansion of the IMF's authority as it seeks to fulfill its mandate to promote financial system stability. It also raises serious doubts about the ability of Home state governments either to enforce their own laws or, in the case of separate subsidiaries where no legal requirement to serve as a source of strength exists, their willingness to provide taxpayer funds at Home in order to relieve financial stresses abroad.

If IMF Board members and private market participants treat these agreements as having the force of law, this is another area where customary practice may be generating new law before our eyes. We cannot know whether in fact these memoranda of understanding will have the force of law unless and until they are triggered.

This is not the first time that the IMF has experimented with memoranda of understanding, creative mobilization of funding, and statements of support for crisis countries.[106] For example, in the Korea case, the IMF describes its engagement with the private sector as follows:

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[104] A separate question for another day is whether private individuals or corporations may have standing to pursue enforcement of such memoranda of understanding in the event that they are not honored during a crisis. To date, the operative legal standard continues to be that private individuals do not have standing under public international law. *Barcelona Traction, Light and Power Company Ltd (Second Phase) (Belgium v Spain)*, 1970 ICJ 3, 44. For a good, clear summary of the case and a modern perspective on its implications, see Lawrence J. Lee, *Barcelona Traction in the 21st Century: Revisiting its Customary and Policy Underpinnings 35 Years Later*, 42 Stan J Intl L 237 (2006) (analyzing the Barcelona Traction case, which held that a corporation is a national of the state in which it is incorporated for the purpose of diplomatic protection).

[105] See Rieffel, *Restructuring Sovereign Debt*, 149–177 (cited in note 89) (discussing the Latin America debt crisis of the 1980s and the Brady Plan solution).

[106] Nouriel Roubini and Brad Setser, *Bailouts or Bail-INS: Responding to Financial Crises in Emerging Markets* 109 (Peterson Institute for International Economics and the Council on Foreign Relations 1994) (discussing partial bailouts and bail-ins of Mexico and Korea). See also,

> ". . . with the evident failure of the earlier strategy, the authorities in the IMF's major shareholder governments began to contact their banks and urged them to announce jointly that they would maintain their credit lines to Korea. It was hoped that a joint public announcement by the largest international banks would stabilize markets by eliminating the fear that Korea would soon run out of foreign exchange. Three initiatives—the strengthened reform program, the accelerated disbursements, and the coordinated private sector rollover of short-term debt—were announced on December 24, 1997. The IMF played a useful role in the more concerted approach to maintaining private sector exposure by setting up systems to monitor daily exposure and facilitating information exchange among the major governments."[107]

IMF engagement with the private sector in the context of sovereign work-out situations is also well known.

The novelty in the Hungary case is the involvement of the EU. The need to rely on the IMF as both a source of capital for the EU and as a convening authority for the meeting suggests the growing importance of the IMF and the relative weakness of the EU to resolve regulatory disputes. The 2009 MoU creates broad statements of support for Hungarian subsidiaries that go much further conceptually than merely keeping credit lines open to sovereigns in the heat of a crisis. The MoU also goes much further than the traditional understanding of the obligation between parent banks and their branches or subsidiaries. It also requires Home state regulators to waive restrictions on outflows of funds from the parent bank in the event that support for Host state operations is required. These MoUs break new ground and potentially invert the Home/Host relationship if they are triggered and enforced fully.

The engagement by the IMF in crafting the details of the regulatory relationships captured in the Hungary MoU also sets up the potential for different policy reactions under the G20 umbrella. The IMF has now established a strong preference for two things. First, the IMF prefers arrangements that clearly state parent banks' commitment to support claims from their foreign offices. Second, the IMF prefers that Home and Host regulators ensure their support flows downstream as needed to avoid intensification of a fiscal or monetary crisis, due to bank failures in the Host country. Both preferences are understandable, given the IMF's current mandate. They may also be conceptually consistent with G20 efforts to create requirements that complex, globally active firms craft winding-up or "de-risking" plans before trouble occurs, if those agreements generate significant support commitments for Host state activities. It is also possible that the "de-risking" agreements could generate

International Monetary Fund, *Evaluation Report: the IMF and Recent Capital Account Crises* ("IEO Report") (2003).

107 *IEO Report* at 20 (cited in note 106).

the opposite obligation: ring-fencing local assets for the use of Host states and limited support arrangements between Home and Host operations.

Given the web of treaty and economic relationships among EU Member States, eurozone members, and eurozone candidate states, and given the growing international prominence and respect that Brussels has acquired following the economic crisis, the need to involve the IMF to orchestrate a statement of support among EU Member State regulators and banks suggests a deep political weakness in Brussels. It suggests that Brussels alone could not have negotiated the kind of support arrangement the IMF sought. The IMF has been quick to capitalize on this weakness, noting, "When the crisis hit, there was no institutional framework—even within the European Union—for coordinating a response."[108] Some European leaders have also expressly recognized the strength of the IMF relative to the EU: "The IMF has a unique governance model. It is fair to conclude that the Fund's governance is relatively effective and efficient, particularly in comparison with other international institutions."[109]

The evolution of the IMF's responsibilities is subtle, but clear. The evolution also suggests that, as the IMF begins to more actively exercise its early warning responsibilities, it could have clear views about what kinds of statements of support and commitments it will require from financial institutions in order to eliminate or forestall building financial vulnerabilities. But whether the IMF is up to the challenge is another question. As leading commentators have noted, the IMF's ability to exercise existing policing authorities in areas where it has direct competence (for example, global imbalances) failed spectacularly to contain the flow of funds into the US, which helped fuel the disastrous boom in housing finance.[110] The IMF's failure here was the lack of political will among Nation States to act upon the IMF's warnings.

Only state action can provide the basis under which the G20 and the IMF can fulfill the promises they are making to the international community. As the earlier history of UNCLOS negotiations suggests, protracted treaty negotiations are not likely to provide appropriate, timely, or effective means of addressing the challenges that global financial markets present to policymakers when both banks and regulators fail to contain risks. Moreover, attempting to codify

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108 *Agreement with Banks Limits Crisis in Emerging Europe*, IMF Survey Magazine Interview, October 28, 2009, online at http://imf.org/external/pubs/ft/survey/so/2009/INT102809A.htm (visited Nov 21, 2009).

109 Statement by Deputy Prime Minister and Minister of Finance, Ministere des Finances, Belgium, Didier Reynders, at the Twentieth meeting of the International Monetary and Finance Committee of the IMF (October 4, 2009) (on behalf of Austria, Belgium, Belarus, Czech Republic, Hungary, Kazakhstan, Luxembourg, Slovak Rep, Solvenia, Turkey).

110 *The IMF and Regulatory Challenges* (cited in note 98).

standards too quickly can backfire as states waste years arguing over new ideas in treaty negotiations. Custom and state action provides more flexible and credible ways to address quickly evolving risk scenarios.

Skeptics will argue that past custom and state action means the trajectory will be retrograde. This Article makes the case, instead, that recent state action is creating a foundation for the IMF to assume a larger and more effective global role in policing global markets through data reporting requirements and engagement in building agreements that structure banks' obligations to their customers at Home and in Host states. The development of customary international law is not linear; we cannot expect the evolution of the IMF's authority in this area to be linear either.

VI. CONCLUSION

The challenges before the global financial system require real political leadership and vision. G20 leaders are actively and consciously changing the navigation system by which financial firms will be supervised globally going forward. In addition to crafting political parameters for regulatory policies in a broad range of areas (for example, capital adequacy, accounting, executive compensation, and transparency), they are increasing the authority of international organizations and informal global standard-setters to articulate norms and act at the global stage when systemic risks arise. They are creating customary international banking law before our eyes.

Paying attention to the alphabet soup of institutional bodies and their international legal status will help market participants and policymakers alike keep track of which areas are garnering global support and which areas would merit attention from a "persistent objector." The evolution of the law of the sea provides good guideposts for policymakers and international lawyers to determine what mechanisms work best (and what pitfalls to avoid) when seeking to articulate new international law norms in the financial context.