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The International Financial Cooperation – Recent Reforms

by

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The current financial crisis demonstrated, once again, the need for strengthened international financial cooperation. This article discusses the features of the international financial architecture and recent changes focusing on the role of the Financial Stability Board (FSB). It briefly reviews the post-war Bretton Wood arrangements and the changes that occurred after their establishment and recounts the genesis of the FSB and its role in promoting a coherent regulatory framework for a globally integrated financial system.

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I. Introduction

The architecture of international financial cooperation is more a product of turmoil, distress and crisis than the outcome of deep reflection on the appropriate design of a coherent system of oversight for our globally integrated financial system. A number of the central banks and international financial institutions that play such a prominent role in the process of international financial cooperation were themselves spawned by crises. The Federal Reserve was created after the Panic of 1907 to provide the country with an "elastic" currency.[1] The Bank for

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1 Federal Reserve Act of 23 December 1913, Pub.L. 63–43, ("An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of

International Settlements, the oldest international financial institution, was the product of the First World War, and the Bretton Woods institutions were created in response the Second World War.

The recent changes in the international financial architecture are no exception. They are very much the product of the financial crisis that began in 2007. This article explores these changes, and focuses on the evolving role of the Financial Stability Board (FSB), which US Treasury Secretary Geithner has described as the "fourth pillar" of the architecture of global economic governance, alongside the International Monetary Fund (IMF), the World Bank (WB) and the World Trade Organisation (WTO).[2]

To set the stage, the defining features of the architecture of international financial cooperation are first delineated and the changes that occurred after the establishment of the Bretton Woods institutions are briefly reviewed. The article then goes on to recount the genesis of the FSB and its role in the process of international regulatory cooperation.

1. Definition

The concept "international financial architecture" is fairly recent in its origins. Andrew Crockett, the first Chairman of the Financial Stability Forum (FSF) and former General Manager of the BIS,[3] has seen it as encompassing three interrelated elements: (i) the basic economic model that governs cross-border monetary and financial relations; (ii) the institutional structure that exists to manage and, where necessary, adapt these relations; and (iii) the distribution of decision-making authority in international institutions (their 'governance').

These three components have evolved significantly in the decades that have passed since the Bretton Woods institutions were established. The received economic model has gone through a number of fairly fundamental shifts, the most recent one being the move away from heavy reliance on the efficient markets hypothesis to a more nuanced view about the stability properties of the financial system. In the intervening decades, we have also experienced a move away from a world where international financial flows are intermediated

rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.")

2 Press Briefing by Treasury Secretary Tim Geithner on the G20 Meeting, 24 September 2009, Pittsburgh.

3 Andrew Crockett "What Have We Learned in the Past 50 Years about the International Financial Architecture? in Reserve Bank of Australia 50th Anniversary Symposium, Proceeding of a Conference held in Sydney on 9 February 2010, Christopher Kent and Michael Robson eds., Reserve Bank of Australia.

through official institutions that provide balance of payments finance to official creditors to one where financial flows are intermediated by the market.[4] As a result the nature of international cooperation and underlying governance arrangements has changed from the treaty-based and government-led Bretton Woods system of fixed exchange rates to a system of "multi-layered governance" in a pluralistic world.[5] The emergence of China, India, Brazil and the other major emerging markets make this observation more apt than when it was first articulated nearly two decades ago.[6]

2. The post-war Bretton Wood arrangements

The post-war Bretton Woods arrangements represented a concerted attempt to reform the modalities of international economic cooperation. The basis for the architecture consisted of inter-governmental treaties. The key decisions in its operation were made by governments, and its management was overseen by international organisations:

(i) The International Monetary Fund (IMF) was established to manage the international monetary system.

(ii) The World Bank was to provide a source of financing for reconstruction and development.

(iii) The General Agreement on Tariffs and Trade (GATT) created a framework for liberalising trade. An International Trade Organisation (ITO), which was agreed after World War II, was never established. Instead the World Trade Organisation (WTO) was established in 1995.

The signatories of the Bretton Woods treaties agreed on a fixed, but adjustable exchange rate system where parities were set in terms of gold or the US dollar which was itself convertible into gold. Countries had a duty to maintain their exchange rate pegs and to consult regarding adjustments ("obligation to achieve a result"). Restrictions on current account transactions were to be gradually eliminated, and balance of payments adjustments were to be managed through domestic fiscal and monetary policies. There was no treaty-based obligation to remove all capital controls, though in practice most industrial countries did so after dismantling controls on current payments.

4 Padoa-Schioppa T. and F. Saccomanni (1994), "Managing a market-led global financial system" in P.B. Kenen (ed.), Managing the World Economy. Fifty Years After Bretton Woods, Washington, DC: Institute for International Economics, pp. 235–68.

5 Rolf Weber, Multilayered Governance in International Financial Regulation and Supervision, Journal of International Economic Law (2010) 13(3) pp. 683–704.

6 Supra note 4.

3. Post-Bretton Wood system

In the early 1970s the growing mobility of capital led to the collapse of the system of fixed exchange rates and resulted in the move to floating exchange rates by the major industrial countries. The IMF's Articles of Agreement were amended accordingly. Article IV of the amended Articles permitted each member to adopt the exchange-rate regime it preferred but conferred upon the IMF itself the task of overseeing the international monetary system and instructed the IMF to exercise "firm surveillance over the exchange rate policies of members" and to "adopt specific principles for the guidance of all members with respect to those policies."[7]

The IMF's role changed. The IMF no longer focused primarily on exchange rates. Instead it paid increasing attention to the fiscal and other policies pursued by governments that affected exchange rates. Its major tasks were to conduct regular assessments of member countries' economic policies, to provide financial assistance to countries with balance of payments difficulties and to provide technical assistance.

Under the amendment to the IMF Articles of agreement, countries were free to choose whatever exchange rate arrangement they wished, provided that it was not based on a gold parity. This reflected the belief that exchange rates should be shaped by underlying market fundamentals, and that open capital markets can provide the needed funding. The role of the IMF as a source of finance for payments imbalances also changed as more and more countries obtained access to international markets.

When financial stability matters came to the fore, the globally integrated nature of the financial system made it more essential than ever for national monetary and regulatory authorities to communicate, collaborate and to coordinate.

The changing nature of the financial (not just monetary) architecture translated into changes of the underlying governance arrangements. The finance ministry centred G7 displaced the central bank dominated G10 as a forum for coordination of economic policies because exchange rate policies became important in a world of flexible exchange rates.

Nonetheless the G10 process led to the emergence of a network of central bank and supervisory committees operating under the auspices of the BIS. They included the Basel Committee on Banking Supervision[8], the Committee

7 International Monetary Fund. *Articles of Agreement,* Article IV (3 b).

8 The Basel Committee on Banking Supervision was established as the Committee on Banking Regulations and Supervisory Practices by the central-bank Governors of the Group of Ten countries at the end of 1974 in the aftermath of serious disturbances in

on the Global Financial System[9], and the Committee on Payment and Settlement Systems.[10]

Regulators and supervisors formed associations, such as the International Organization of Securities Commissions (IOSCO)[11] and the International Association of Insurance Supervisors (IAIS)[12]. A decentralised model of co-operation emerged. It relied on regular meetings of senior policy makers and officials of national authorities, underpinned by bilateral agreements among key jurisdictions.[13]

The initial objectives of these groupings were modest. Kapstein[14] reported on the G10 central bank governors' general view that the Basel Committee's objective "should *not* be to make far-fetched attempts to harmonize the twelve countries' individual systems of supervision, but should be to enable its members to learn from each other and to apply the knowledge so acquired to improving their own systems of supervision, so indirectly enhancing the likelihood of overall stability in the international banking system".[15]

The committees identified common approaches to common problems and achieved consensus on key supervisory and regulatory practices. Initially their standards were informal agreements among a small group of technocrats from relatively homogenous countries; later they provided the basis for a framework for international financial cooperation. The globalisation of both financial markets and institutions gave this process of cooperation increasing significance. It was motivated by the shared concern with financial stability given that the risks of contagion had greatly increased in the more global market place. It was also driven by level playing field considerations and concerns of national authorities about the competitive disadvantages of their financial institutions and a risk of a "race to the bottom," with regulations weakening everywhere.[16]

international currency and banking markets (notably the failure of Bankhaus Herstatt in Germany). See Charles Goodhart (2011) The Basel Committee on Banking Supervision: a history of the early years, 1974—1997. Cambridge University Press.

9 www.bis.org/cgfs/index.htm

10 www.bis.org/cpss/index.htm

11 www.iosco.org

12 www.iaisweb.org/

13 A bilateral a bilateral agreement on bank capital adequacy between the United States and the United Kingdom was the basis of the Basel Capital Accord. See Ethan B Kapstein, Architects of stability? International cooperation among financial supervisors, BIS Working PapersNo. 199, February 2006.

14 Supra note13.

15 Cited in Ethan Kapstein, Governing the Global Economy: International Finance and the State, Cambridge, Ma.: Harvard University Press, 1994.

16 Supra note13.

4. The Asian crisis and the Financial Stability Forum

In response to the Asian financial crisis, the finance ministers and central bank governors of twenty-two leading economies met in Washington in April 1998 to promote greater international cooperation with respect to financial market oversight. They had earlier established three working groups that were charged with making proposals to reduce the likelihood of crises and to better manage the ones that occurred. One of these working groups was charged with examining ways to strengthen financial systems.[17] It concluded that weak banking systems and poorly developed capital markets contributed to the misallocation of resources that led to the Asian financial crisis and that the implementation of sound practices for supervision, accounting and disclosure was key to the strengthening of domestic financial systems.[18]

This would require close international cooperation and collaboration among those in the official sector who are involved in the supervision of financial systems. However, coordination among the various bodies engaged in the process of regulatory policy making was lacking. One of the Working Group's recommendations was the creation of a "Financial Sector Policy Forum" which would bring together all relevant actors to discuss financial sector issues. This was a driver behind the establishment in 1999 by the G7 of the Financial Stability Forum (FSF).

The blueprint for the FSF was set out in a report by Bundesbank President Hans Tietmeyer. G7 Ministers and Governors had commissioned Hans Tietmeyer to recommend new structures for enhancing cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system.[19] Following his report, the G7 Ministers and Governors endorsed the creation of the FSF at a meeting in Bonn in February 1999.[20] The FSF was established "to ensure that national and international authorities and relevant international supervisory bodies and expert groupings can more effectively foster and coordinate their respective responsibilities to promote international financial stability, improve the functioning of the markets and reduce

17 They established in three working groups, charged with examining (1) transparency and accountability; (2) ways of strengthening financial systems; and (3) prevention and resolution of international financial crises.

18 Working Group on Strengthening Financial Systems 1998

19 Tietmeyer, Hans. 1999. Report on International Cooperation and Coordination in the Area of Financial Market Supervision and Surveillance, Frankfurt: Deutsche Bundesbank.

20 "Communiqué of G-7 Finance Ministers and Central Bank Governors." 20 February 1999.

systemic risk"[21] and convened for the first time in April 1999 under its first Chairman, Andrew Crockett. Its membership consisted of national authorities responsible for financial stability in significant international financial centres (treasuries, central banks, and supervisory agencies); sector-specific international groupings of regulators and supervisors engaged in developing standards and codes of good practice ("standard setting bodies")[22] and international financial institutions. Though initially conceived as an initiative of the G7 countries, national membership in the FSF comprised the relevant authorities in Australia, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, the United Kingdom, and the United States, with the ECB being included shortly afterwards. Switzerland joined the FSF in 2007.

The G-20 replaced the G22 as the focus of international economic cooperation. As the crisis receded, the need for concrete action seemed less pressing. In contrast to the G22, which operated through working groups mandated to make concrete recommendations, the G20 originally was intended to provide an on-going forum for discussion of issues related to global economic and financial stability among Finance Ministers and central bank Governors from the systemically important countries.[23] It remained such a discussion forum until the crisis of 2007 demonstrated the need for action. At that time it began to meet at the level of heads of state and government and assumed a more important coordinating role, designating itself the premier forum for economic cooperation[24]

5. The FSB and the G-20 processes

a. Origins

The FSF played a pivotal role in addressing the causes of the crisis centred on the industrial countries. It formed a Working Group on Market and Institutional Resilience to analyse the underlying causes of the crisis and to make

21 Ibid.

22 Basel Committee on Banking Supervision ("BCBS"), International Accounting Standards Board ("IASB"), International Association of Insurance Supervisors ("IAIS"), International Organization of Securities Commissions ("IOSCO"), Committee on Payment and Settlements Systems ("CPSS"), and Committee on the Global Financial System ("CGFS").

23 For the history of the G20, see G20-website http://www.g20.org.

24 At the Pittsburgh Summit, the Leaders designated the G20 to be the premier forum for economic cooperation. Pittsburgh Leaders' Statement para. 19.

proposals to enhance market stability and resilience. In April 2008, it released a report with a set of 67 recommendations.[25]

The crisis led to a fundamental re-think of broader frameworks of financial and economic policies and existing regulatory practices and the future of financial regulation and supervision. A series of reports by public sector policymakers and officials acknowledged serious shortcomings in current policies and stressed the need for strengthened regulation and supervision in the financial sector and its coordination at the international level.[26]

With the FSF's prominence in addressing the crisis came calls for reforms of the FSF itself. At the G20 Summit in Washington DC in November 2008, the G-20 Leaders called for an expansion of the membership of the FSF and subsequently agreed at the G-20 Summit of April 2009 on the need to place the FSF on a stronger institutional ground and to broaden its mandate.[27]

In their *Declaration on Strengthening the Financial System* of April 2009, the G20 stipulated that the expanded FSF be re-established under the name of the Financial Stability Board (FSB) with a stronger institutional basis, a broader mandate, and enhanced capacity.[28] Not only the FSB but also its member groupings, such as the Basel Committee, were enlarged to have broadly the same membership as the G-20. The new FSB held its inaugural meeting in June 2009 in Basel.[29]

At the Pittsburgh Summit in September 2009[30], the G20 Leaders endorsed the FSB's institutional strengthening through its Charter, which sets out the FSB's mandate, tasks and organisational structure as well as commitments to promote the FSB's objectives and policies. The G20 Seoul Communiqué reaffirmed the

25 See Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience, April 2008. The proposed concrete actions in five areas: (i) strengthened prudential oversight of capital, liquidity and risk management; (ii) enhancing transparency and valuation; (iii) changes in the role and uses of credit ratings; (iv) strengthening the authorities' responsiveness to risks; and (v) robust arrangements for dealing with stress in the financial system."

26 Report of the High-Level Group on Financial Supervision in the EU, 2009 ("De Larosière Report"); Markus Brunnermeier, Andrew Crockett, Charles Goodhart, Avinash D. Persaud and Hyun Shin "The Fundamental Principles of Financial Regulation", Geneva Reports on the World Economy 11, 2009; G-20 (2009), "Working Group on Enhancing Sound Regulation and Strengthening Transparency (Co-Chairs: Tiff Macklem and Rakesh Mohan); Group of Thirty (2009), "Financial Reform: A Framework for Financial Stability" (Chairman: Paul A. Volcker), Washington D.C.; Turner Review (2009), "The Turner Review: A Regulatory Response to the Global Banking Crisis" by Lord Turner, Chairman, Financial Services Authority, UK.

27 G20 Declaration on strengthening the financial system – London, 2 April 2009.

28 G20 Declaration on Strengthening the Financial System, London, 2 April 2009.

29 Press release Financial Stability Board holds inaugural meeting in Basel 27 June 2009.

30 Leaders' Statement, 24–25 September 2009, Pittsburg Summit.

FSB's role in coordinating at the international level the work of national financial authorities and international standard setting bodies in developing and promoting the implementation of effective regulatory, supervisory and other financial sector policies in the interest of global financial stability.[31]

i. Mandate and tasks

The FSB's mandate and tasks set out in Article 2 of its original Charter of September 2009[32] are to:

- assess vulnerabilities affecting the global financial system and identify and review on a timely and on-going basis the regulatory, supervisory and related actions needed to address them, and their outcomes;
- promote coordination and information exchange among authorities responsible for financial stability;
- monitor and advise on market developments and their implications for regulatory policy;
- advise on and monitor best practice in meeting regulatory standards;
- undertake joint strategic reviews of the policy development work of the international standard setting bodies;
- set guidelines for and support the establishment of supervisory colleges;
- support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- collaborate with the Fund to conduct Early Warning Exercises.[33]

The Charter also empowers the FSB to undertake any other tasks agreed by its Members in the course of its activities and within the framework of the Charter.[34]

31 G20 Seoul Summit Declaration, 11–12 November 2010, para. 40

32 FSB Charter, September 2009, Article 2.

33 The IMF-FSB Early Warning Exercise is presented twice yearly to senior policy makers and covers economic, macro-financial and financial system risks. The key output of the EWE is a confidential presentation of risks and vulnerabilities to the International Monetary and Financial Committee (IMFC). This presentation is prepared in close cooperation between IMF and FSB staff, based on a common understanding of stresses for the global economy and financial system that are likely to emerge. The exercise does not seek to predict the timing of crises. The primary purpose of the EWE is to identify underlying vulnerabilities and imminent tail risks that predispose a system to a crisis, so that corrective policies can be implemented and contingency plans put in place ahead of time. See International Monetary Fund, The IMF-FSB Early Warning Exercise Design and Methodological Toolkit, September 2010.

34 FSB Charter Article 2(i)

ii. Membership

Membership falls into three categories: (i) authorities responsible for maintaining financial stability, such as ministries of finance, central banks, supervisory and regulatory authorities;[35] (ii) international standard-setting bodies (SSBs);[36] and (iii) i*nternational financial institutions (IFIs)*[37].

Membership comprises authorities from G-20 countries and, in addition, Hong Kong, the Netherlands, Singapore, Spain and Switzerland. The number of authorities from each jurisdiction that are represented on the FSB varies from one to three reflecting the size of the national economy, financial market activity and national financial stability arrangements of the jurisdiction.[38] The Charter sets out a commitment for jurisdictions represented on the FSB to (i) pursue the maintenance of financial stability; (ii) maintain the openness and transparency of the financial sector; (iii) implement international financial standards; and (iv) undergo periodic peer reviews.[39] More specifically, jurisdictions should undergo an assessment under the IMF-World Bank Financial Sector Assessment Program (FSAP) every five years and disclose their degree of adherence of international standards, notably by publishing the detailed assessments prepared by the IMF and World Bank as a basis for the Reports on the Observance of Standards and Codes (ROSCs).[40]

35 FSB Charter Article 10 (1). Jurisdictions with one seat in the plenary are Argentina, Hong Kong, Indonesia, Saudi Arabia, Singapore, South Africa and Turkey; jurisdictions with two seats in the plenary are Australia, Mexico, Netherlands, South Korea, Spain and Switzerland; jurisdictions with three seats in the plenary are Brazil, Russia, India, China, Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. The European Union also is represented, with the Central Bank and the European Commission as member authorities. In the case of jurisdictions with only one seat, representation is generally assumed by the central bank. Countries with two seats are represented by the central bank and the finance ministry. Finally, in the case of those countries that have three seats in the plenary, the third seat is generally occupied by a financial regulatory or supervisory authority. The FSB will review periodically the eligibility of Members in the light of the FSB's objectives. FSB Charter Article 4 (1)

36 International standard-setting bodies comprise the Basel Committee on Banking Supervision (BCBS), the Committee on Payment and Settlement Systems (CPSS), the Committee on the Global Financial System (CGFS), the International Accounting Standards Board (IASB), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO).

37 The IFIs include the International Monetary Fund (IMF), the World Bank, the BIS, and the Organisation for Economic Cooperation and Development (OECD).

38 FSB Charter Article

39 FSB Charter Article 5 (1).

40 FSB Framework for Strengthening Adherence to International Standards, 9 January 2010.

SSBs should report to the FSB on their work[41] to enable the FSB to fulfil its mandates to conduct "joint-strategic reviews of the policy development work of the international standard setting bodies" and to "promote and help coordinate the alignment of the activities of the SBBs to address any overlaps or gaps and clarify demarcations in light of changes in national and regional regulatory structures relating to prudential and systemic risk, market integrity and investor and consumer protection, infrastructure as well as accounting and auditing."[42]

IFIs are governed by their respective constituent treaty instruments. Their participation in the FSB is therefore guided by their own mandates and frameworks.[43] The FSB is to collaborate with the IFIs to "address vulnerabilities affecting financial systems in the interest of global financial stability."[44]

iii. Organisational structure

The Plenary is the FSB's only decision-making body.[45] It takes all decisions in connection with the FSB's work programme, adopts FSB policy recommendations and guidance, appoints the Chair and decides on any other matter governing the business and affairs of the FSB. Decisions are taken by consensus.[46] The FSB Steering Committee provides operational guidance between Plenary meetings to carry forward the directions of the FSB.[47] It therefore meets more frequently than the Plenary. Not all members are represented on the Steering Committee, which according to the Charter should nevertheless have a balanced representation of both geographic regions and institutional functions.[48]

41 FSB Charter Article 5 (2).

42 FSB Charter Article 2 (1) (e).

43 Article 5 (3).

44 Article 1.

45 Pursuant to FSB Charter Article 8 (1) Representation at the Plenary is at the level of the central bank governor or immediate deputy; head or immediate deputy of the main supervisory/regulatory agency; and deputy finance minister or deputy head of finance ministry.

46 FSB Charter Article 7. Consensus is not synonymous with unanimity. The Handbook for FSB Peer Reviews of 19 December 2011 describes the process of achieving consensus as follows: "the views of all members are considered and compromises are sought, but that no single jurisdiction can block a decision supported by a clear majority; compromises are sought, differences are accepted, but dissenters do not stand in the way of a decision." See http://www.financialstabilityboard.org/publications/r_120201.pdf

47 FSB Charter Article 13.

48 FSB Charter Article 12. The current composition of the Steering Committee gives much weight to central banks with more than half of the seats on the committee being taken up by central bank representatives.

The Chair presides over the Plenary and the Steering Committee.[49] The Chair is appointed by the Plenary for a term of three years, renewable once. The Chair, currently Mark Carney, Governor of the Bank of Canada, is the "principal spokesperson" for the FSB.[50]

The Plenary may establish standing committees and working groups as necessary to accomplish its mission.[51] The Plenary has established three Standing Committees, which reflect the FSB's three-pronged approach to promoting financial stability in line with its mandate set out in the Charter consisting of (i) the assessment of systemic risks and vulnerabilities ("Standing Committee on Assessment of Vulnerabilities (SCAV)"); (ii) the identification of suitable regulatory and supervisory policy actions to address these risks and vulnerabilities ("The Standing Committee on Supervisory and Regulatory Cooperation (SRC)"); and (iii) the coordinated implementation of these agreed actions ("Standing Committee on Standards Implementation (SCSI)")[52]. In addition to these three Standing Committees the FSB has established a number of ad hoc working groups necessary to carry out its tasks.

The Charter stipulates in Article 3 that the FSB "will consult widely amongst its Members and with other stakeholders including private sector and non-member authorities. At the Seoul Summit in November 2010, the FSB announced the creation of regional groups.[53] They are intended to provide an institutional mechanism for interested authorities and FSB members to interact with respect to the vulnerabilities affecting regional and global financial systems and policy initiatives to promote financial stability. Each of the six regional consultative groups (Europe, Americas, Asia, Middle East and North Africa, Sub-Saharan Africa, and the Commonwealth of Independent States) is co-chaired by a non-member and an FSB member, both from the region. The institutional membership of the regional groups mirrors that of the FSB, comprising central banks, supervisory and regulatory authorities and ministries of finance.

The FSB is supported by a Secretariat at the BIS. The Secretariat is headed by a Secretary General, who is appointed by the Plenary. The Secretariat staff are generally seconded from member authorities or organizations. Under Ar-

49 FSB Charter Article 14.
50 FSB Charter Article 14.
51 FSB Charter Article 11.
52 Which includes for intance the monitoring of national implementation efforts under the Coordination Framework for Implementation Monitoring (CFIM) in collaboration with relevant standard-setting bodies http://www.financialstabilityboard.org/publications/r_111017.pdf
53 Press release of 3 November 2010 Financial Stability Board proposes to establish regional consultative groups.

ticle 15(5) of the Charter, the Secretary General and the Secretariat Staff, in the discharge of their functions, owe their duty entirely to the FSB and to no other authorities or institutions.

Towards greater strengthening

The FSB has assumed a key role in promoting the reform of international financial regulation. Following its re-establishment as the FSB, it had provided regular reports to the G20[54] on progress since the Washington Summit in the implementation of the G20 Recommendations by the FSB, IFIs and international standard-setters as well as national jurisdictions.

The FSB is different in nature from the other three pillars of global economic governance. The FSB is not a treaty-based international organisation. In academic literature, it is variously termed a "soft law institution",[55] a "transnational or transgovernmental regulatory network"[56] or a "trans-network organisation"[57] Its Charter does not have the formal status of an intergovernmental agreement or treaty and has not been ratified by national governments or legislatures. Rather, it is a statement of an understanding about modalities for cooperation and, as such, is a political rather than a legal document.[58]

The existing arrangements raise questions about how to address the need for the strengthening of the global financial architecture so that it provides for a level playing field, global financial stability, innovation and market discipline. Numerous proposals have been made to address this need. They range from

54 FSB report on Progress since the Washington Summit in the Implementation of the G20 Recommendations for Strengthening Financial Stability, November 2010; FSB Overview report on progress for G20 Leaders, June 2010; Progress since the St Andrews meeting in Implementing the G20 Recommendations for Strengthening Financial Stability, April 2010; Progress since the Pittsburgh Summit in Implementing the G20 Recommendations for Strengthening Financial Stability November 2009; Overview of Progress in Implementation – Report by Financial Stability Board to G20 Leaders, September 2009.

55 Eilis Ferran and Kern Alexander, Can Soft Law Institutions Be Effective? The Case of the European Systemic Risk Board (European Central Bank Legal Working Paper Series)

56 For policy networks, see generally Anne Marie Slaughter, A New Global Order (2004). Joseph 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' (2009) 43 International Lawyer 175.

57 Domenico Lombardi, The Governance of the Financial Stability Board, Brookings Institution, Isues Paper, September 2011.

58 Article 16 of the Charter states that the Charter "is not intended to create any legal rights or obligations".

the creation of a global systemic risk regulator[59], or a World Financial Authority[60] to the establishment of an international financial regulator[61] or the adoption of a global bank charter.[62]

The arguments in favour of these proposals are that they align more closely the regulatory and supervisory framework with the global nature of financial firms. They address the lowest common denominator problem and discourage countries, at least those within the proposed frameworks, from isolating themselves from the globalized economy by imposing capital controls or other restrictions that hamper or distort the operation of the financial market

However, all proposals would to differing degrees require States to surrender sovereignty. All proposals are essentially rules-based and rely on centralised decision-making power. They would require a treaty basis or other form of binding legal arrangement to be implemented, and they would need quasi-universality, or at least the membership and support of the largest countries, to be effective. The breakdown of the Bretton Woods system illustrated that countries will not abide by rules if the rules are not in their interest and will not support a system where obligations are asymmetric. An international regime that does not take account of national policy interests can easily give rise to tensions between democratic national policy making and decision making at an international level.[63] It is therefore not realistic to expect that politicians will be willing to surrender the responsibility for regulating financial institutions to a supranational or a foreign entity as long as national taxpayers remain ultimately liable should regulation fail.

The approach now being followed by the international community to improve the international financial architecture takes account of these realities. The FSB is not being given formal rule-setting and enforcement powers or dispute resolution tools similar to those of the WTO. Still, the fact that the FSB cannot be qualified as a traditional "hard law" international financial institution created through a treaty in no way undermines its capacity to act. By placing the onus of

59 See, .e.g, Stephen Roach "Leadership Imperatives for a Post-Crisis World", in Hemerijck, A., Knapen, B. and Van Doorn, E. (2010) Aftershocks: Economic Crisis and Institutional Choice. Amsterdam: Amsterdam University Press.

60 John Eatwell and Lance Taylor, Global Finance at Risk: The Case for International Regulation, Polity Press, 2000.

61 Carmen Reinhart and Kenneth Rogoff, "Regulation should be international". Financial Times, 18 November 2008; Barry Eichengreen, "Not a New Bretton Woods but a New Bretton Woods process" in Eichengreen and Baldwin (eds) What G20 leaders must do to stabilise our economy and fix the financial system, VoxEU.org., 2008.

62 Christine Cumming and Robert A. Eisenbeis, Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required? Federal Reserve Bank of New York Staff Reports, no. 457, July 2010.

63 Kapstein, supra note 13.

responsibility for action on the national authorities, it has created a credible and practical mechanism for promoting greater coordination and harmonization of regulatory policy. The Heads of State and Government of the G20 have defined FSB's mandate and role and determined its tasks. Their declarations in support of it carry a strong moral and political commitment on their part to act in accordance with the FSB's financial stability objectives. Its procedures for monitoring adherence to agreed policy commitments give force to reputational incentives and supplement discipline through the markets.

The FSB has assumed a key role in promoting the reform of international financial regulation. At the Cannes Summit in November 2011, the Heads of State and Government of the G20 acknowledged the FSB's growing role in this area and agreed to strengthen FSB's capacity, resources and governance. More specifically they called for the "establishment of the FSB on an enduring organizational footing "with legal personality and greater financial autonomy, while preserving the existing and well-functioning strong links with the BIS".[64]

II. Conclusion

The international financial community is becoming more interconnected and interdependent day by day. While this creates increased financial opportunities for market participants, and may serve to promote greater efficiency in resource allocation, it also opens up dangers of systemic risk and could threaten the safety and soundness of the international financial system.

The FSB has become the central locus for cooperation in the oversight of financial markets and financial institutions, and for the coordination of regulatory and supervisory policies. Its basic raison d'être is to create a coherent regulatory framework for a globally integrated financial system in a world of sovereign states that are unwilling to cede authority to an international authority. A major strength of the FSB is that it addresses the challenges that this constellation of forces creates. It brings together the principal decision-makers of all the important financial jurisdictions. Member authorities undertake much of the work of developing policy recommendations. The FSB Secretariat facilitates the process but the member institutions themselves determine the recommendations that are presented to and endorsed by the Plenary. Even though the recommendations do not have the force of law, the process by which they are developed give them a strong moral force and make national authorities more willing to adopt them. The FSB is a member-driven process, and actions to put it on a stronger footing will need to ensure that it will remain member driven.

64 Cannes Final Summit Declaration, 4 November 2011.