The Role of International Organizations in Financial Market Reform

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I. Introduction

Since the end of the Second World War, we have experienced one of the greatest continuing developments in history, world economic globalization. Economic growth since 1945 has been unprecedented. Moreover, this growth, which began primarily within domestic markets, has become truly international and has manifested itself in the integration of financial markets throughout Europe, Asia and the Americas. And, this growth has created emerging capital markets throughout the world. However, continued and sustainable growth requires a policy framework that prominently includes an orientation toward integration in the global economy.[1]

"Globalization, the ongoing process of greater interdependence among countries and their citizens, is complex and multifaceted."[2] The integration and emergence of economic growth has been accompanied by times of downturn and even crisis. Now, as we are once again emerging from an economic crisis, comparable to the scale of the previous crises in Asia, Latin America, and perhaps even America's Great Depression, governments and regulators in advanced and emerging economies are working to develop a new regime of regulation to ensure that this type of crisis "never happens again." However, the reality is that financial crises have occurred "for as long as there have been financial markets."[3] Guiding the reform efforts to minimize the effects of these crises, in many cases, are IOs such as the International Monetary Fund (IMF), the G20, the

[1] Fischer, Stanley, "Globalization and its Challenges, Richard T. Ely Lecture, revised from version presented at the American Economic Association meetings in Washington, DC, 2 (January 2003).
[2] Id.
[3] Feldstein, Martin, Economic and Financial Crises in Emerging Market Economies1 (Martin Feldstein, ed., 2003).

Financial Stability Board (FSB and formerly known as the Financial Stability Forum), and the Basel Committee on Banking Supervision (BCBS).

The current global financial crisis has revealed the potential costs that accompany the benefits of capitalism, as well as the limited effectiveness of regulation in restraining risk taking by market participants. Both this crisis and the prior crises in Asia and Latin America have demonstrated that globalization in finance has enormous consequences. Globalization has significant growth effects in places like South America and Asia, where production costs are significantly less than in highly developed economies like Europe and the United States. Moreover, as previous crises have indicated, economic crises not only impose costs on advanced but also reduce the flow of financial capital to emerging markets.

Significantly, economic globalization creates both benefits and unanticipated consequences for emerging markets. Emerging and developing economies have benefitted in recent decades from globalization and the economic productivity advantages compared with other nations, but the most recent crisis has threatened to take some of that away.

So, as the world embarks on another round of regulatory development in the wake of a crisis, emerging economies are looking for guidance from the leading economic producers as well as IOs, such as the IMF, the G20, the FSB and the BCBS. One point of this discussion has focused on the growing integration of global banking and financial markets and the most effective and efficient means to regulate those same markets.

Globalization in finance and banking requires the convergence of law and economics in order to develop efficient and effective global regulatory regimes that can

monitor emerging markets, foster increased global banking integration and minimize the costs of a potential crisis in the future. In order to nurture such convergence across borders of advanced and emerging economies, IOs are critical and must serve a positive role in developing standards and model regulations to improve cross-border regulatory cooperation and to increase the possibility of creating a truly global financial architecture.

Promoting increased global banking integration through IOs creates efficiency in financial services regulation and can thereby serve to minimize the effects and frequency of financial crises. The resulting economic efficiencies should provide significant benefits to emerging economies. While it is very unlikely that a legitimate global regulator will take shape within the foreseeable future, or that IOs such as the IMF, the FSB or the G20 will develop a specific, widely-adopted rules-based regulatory regime for the global economy beyond the current "soft law" these organizations produce, increased integration of the financial markets around the world will require development of generally accepted global financial standards.

However, the legal and regulatory challenges of the globalization in finance, especially in the wake of a major financial crisis, must be considered by engaging and combining the disciplines of law and economics. Blending law and economics is absolutely necessary for efficient and effective integration of financial markets that have developed a global footprint. Globalization of finance demands this blend to create useful international regulatory convergence and cooperation as a means to develop adequate and adaptable legal regimes, especially in emerging market economies. This blending will increase the benefits of global banking integration while minimizing threats

of crises in the future. Moreover, in order to effectively develop such convergence and reform, IOs, in particular, the IMF, the G20 and FSB must play a positive role.

My discussion will begin below with an identification of the legal challenges of globalization of financial services, as well as the economic effects, with particular consideration given to emerging market economies, such as the BRIC nations of Brazil, Russia, India and China. I will consider the struggle between the absolute nature of the law with the flexibility and adaptability of economics with respect to financial regulation. This will include analysis of the international role of organizations such as the IMF, the G20 and the FSB.

I will then turn to brief overviews of past crises, such as Asia and Latin America, with an analysis of the domestic and global response to each. Here, I will explore the size, scope and effects of such crises, particularly as felt in emerging markets.

The core of our analysis will examine the legal and economic challenges of adapting regulation at the international level to foster the beneficial effects of globalization, as well as the role that IOs must play in developing a global architecture for financial services. Moreover, the adaptation of regulation presumes that it will become more efficient and effective for a global economy, especially for emerging markets; however, such efficiencies previously seen in the world's economic most advanced economies must be nurtured and translated on a global scale to adapt to emerging economies that are associated with varied, and sometimes, unstable political, social and cultural challenges.

In particular, these challenges can be addressed through the convergence of law and economics such that economic efficiencies inform the development of legal rules in

order to provide an efficient allocation of capital, resources, and regulation. Emerging economies are absolutely necessary for the developed economies to reduce their costs and improve the efficiency of their economies.

I will conclude with remarks on the convergence of law and economics as a way of developing new regulatory regimes and standards by which the emerging markets of the world will continue to develop with a level of regulatory certainty and flexibility not previously seen.

II. Background on Globalization in Finance and the Emergence of Coordination through International Organizations

Globalization has driven domestic and global economic growth since the end of World War II, and particularly during the past three decades. Advanced economies developed complex and integrated networks for exporting and importing goods, while emerging economies and developing nations have participated in these networks with low production costs and valuable mineral elements. Comparative advantages and efficiencies continue to drive globalization, and emerging markets like Brazil, Russia, India and China have established themselves as global economic players. However, their expansion has, to date, been more limited in global banking and the financial markets.

International financial markets have developed at a strong pace and have facilitated global trade and production. Many factors are identified as playing a role in this development, such as the increase in financial liberalization policies, deregulation policies, technological and financial innovation, and an expanded investor base. These factors have permitted both advanced and emerging market economies to participate in global financial markets where debt and equity is traded and settled across borders.

The depth and activity of financial sector growth, initially in advanced economies, increased after 1970 and boomed in the 1990s.[4] Financial intermediation through depository institutions, insurance companies and securities markets expanded at a remarkable rate while the spectrum of financial services and products expanded substantially.[5] For example, "the sum of credit from financial institutions, stock market capitalization, and private bonds outstanding reached, on average, approximately 260 percent of GDP for G-7 countries in 2004, compared with 100 percent in 1975."[6]

In order to account for the risks and complications that develop with such growth, international standard setting bodies have emerged. They are not entities with separate legal personalities created by specific nations, but rather they are informal associations of state representatives and professionals that convene to address specific problems (e.g. identifying abnormalities in the market, and developing standards to combat inefficiencies in the global marketplace). "Many regulators worry that competition among regulators results in a race to the bottom in which regulatory standards fall to the lowest common denominator."[7] In fact, these international standard-setting bodies set the minimum standards that their members agree to meet to prevent such a race the bottom.[8] Their work has been described as "negotiated convergence" because the outcome is derived from extensive negotiation between different national authorities and involves the usual compromises and trade-offs inherent in bargaining.[9]

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[4] de la Torre, Augusto and Schmukler, Sergio L., Emerging Capital Markets and Globalization: The Latin American Experience 26 (Stanford University Press, 2007).
[5] Id.
[6] Id.
[7] Schooner, Heidi Mandanis and Taylor, Michael, W., Global Bank Regulation: Principles and Policies, xviii (Elsevier 2010).
[8] Id.
[9] Id. at xxi.

Moreover, the globalization of financial services and the integration of financial markets have required that national regulators develop cooperative relationships in order to facilitate oversight and regulation of global banking and financial services markets.[10] Further, it is this cooperation among nations and among standard setting bodies that has produced some significant convergence in regulation over the past several decades.[11]

There will always be limits associated with such international standard setting bodies and their ability to shape global regulation and financial activity. However, the benefits will far exceed the costs of utilizing these entities, especially for emerging market economies, because the soft law that these IOs create through coordination promotes financial stability and efficiency for global banking and financial services. A more viable alternative to the global financial regulator concept, which appears to be beyond practicality, might be to place the soft law system of international agreements on a more robust legal foundation.[12] It is suggested that this would likely require an international treaty to form a sort of "World Financial Organization."[13] This means that:

> "Countries seeking access to foreign markets for financial institutions they charter would have to meet the obligations for supervision and regulation. Implementation would be left to individual states. In this way, regulation would be tailored to the structure of individual financial markets. Specifically, other countries could prohibit banks chartered in out-of-compliance countries from operating in their markets. This would protect complying banks from the destructive spillovers of poor regulation. This structure could help foster a political economy of compliance. Governments seeking to secure market access for their banks would have an incentive to upgrade supervisory practice. Resident financial institutions desirous of operating abroad would be among those lobbying for the requisite reforms."[14]

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[10] Alexander, Kern, *Global Financial Standard Setting, The G10 Committees, and International Economic Law*, 34 Brooklyn J. Int'l L. 861, 867 (2009)
[11] Schooner and Taylor, *supra* note 7 at xxi.
[12] Id. at 292.
[13] Id.
[14] Schooner and Taylor, *supra* note 7 at 292-293.

In any event, whether by treaty or by strengthening the soft law nurtured by international organizations, the primary concern in international bank and financial market regulation is avoiding spillover of problems from one country to another.[15] Effective international regulation also requires that all countries apply broadly similar prudential requirements so that financial institutions such as banks operating in one jurisdiction are not significantly more or significantly less regulated than banks operating in that or other jurisdictions.[16]

1. Integration

Capital market development in advanced economies has been accompanied by an increasing financial integration across nations. Globalization of finance and trade is not new. International capital flows have existed for centuries. For example, in the 15th and16th Centuries, the Portuguese were rounding the southern tip of Africa on their way to India and China to trade in spices, silks and gold. Opposite sides of the globe began connecting and integrating via these Portuguese trade routes and soon the English and Dutch followed suit in developing international finance and commerce. According to some measures, the extent of global capital mobility and capital flows even a hundred years ago – especially during the gold standard era (1880 – 1914) – is comparable to today's level. At that time, however, participation in financial globalization was limited to a few nations.[17]

More recently, the effects of financial globalization have contributed to the concentration of market capitalization and liquidity in a few international financial

[15] Id. at xvii (in terms of bank regulation).
[16] Id. at xvii-xviii.
[17] de la Torre, *supra* note 4 at 9.

centers, such as London, New York and Tokyo and Hong Kong. Even today, financial activity in these cities vastly overshadows market activity elsewhere.[18]

As noted above, the prominent feature of the recent trend toward financial globalization has been the internationalization of financial services and the use of international financial intermediaries by local issuers and investors, predominantly in emerging market economies. An increased presence of international financial intermediaries through branches and subsidiaries of mega-banks in local markets and the use of foreign financial intermediaries and markets by local issuers and investors have harbored such growth.[19]

However, the boom in capital flows in the 1970s and early 1980s was followed by a sovereign-debt crisis in emerging market economies that started in Mexico in 1982. To solve the crisis, an internationally agreed-upon framework – the Brady Initiative – was developed, and so-called "Brady Bonds" were created to restructure the debt in the late 1980s. This restructuring eventually led to the reentry of emerging countries into international capital markets and the development of liquid sovereign bond markets for those countries.[20]

Emerging market economies and other developing countries have attempted a number of methods for attracting available capital as a means of expanding their integration with international markets. For example, one way to attract this capital was through financial liberalization, which took place in the late 1980s and early 1990s in emerging markets and developing countries, years after advanced economies had

[18] Id at 30.
[19] de la Torre, *supra* note 4 at 11.
[20] Id.

engaged financial liberalization policies.[21] The intention of fostering capital markets through financial liberalization squared well with the global trend of moving toward a market-oriented system.[22]

New dynamics have emerged such that new centers of power in the BRIC nations are coming into the limelight. The expansion of international finance into countries and regions with political, social or other uncertainties creates challenges to integration for largely democratic advanced economies. "State borders no longer contain and define economic activity."[23]

Increasing financial integration, the growing importance of emerging market economies, cross-border capital flows, and financial transactions have encouraged the creation of international standard setting bodies, such as the Basel Committee for Banking Supervision, the Financial Stability Board, the G20, and others as multilateral institutions charged with attempting to "regulate the cross-border activities of transnational corporations and other firms, and to control and minimize the cross-border externalities produced by certain types of economic and financial risk taking."[24] It is these multilateral institutions that must play a positive and effective role as financial integration expands. Emerging market economies will seek guidance from such organizations as they efficiently integrate into global finance.

2. Emergence of International Coordination and Organizations

As globalization continues to change the financial structure of domestic markets and the world economy, the absence of effective international coordination presents a

[21] Id.
[22] Id. at 12
[23] Alexander, *supra* note 10 at 865 (citing John Eatwell & Lance Taylor, Global Finance at Risk, Ch. 1 (1999)).
[24] Alexander, *supra* note 10 at 865.

serious challenge to financial stability and growth.[25] The expansion, diversification, and global impact of banking and financial activity have emerged with the increase of "global competition among bank and non-bank financial intermediaries" and have resulted in the development of "global financial service companies and the consolidation and conglomeration of the banking and financial services industry."[26]

International financial regulation is generally understood as the intervention of IOs and national governments in the economic activities of institutions and individuals, including rules and standards developed by IOs and implemented by national regulatory bodies supervising financial services activity.[27] Such regulation is designed to minimize risk, particularly insolvency and credit risks, investment or market risks, as well as systemic risks from failure of a financial intermediary. [28]

In 1944, during World War II, delegates from 44 countries descended upon Bretton Woods, New Hampshire to discuss the creation of a set of international financial institutions.[29] The Bretton Woods system created the World Bank to provide reconstruction money for Europe, and the IMF to provide short-term loans for national governments.[30] The Bretton Woods system also created rules governing commercial and financial interactions with countries around the world. However, the principal goal of the

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[25] Id. at 866 (referring to Delbrack, Jost, *Structural Changes In the International System and Its Legal Order: International Law in the Era of Globalization*, 11 Schweizerische Zeitschrift Fur Itnernationales Und Europaisches Recht 1, 16 (2001)(Switz.).
[26] Id. at 865 (referring to Norton, Joseph J., *The Multidimensions of the Convergence Processes Regarding the Prudential Supervision of International Banking Activities: The Impact of the Basel Supervisor's Committee's Efforts Upon, Within and Without the European Community*, Festschrift in Honor of Sir Joseph Gold, 249 (1990).
[27] Weber, Rolf H. and Arner, Douglas, W., *Toward a New Design for International Financial Regulation*, 29 U. Pa. J. Int'l L. 391, 392-393 (2007)
[28] Id.
[29] Gard, R. Ronald, *George Bailey in the Twenty-First Century: Are we Moving to the Postmodern Era in International Financial Regulation with Basel II?*, 8 Transactions 161, 166 (2006) (citing Moffitt, Michael, The World's Money: International Banking from Bretton Woods to the Brink of Insolvency 14 (1983)).
[30] Id. (citing Nace, Ted, Gangs of America: The Rise of Corporate Power and the Disabling of Democracy 189 (2003)).

Bretton Woods meetings was to stabilize the world's economy for prosperous world trade, especially in the wake of WWII.[31]

"The profile of IOs such as the IMF and the World Bank makes them the usual starting point in any discussion of problems in the international financial system, and this was, in fact, the approach chosen following the Mexican crisis in 1995 and the East Asian financial crisis in 1997-98."[32] After these crises, stronger IOs and closer coordination between national authorities became critical to an effective response. Before the 1980s, financial crises had a limited global effect, but as integration has increased because of financial globalization, crises have produced dramatic regional and global effects for financial institutions and markets.

3. Background on International Organization Efforts: IMF, G20, FSB and BCBS

Efforts of the IOs design policies for better crisis prevention have been comprehensive.[33] They have been broad in scope and include initiatives to support goals of transparency, greater attention to crisis vulnerabilities, greater attention to country risk, better risk management generally, to name a few.[34] Moreover, in order to assess for the

[31] Id at 166-167 (citing Rosenberg, American Economic Development Since 1945: Growth, Decline and Rejuvenation 84 (2003) and Moffitt, *supra* note 30, at 20).
[32] Weber & Arner, *supra* note 27 at 400 (referring to Kiuchi, Takashi, The Asian Crisis and Its Implications, in Shaping a New International Financial System 37 (Karl Kaiser et al. eds., 2000)).
[33] Frankel, Jeffrey A. and Roubini, Nouriel, The Role of Industrial Country Policies in Emerging Market Crises, 226-227 (Martin Feldstein ed., University of Chicago Press 2003).
[34] Id. The broad scope identified by Messrs Frankel and Roubini includes a cast series of initiatives and actions, including: (1) transparency and accountability of emerging markets, their economic agents, and the IFIs (such as the IMF), and greater disclosure and reporting by banks and other financial institutions in advanced economies; (2) greater attention given by the IMF and emerging markets to indicators of vulnerability to crises; (3) greater attention to national balance sheet analysis and risk management, especially liquidity and balance sheet risks; (4) optimal public debt management to reduce liquidity risk, exchange rate risk, and balance sheet risk; (5) prudential regulation and supervision of financial systems in emerging markets; (6) policies to maximize the benefits of international capital flows; (7) work on highly leveraged institutions (including hedge funds); (8) work on offshore financial centers; (9) reform of the

implementation of policies in furtherance of these goals, IOs have a number of programs and initiatives of note. These include, for example, the IMF and World Bank's Financial Sector Assessment Program (FSAP), IMF stabilization and structural programs, G20 meetings of Foreign Finance Ministers and Central Bank Governors, the Basel Committee's Core Principles for Effective Banking Supervision, and the Financial Stability Board's ongoing encouragement and coordination of international implementation of effective financial sector policies.

A. IMF and World Bank Financial Sector Assessment Program

The International Monetary Fund (IMF) and World Bank, through their joint Financial Sector Assessment Program (FSAP), seek to increase the effectiveness of efforts to promote the soundness of financial systems in their member countries. The FSAP utilizes experts from a national agencies and standard-setting bodies in order 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."[35]

A critical component of the FSAP is the detailed evaluation of the specific country's observance of relevant financial sector standards and codes – the Report on Observance of Standards and Codes (ROSC), which is conducted using quantitative analysis and qualitative tools to help identify the risks and vulnerabilities of a country's financial system, ascertain the sector's developmental needs, and prioritize policy

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Basel capital adequacy standards; (10) private contingent capital lines; (11) implementation of international standards and codes; and (12) better governance of the financial and corporate systems.

[35] Financial Sector Assessment Program, http://www.imf.org/external/np/fsap/fsap.asp#P, (last visited July, 26, 2010)

responses.[36] "The FSAP also forms the basis of Financial System Stability Assessments (FSSAs), in which IMF staff addresses 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."[37]

B. IMF Stabilization and Structural Programs

The IMF also engages countries in need of support through financing and liquidity mechanisms through stabilization and structural programs that impose duties on the receiving country to get out the crisis or shortcoming they face. These programs typically involve many conditions and requirements for reforming the national economic structure with respect to, for example, financial market or banking regulation. This is inherently difficult because it is really a domestic and political undertaking as "it entails sorting out property rights among claimants and, perhaps even more important, allocating the losses among various groups – at least between shareholders, borrowers and taxpayers."[38]

However, this is an area where having other international organizations, such as those discussed herein, would be beneficial. These institutions could greatly assist the IMF in supporting financial restructuring efforts in countries receiving aid.[39] Through close coordination, the IMF would be better equipped to credibly support a stabilization program without being assured that appropriate financial restructuring will take place."[40]

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[36] Id.
[37] Id.
[38] Krueger, Anne O., IMF Stabilization Programs, 333 (Martin Feldstein ed., University of Chicago Press 2003).
[39] Id. at 333-334.
[40] Id.

IMF structural program and policy advice has not traditionally strayed from the financial liberalization and market-opening policies of the Washington Consensus.[41] However, due to the response from the IMF's actions in the wake of the Asian crisis, debate has since been underway to more appropriately define the scope of the IMF response to crisis and its policies of conditionality of aid.[42]

Traditionally, the IMF structural policies and conditions for receiving aid are focused on "dismantling government-imposed distortions or putting in place various institutional features of a modern market economy.[43] These include financial sector reform, trade liberalization and economic privatization, among other condition policies.[44] "Although the structural conditions the IMF attaches to its loans are often demanding, emerging economies recognize that a Fund program represents their best chance to make real traction on the structural weaknesses that have underpinned their crisis vulnerability."[45]

C. G7, G10 and G20 Meetings

The Group of Twenty (G20) Finance Ministers and Central Bank Governors was "established in 1999 to bring together systemically important industrialized and developing economies to discuss key issues in the global economy."[46] Its objective is to promote strong, sustainable and balanced growth.[47] However, before the G20 was

[41] Goldstein, Morris, IMF Structural Programs, 413 (Martin Feldstein ed., University of Chicago Press 2003).
[42] Id. at 366.
[43] Id.
[44] Id.
[45] Id. at 369.
[46] The G-20 , www.G20.org (last visited on July 26,2010).
[47] Ngozi N. Okonjo-Iweala, Remarks at the World Bank – Korea Conference on Post Crisis Growth and Development: Why the G20 Should be Interested in the Development of the G160+ (June 5/6 2010) (transcript available at www.g20.org).

established, the Group of Seven (G7) and Group of Ten (G10) and others were convened for much the same reasons, only without the participation of emerging markets.

The G-22 met at Washington D.C. in April and October 1998. Its aim was to involve non-G-7 countries in the resolution of global aspects of the financial crisis then affecting emerging-market countries. Two subsequent meetings comprising a larger group of participants (G-33) held in March and April 1999 discussed reforms of the global economy and the international financial system. The proposals made by the G-22 and the G-33 to reduce the world economy's susceptibility to crises showed the potential benefits of a regular international consultative forum embracing the emerging-market countries. Such a regular dialogue with a constant set of partners was institutionalized by the creation of the G-20 in 1999.[48]

The G-20 was created as a response both to the financial crises of the late 1990s and to a growing recognition that key emerging-market countries were not adequately included in the core of global economic discussion and governance. The G20 is key to the development of cooperation of international standards and principles.

D. Bank for International Settlement and the Basel Committee on Banking Supervision

The Bank for International Settlements (BIS), Basel, Switzerland, is a multilateral bank for national central banks. Traditionally, it has been supported by the G10 countries, which consisted of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, United Kingdom, and the United States, with Switzerland as an

[48] G20, *supra* note 47.

additional significant participant.[49] The BIS, among other things, often plays a role in settling international loan arrangements; but its role as a "forum or catalyst for international monetary cooperation and regulatory policy development" has gained significance given recent financial crisis.[50]

In 1974, after the failure of Herstatt Bank in Germany and Franklin National Bank in New York created international repercussions throughout an increasingly internationalized banking market, the G10 sponsored an informal understanding on the resolution of international banking failures, known as the Basel Concordat.[51] The Collapse of the Bretton Woods system in the 1970s encouraged the development of the Basel Committee.[52] Moreover, "the governors of the BIS acknowledged the need to establish a framework of multilateral bank supervision, so they formed the Committee on Banking Regulations and Supervisory Practices, known as the Basel Committee on Banking Supervision."[53] The Basel Committee on Banking Supervision (BCBS) promotes cooperation among national regulators as well as attempts to facilitate the establishment of broadly delineated principles to guide national regulatory systems in establishing their own detailed arrangements.[54]

"Since the issuance of the Concordat in 1974, the BCBS has given further attention to the problems of supervising transnational banking enterprises."[55] For example, the 1991 collapse of the Bank of Credit and Commerce International (BCCI) caused the BCBS to review the coordination of international banking supervision, which

[49] Malloy, Michael P., *Emerging International Regime of Financial Services Regulation*, 18 Transnat'l Law. 329, 330 (2005).
[50] Id.
[51] Id.
[52] Gard, *supra* note 29.
[53] Malloy, *supra* note 50.
[54] Id.
[55] Id at 331.

appears to fail according to these events.[56] In June of 1992, the BCBS issued a report that established minimum standards on the supervision of international banking conglomerates; and although not binding, the standards were to be implemented by participating countries.[57]

Recently, the BCBS, in conjunction with the IMF and the International Bank for Reconstruction and Development, developed a set of core principles for effective banking supervision. These are twenty-five basic principles ranging from preconditions for effective banking supervision to principles for cross-border banking.[58] "Significantly, the principles address in detail prudential regulations and requirements, which have the effect of requiring careful supervision of management operations and internal controls."[59] These principles have been included in IMF and World Bank FSAPs and continue to develop as the key pieces in banking supervision on an international scale. They are also among the 12 key sets of standards encouraged for adoption by the Financial Stability Board.

E. Financial Stability Board

The Financial Stability Board (FSB) was created in April 2009 as the successor to the Financial Stability Forum (FSF) with a broadened mandate to promote financial stability. Originally established in 1999 by the G7 Finance Ministers and Central Bank Governors, the goal of the FSF was to enhance cooperation among national and international supervisory bodies.[60] The FSB coordinates "the work of national financial authorities and international standard setting bodies to develop and promote the

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[56] Id.
[57] Id. (citing 12 U.S.C. 3105(d)(2)(1)(A); 3105 (d)(3)(A); and 3105 (e)(1)(A)).
[58] Malloy, *supra* note 50 at 331-332.
[59] Id. at 332.
[60] Financial Stability Board, www.financialstabilityboard.org/about/history (last visited on August 4, 2010).

implementation of effective regulatory, supervisory and other financial sector policies.[61] The FSB creates a forum for national authorities responsible for financial stability in significant international financial centers, such as New York, London, Tokyo and Europe, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.[62]

The FSB's mandate stipulates that the FSB is to, among other things: assess vulnerabilities affecting the financial system and identify and oversee action needed to address them; promote coordination and information exchange among authorities responsible for financial stability; monitor and advise on market developments and their implications for regulatory policy; and collaborate with the IMF to conduct early warning exercises.[63] The growing role of the FSB is to work through FSB members to encourage and develop consensus around its multilateral agenda for strengthening the global financial system. In order to engage in broad-based outreach, the FSB holds meetings with its member countries, as well as holding meetings in regions of non-member countries. As an FSB member, each country agrees to, among other things, implement international financial standards,[64] which the FSB has determined to be critical to a sound financial system.

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[61] Financial Stability Board www.financialstabilityboard.org/about/overview, (last visited on August 4, 2010).
[62] Financial Stability Board www.financialstabilityborad.org, (last visited on August 4, 2010).
[63] Financial Stability Board www.financialstabilityboard.org/about/mandate, (last visited on August 4, 2010).
[64] Financial Stability Board, www.financialstabilityboard.org//cos/key_standards,(last visited on August 4, 2010). 12 Key Standards for Sound Financial Systems. These include the 12 Key International Standards and Codes, which contain the following: (1) the Code of Good Practices on Transparency in Monetary and Financial Policies, issued by the IMF; (2) the Code of Good Practices on Fiscal Transparency, issued by the IMF; (3) the Special Data Dissemination Standard/General Data Dissemination System, issued by the IMF; (4) Insolvency and Creditor Rights standard, issued by the World Bank; (5) the Principles of Governance, issued by the OECD; (6) the International Accounting Standards, issued by the IASB; (7) the International Standards on Accounting, issued by the IFAC; (8) the Core Principles for Systemically Important Payments Systems and Recommendations for Securities Settlement Systems, issued y the CPSS/IOSCO; (9) the Forty

III. Background on Financial Crisis and Reform

1. Current Crisis

Economists, regulators and market researchers have extensively analyzed the causes of the current financial crisis and have proposed reforms to ensure that such a crisis never happens again. They note that "major underlying factors to the current situation were, among others, inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These developments, together, contributed to excesses and ultimately resulted in severe market disruption."[65] Particularly, the IMF indicated that this crisis was really a case of fragmented surveillance, a dispersed policy debate among IOs, limited collaboration, ad-hoc cross-border facilities for financing and a failure to engage key decision-makers.[66]

In the recent era of global economic growth, increased capital flows, and prolonged stability, market participants sought higher yields without an adequate consideration of the risks. Moreover, weak underwriting standards, unsound risk management practices, unbelievably complex financial products, and excessive leverage created systemic vulnerabilities.[67] In hindsight, policy-makers, regulators and supervisors did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic

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Recommendations of the Financial Action Task Force/9 Special Recommendations Against Terrorist Financing, issued by the FATF; (10) the Core Principles for Banking Supervision, issued by the BCBS; (11) the Objectives and Principles of Securities Regulation, issued by the IOSCO; and (12) the Insurance Core Principles, issued by the IAIS.

[65] G20 Declaration of the Summit on Financial Markets (November 2008)

[66] Blanchard, Oliver, Caruana, Jaime et al., *Initial Lessons of the Crisis*, IMF Paper ¶ 2 (6 February 2009).

[67] G20 Declaration, *supra* note 66.

ramifications of domestic regulatory actions.[68] However, as the factual complexity and toxicity of the riskiest of these products has emerged, it has revealed that, in many cases, even the institutions creating the most exotic of these high yield products could not comprehend their characteristics when put under stress.

"Effective regulation may be as much a matter of effective surveillance over trends and incentives in financial markets as it is of rules."[69] As evidenced by each financial crisis over the last 30 years,[70] financial markets evolve quickly and the reaction to strong movements in the markets can occur literally overnight. Going forward, regulation must balance risk-taking against systemic risk and crisis.[71]

However, the crisis is ongoing and while many of these conclusions appear sound, we will not know the full implications of the crisis for years to come. This also means that demanding reform of global financial markets before we fully understand the causes and effects of the current crisis is premature. Fundamental improvement in the institutional and legal framework, the extent of which is yet to be determined, is needed. The IMF indicated that these fundamental improvements should provide a "binding code of conduct across nations – which is partly a political task beyond the capacities of regulators and supervisors."[72]

Further, the IMF has suggested that if countries can move beyond the necessary division of fiscal costs associated with an internationally binding code of conduct, then a number of options to move forward emerge. One obvious proposal seems to be an

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[68] Id.
[69] Blanchard et al., *supra* note 67 at ¶ 15.
[70] In particular, I refer to the Latin American debt crises in the 1980s and the 1990s crises in Southeast Asia, Russia and Brazil for their effect on the global marketplace and the speed with which each of the crises took hold of economies.
[71] Blanchard, *supra* note 67 at ¶ 15.
[72] Id. at ¶ 28.

international charter for banks that operate across borders, which spells out the procedures for joint risk assessment by various supervisors, remedial actions and burden-sharing.[73] A second proposal from the IMF is to "have home and host supervisors agree on these issues and for [supervisory] colleges to become the arbiters in enforcing understandings (e.g. burden sharing of losses in proportion to a bank's exposure in each jurisdiction)."[74] This is beyond the scope of this paper, but in order to get there, the IMF needs to work with its sister IOs to develop broad support and understanding for such proposals.

Since an abundance of literature now exists with respect to the ongoing crisis, I will limit my comments as to the causes and what I believe should be done to reform the global financial markets. What I will do is examine a few historical examples of previous crises, primarily in emerging market economies, the effects of such crises for those and other emerging market economies, and efforts at post-crisis reform in those cases.

2. History of Economic and Financial Crisis

As international finance began to reemerge soon after World War II (initially in the form of the Euromarkets - the basis of today's global financial system), due to the Bretton Woods design for an international economic system and focus on trade liberalization, fixed exchange rates and closed domestic financial systems, the international community failed to direct any real effort towards the international regulation of finance, meaning that such regulations was left to be dealt with by domestic law.[75] Since Bretton Woods, the world's economy has re-integrated and become

[73] Id.
[74] Id.
[75] Weber, *supra* note 27 at 391.

globalized in many ways.[76] A substantial expansion of the global capital market occurred in the late 1980s and 1990s with rapid increases in private debt and equity flows and in foreign direct investment in emerging market economies.[77]

As international finance has developed and globalized, it has been challenged by a number of crises, including: the developing country debt crisis of the 1980s; global stock market collapse of 1987; crisis in the emerging markets in Asia in the 1990s; and periodic collapses of international financial intermediaries such as Commerce International and Long Term Capital Management.[78] The expansion in the 1980s and 1990s "reflected a wide variety of changes in the global political environment, in financial technology, and in investors' preferences."[79] Moreover, the general global shift to more democratic and market-oriented policies around the world, as advocated by IOs, increased the attractiveness of lending and investing in emerging markets in the last three decades.[80]

Such financial crises created international implications in Europe, Mexico, East Asia, Russia, Turkey, and Argentina, among others.[81] Each of these events has resulted in international efforts to prevent similar situations through financial regulatory cooperation."[82]

For example, a massive influx of capital in the 1970s and 1980s, especially in Latin America, led to the debt crisis that began in Mexico in 1982.[83] As noted above, the response was an international effort and came in the form of the "Brady Initiative." This "provided a context for indebted nations to negotiate reductions, within IMF-supported

[76] Id.
[77] Feldstein, supra note 3 at 2.
[78] Weber, *supra* note 27 at 392.
[79] Feldstein, supra note 3 at 2.
[80] Id.
[81] Id.
[82] Weber, *supra* note 27 at 393.
[83] de la Torre, supra note 4 at 31 -32.

programs, in the debt with commercial bank creditors, which turned the debt into so-called "Brady Bonds."[84]

After this renegotiation, investor confidence began to return to developing countries, albeit at a slow pace, which encouraged the growth of the emerging country bond markets and increased capital flows in the 1990s.[85] This transformed the type of capital that began to flow to emerging market economies in the 1990s. Now, instead of loans from banks, the emerging market economies were receiving capital flows from their bond and equity market offerings, which also attracted increased levels of foreign direct investment.[86]

However, the 1990s were also host to the Asian, Russian and Brazilian crises. These crises again called attention to the emerging market struggles with the volatility of capital flows. Moreover, contagion emerged again as one of the derivatives of financial globalization causing headache in global markets.[87] These crises were a new breed of crisis because the debt was not concentrated in the large multinational commercial banks, but had been shifted to bonds and securitized loans; and because the debtors were no longer sovereign governments but were private commercial banks and non-financial corporations.[88]

"Industrial countries responded to the crises of the 1990s both directly and through the IMF with substantial packages of financial support and with the imposition of wide-ranging requirements of domestic economic reforms."[89] However, support was

[84] Id. at 32.
[85] Id.
[86] Id.
[87] Id. at 34-35.
[88] Feldstein, supra note 3 at 15.
[89] Feldstein, supra note 3 at 2-3.

only required in those economies that began with weak banking system.[90] "Countries with strong banking systems and good bank supervision, like Singapore, avoided the difficulties that happened in the crisis countries."[91]

Moreover, as discussed herein, while it appears that the IMF's response to these crises varied from country to country, the following basic approach was the same in each case:

> "The IMF prescribed floating the currency, since the old fixed rate could not be defended, but mandated high interest rates and tight fiscal policy to limit the extent of the currency's decline and to reduce the budget deficit. It developed structural reform plans covering a wide range of areas, including reform of commercial and central banking, ending government support for private companies, opening product and capital markets, changing labor laws and corporate governance rules, eliminating subsidies for various products, and so on. These extensive and detailed structural reforms were without precedent in the IMF's dealing with the industrial countries in the 1950s and 1960s or with the Latin American crisis countries in the 1980s. Rather, they were similar in style to the technical assistance given to countries of Eastern Europe and the former Soviet Union in the early 1990s."[92]

A. Financial Crisis in Asia

The Asian crisis is a significant comparison to the current debate because it "rekindled fundamental debates about the role of governments and markets in capitalist development."[93] Also, similar to the story of the current crisis, the Asian crisis occurred before anyone knew what was happening. It was "baffling" because the so-called macroeconomic fundamentals seemed sound in Asia going into the crisis and, in contrast to the situation in Mexico or other Latin American countries in the 1980s most of the debt

[90] Feldstein, supra note 3 at 8.
[91] Id.
[92] Feldstein, supra note 3 at 15-16.
[93] Khan, Haider A., Global Markets and Financial Crisis in Asia: Towards a Theory for the 21st Century 4 (Palgrave Macmillan 2004).

was not sovereign.[94] Instead, it was a private sector debt crisis.[95] In hindsight, there were a number of preconditions in Asia leading up to the crisis, including:

> "(1) very high rates of domestic savings, intermediated from households to firms via banks, creating a deep structure of *domestic* debt; (2) Fixed-exchange-rate regimes, with currencies pegged to the US dollar (apart from Japan, and partially, Korea), that created the perception of little risk in moving funds from one market to another; (3) liberalization of capital markets in the early to mid 1990s and deregulation of domestic financial systems at about the same time, without a compensating system of regulator control; and (4) vast international inflows of financial assets, coming from excess liquidity in Japan and Europe being channeled through financial institutions scouring Asia for higher returns and lending at even lower nominal rates than domestic borrowers could borrow from domestic sources, creating a deep structure of *foreign* debt."[96]

It caught the entire world economy by surprise as "neither the existing surveillance mechanisms, nor markets warned the euphoric investors adequately of impending calamity."[97] What began as a currency crisis developed into a full-blown financial and economic crisis, triggered in 1996 by the slowdown in exports.[98] This slow export growth triggered skepticism regarding future growth prospects, which threatened foreign capital inflows, which were needed to sustain current account deficits. This lead to concerns over the fixed exchange rates, leading to their collapse, which caused investors to withdraw from the region and the asset bubble burst.[99] This, again as we have seen over the last few years, resulted in financial intermediaries facing insolvency and fill-blown financial crisis.

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[94] Id. at 2.
[95] Id.
[96] Id. at 4 (citing Wade, Robert, The Asian Debt-and-Development Crisis of 1997-?: Causes and Consequences, World Development 26(8) (1998) 1535-1553).
[97] Khan, supra note 94 at 5.
[98] Id.
[99] Id.

Needless to say, the financial crisis in Asia caused a great deal of consternation about the financial liberalization policies that the Asian region underwent just years before. In South Korea, for example, the financial liberalization and market-opening policies of the early 1990s, such as interest rate deregulation, increased managerial autonomy at banking organizations and foreign exchange liberalization, provoked increased investment in the country.[100] However, the South Korean financial institutions were not ready for financial liberalization.[101] Some argue that "on most criteria, one can evaluate the IMF programs in Korea as having been successful."[102] A clearer focus on the factors that contributed to the rapid emergence of the crisis and lessons for economic policy management for crisis avoidance by the IMF can be criticized, but on balance, Koreans and the rest of the world are better off because of the IMF's activities during the very difficult crisis period and its aftermath.[103]

Thereafter, the Japanese Yen fell and Asian exporters started to drop, which caused traditional financial intermediaries to suffer and confront insolvency, resulting in financial and economic crisis.[104] This is where IOs must play a more significant role for monitoring international finance and encouraging of various forms of regulation, such as the prudential regulation that Korea lacked failed to implement. IOs today have a wide reach and while their "soft law" is not binding, it must be considered. National

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[100] Id. at 61-63.
[101] Id. at 63-64. Korean financial institutions were not prepared for financial market liberalization and market opening because they had not developed sufficient expertise in credit analysis, risk management, due diligence, and international finance in general. The supervisory authorities were also pressured to overhaul their regulatory system in order to make it more compatible with a liberalized system. In the process, many restrictions and control measures were eliminated or relaxed. At the same time the authorities did not install the new system of prudential regulation that was needed to safeguard the stability and soundness of financial institutions. In these developments lay the potential for a serious financial crisis.
[102] Krueger, *supra* note 39 at 335.
[103] Id.
[104] Khan, *supra* note 94 at 63-64.

governments, especially those of emerging market economies, must consider the effect of this "soft law" because there will always be market instability somewhere in the global financial markets.

The IMF response to the crisis in Asia, in particular, has been debated and viewed as inadequate because "the Washington Consensus policy mix of monetary tightening and fiscal restraints was imposed as part of the IMF conditionality package in Asia because the experience of the IMF during the Mexican crisis in 1995 had convinced them that such a policy mix was appropriate for Asia as well." The IMF response is viewed by some to have brought the world to the brink of total meltdown.[105] What the IMF failed to identify and adjust for was the difference in pre-crisis conditions in Asia versus those in the sovereign debt-laden Latin American countries.[106] However, in the current globalized economy in which capital outflows can magnify quickly, the IMF seems absolutely essential for ensuring the world's ability to react in a timely fashion.[107] "Moreover, as long as there are weak financial systems negatively affected by exchange rate movements or capital outflows, it will continue to be necessary for the IMF to address financial restructuring as well as exchange rate issues."[108]

After the East Asian crisis, the development of local capital markets was regarded as a way to make emerging market financial systems more stable and efficient. The rationale was that financial markets, especially bond markets, could be the "spare tire" of the system, sustaining finance when the "main tire" (banks) is flattened by a crisis.[109] Capital markets in these [emerging] economies would be able to absorb financial shocks

[105] Stiglitz, Joseph E., Globalization and its Discontents 89 (W.W. Norton & Company, Inc. 2003) (2002).
[106] Khan, *supra* note 94 at183.
[107] Krueger, supra note 39 at 345.
[108] Id.
[109] de la Torre, supra note 4 at 34-35.

by passing on changes in asset values to investors as they occurred.[110] The Asian crisis demonstrated the ability for globalization to create mass financial instability and contagion. [111] "Under fairly realistic conditions the banking system of emerging economies can respond in a way that intensifies the impact of adverse financial shocks."[112] It also "rekindled fundamental debates about the role of governments and markets in capitalist development."[113]

B. Difference between Latin America and the Asia in the 1990s

As opposed to the Asian financial crisis, the earlier Latin American crises emerged amid significant amounts of sovereign debt. Latin America's debt crises were more concrete and were based on very real debt levels. "In the Latin American debt crisis, the presumption that bad loans and bad investments were the debtor's fault meant that the 1980s became the lost decade for Latin America."[114]

The Asian crisis, as noted above, developed from the activities of the private sector, a more similar scenario to what we have gone through since 2007 in the United States.[115] It was really a crisis of confidence for the Asian countries. Unfortunately, the IMF looked to the response that was taken in the sovereign-debt burdened Latin American crisis to form a response to the Asian crisis. IMF bail-outs of Asian debtors "were made available for the purpose of fully repaying short-term bank debt – the very debt that, through its instability, had triggered the crisis and the very debt that, through

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[110] Id. at 12.
[111] Khan, supra note 94 at 172.
[112] Id. (citing Knight, Malcolm, Developing Countries and the Globalization of Financial Markets, IMF Working Paper WP/98/105 (July 1998)).
[113] Khan, supra note 94 at 4.
[114] Buckley, Ross P., *A Tale of Two Crises: The Search for the Enduring Reforms of the International Financial System*, 6 UCLA J. Int'l L. & For. Aff. 1, 42 (2001).
[115] Id. at 37 (citing Stiglitz, Joseph, Statement to the Meeting of Finance Ministers of ASEAN plus 6 with the IMF and the World Bank, Kuala Lumpur, Malaysia (Dec. 1, 1997)).

high interest rates, had well rewarded the banks. Such bail-outs were highly counterproductive."[116] IMF program support in Asia structured in this manner was the "wrong call" because the IMF's perspective had not changed from what it had experienced in Latin America, even though the crises were very different.[117]

C. Brazilian Financial Crisis – IMF Learns from Mistakes in Asia

After the Asian and Russian crises in the late 1990s, the IMF and World Bank joint meetings began to focus more on instituting more fundamental change to international law and institutional reform packages instead of determining country specific needs.[118] The unexpected nature of the Asian financial crisis, as well as its immediate global impact, caused the IMF to focus on the need to create a new international financial architecture, [119] the core elements of which would be "transparency, internationally accepted standards, financial sector building, private sector involvement and contingent credit lines."[120]

As the reforms were being discussed, Brazil became enthralled with its own financial crisis as it began devaluing its currency, eventually by up to 40 percent.[121] The devaluation of its currency sent the crisis into full force, but the IMF, alongside the Brazilian Central Bank, the Brazilian government and other international organizations,

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[116] Buckley, supra note 116 at 42.
[117] Id. at 43.
[118] Guira, Jorge M., *Preventing and Containing International Financial Crisis: The Case of Brazil*, 7 Law & Bus. Rev. Am. 481, 482(2001).
[119] Id.
[120] Id. at 482-3 (citing IMF: *A Guide to Strengthening the Architecture of the International Financial System* (Apr. 1999; IMF: *Progress in Strengthening the Architecture of the International Financial System*, Oct. 12, 1999)).
[121] Guira, supra note 119 at 483.

worked to restore the economic fundamentals and confidence in the Brazilian financial system in relatively short order.[122]

Instead of the strategies used in Mexico and Asia earlier in the 1990s, in Brazil, the IMF, along with others, "primarily focused on maintenance of confidence through surveillance and monitoring and on encouraging the adoption of certain international agreements and policy prescriptions in banking and securities law."[123] Further, Brazil and the IMF jointly announced a broad support package in late 1998, which also drew support from the World Bank and Inter-American Development Bank who each indicated intentions to "commit funds towards social support programs, priority public investments and public administration and small business credits." [124]

Ultimately, "the coordinated IMF and Brazilian government program (with some private sector and other international financial institutions assistance) was yielding positive results that were fueling confidence in Brazil's ability to manage its way out of the devaluation into a smoother stabilized future."[125] It appears that although international and domestic coordination in Brazil may not have been able to prevent the crisis from happening, they may have played a large role in containing it.[126] Moreover, it is suggested that "the international financial architecture proposals had a modestly positive effect on the ability of Brazil's decision makers to adopt legal and institutional reform measures that matter."[127] The experience in Brazil therefore appears to have bolstered the status of IOs in resolving financial crisis in the wake of criticism over the

[122] Id. at 483-4.
[123] Id. at 485.
[124] Id. at 499.
[125] Id. at 502.
[126] Id. at 500.
[127] Id. at 506.

Asian crisis because the IMF focused on regulation and surveillance through international coordination.

3. Effects of Past Crises

These global trends, as outlined in the previous section, affected emerging market economies in a variety of ways. First, new capital became available in the international financial markets, with developing countries trying to attract it to their domestic markets. Second, developing countries tried to encourage the development of capital markets, as manifested in advanced economies, by instituting a series of financial and regulatory reforms. Third, the boom-and-bust pattern of capital inflows, particularly in the late 1990s, made policy makers increasingly aware of the need to properly manage the risks of global financial integration.[128]

The major policy lesson from the crises in the 1990s may well be that most domestic financial systems in emerging market economies were not strong enough to withstand major capital flow shocks.[129] The recurring financial crises in the 1990s, many of which were, associated with debt rollover problems due to predominantly short-term bond maturities, created a global consensus that countries relying excessively on short-term borrowing are more vulnerable to sudden reversals of capital flows and to liquidity crises.[130] The crises of the 1990s was also the catalyst for the development of the G20. In response to the growing need to examine emerging markets, the Group of Twenty was developed after the Asian crisis to include a broader base of policy-making officials that was more comprehensive than the G7, G8 or the G10. Moreover, even recent G20

[128] de la Torre, supra note 4 at 35.
[129] Id. at 37.
[130] Id. at 102.

meetings have concluded that there is a need for increased input from emerging market economies in the scope of policy development.[131]

In 2010, we are again seeing this risk play out with the sovereign debt crisis having already consumed Iceland and Ireland, and now consuming Greece and Europe's integrated system as a result. Therefore, several scholars have recommended a course of action that requires the lengthening of government debt maturities as a key step to stabilization as a result of adverse financial market and economic shocks.[132]

4. Regulatory Responses to Past Crises

Inviting regulatory reform as a crisis response has been a knee-jerk reaction for economies. It reflects political, economic and social forces all at the same time. Thus is one of the many challenges to implementing it effectively. However, if proper guidance is given and accepted by those economies in need of it, thoughtful reform is accomplished, the benefits can far exceed the costs of the crisis.

Following the Asian Crisis, a theory emerged that the vulnerability of emerging market economies was largely related to the lack of diversification in their domestic financial systems, primarily because of their traditional focus on bank-based financial intermediation. In contrast to emerging markets, the United States, in the 1980s and 1990s, was able to withstand the banking crisis in Latin American as well as its own savings and loan banking crisis because of the diverse range of capital market alternatives in financial intermediation.[133]

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[131] The G20 Summit in Pittsburg cemented the need for a more inclusive role of emerging market economies.
[132] de la Torre, supra note 4 at 102.
[133] Id. at 38.

The resulting reform packages came largely in two stages. The first set of reforms focused on stabilizing the macroeconomic environment, setting up basic legal and regulatory frameworks, liberalizing domestic financial markets, and opening up the capital accounts. The second set of reforms focused on building better institutional and market infrastructures to increase market activity and liquidity, broaden investor participation, and expand the universe of instruments traded.[134]

"Enticed by the potential benefits of having a well-functioning, market-oriented system, governments also approved new legislation aimed at creating the proper legal frameworks and market infrastructures and institutions for capital markets to flourish."[135] Emerging market economies have developed domestic securities and exchange commissions, a more robust regulatory and supervisory framework, and focused on establishing and improving the basic environment for market operations. More recently, new laws and regulations have emerged with the intention of protecting creditors and investors and enhancing the core financial infrastructure, including improvements in the legal framework through property rights, minority shareholders rights, bankruptcy laws, and insider trading regulations, among others.[136]

A. Immediate Response

Emerging market economies began implementing financial market reforms to diversify their financial intermediation options and foster the domestic development of capital markets. In order to accomplish this, the reforms, modeled on many of the advanced economies of the their western counterparts, focused primarily on: (i) creating a favorable environment for capital markets, such as strengthening the macroeconomic

[134] Id. at 12.
[135] Id. at 13.
[136] Id.

stability and the enforcement of property rights; (ii) enhancing efficiency and market discipline in the entire financial system through greater competition – such as capital account liberalization; (iii) supporting, indirectly, capital market development through pension reform and privatization programs; and (iv) implementing capital market-specific reforms, such as developing a regulatory and supervisory framework and improving the securities clearance and settlement systems.[137]

Perhaps the most important precondition for a functioning system of capital markets is the development of the regulatory and supervisory framework. This development enhanced the essential feature of investor confidence and protection necessary for investment in the domestic capital markets. Such reforms can also assist in mitigating information problems through improved transparency, enhanced market integrity and more reliable contract enforcement.

One of the most immediate and tangible effects of appropriate regulatory reform is the reduction in transaction costs that accompanies modernization of financial market activities. Modernization of trading, custody, clearing and settlement systems creates market efficiencies, which can lead to diversification and attraction of capital investment.[138]

Moreover, privatization schemes employed in post-crisis economies directly increase the availability of investable assets. The process of financial liberalization in many of these economies fosters discipline and efficiency in the system, while making available foreign capital to local firms and foreign assets to local investors. In combination, these reforms can allow investors to diversify their portfolios within a much

[137] Id. at 38 -39.
[138] Id. at 39-40.

broader universe of assets and at lower transaction costs, which further encourages participation in capital market activities, raising the available supply of funds.[139] "This virtuous circle can be strongly complemented by pension system reforms – which bring retirement-related savings to the capital markets – and by the expansion of the mutual fund industry, which is key to offering investors attractive alternatives to traditional bank deposits."[140]

The promotion of capital market reform through financial liberalization "ended a long period of financial repression where financial growth, integration and expansion was limited by governments that restricted financial intermediation through control of interest rates, credit availability and allocation and the actual operations of financial institutions."[141] Moreover, while emerging market economies were enacting legal and regulatory reforms to encourage financial liberalization, IOs were developing standards that would further assist these emerging economies with the guidance they needed for development and global integration.

B. International Coordination

Since the creation of the Financial Stability Forum in 1999, regulatory reform agendas have developed at a rapid pace, and in many cases, such as Asian and Latina American emerging economies, reform has actually taken place. However, as we have seen over the last few years in response to the global credit crisis, the regulatory agendas of IOs face substantial challenges to coordination. The question how do IOs create

[139] Id.
[140] Id.
[141] Id. at 40.

standards that lack the status of legitimate law (so-called soft law),[142] but effectively and efficiently outline a cooperative framework moving forward for international financial regulation while avoiding host-government interference?

Some argue that a way around the problem of governments becoming "market players and referees" would be to "introduce rules that would require the domestic regulator to step in if credit and asset prices are growing at above-average rates. That would shield the government from claims that the next boom is somehow different and should be left to run its course. But it comes at the cost of flexibility."[143]

"Solutions to the global financial crisis have a strong international dimension."[144] However, despite the positive and detailed work of these IOs, the debate about regulatory reform has waged on.[145] For example, if Europe and the US were to adopt different systems for regulating or resolving multinational institutions, as it appears they currently are in response to the current financial crisis, the ability of these international institutions to function could be significantly impaired.[146] Financial market reforms have gone on separately. These different tracks of regulatory proposals and implementation are

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[142] "Soft laws" have been defined as "statements prepared by individuals in a nongovernmental capacity, but which purport to lay down international principles." Norton, Joseph J., *An Interim Filling the Gap in Multilateral, Regional, and Domestic Hard Law Deficiencies. Respecting Financial Services Integration within the Americas*, 12 Law & Bus. Rev. Am. 153, 162 (2006) (citing Chinkin, C.H., The Challenge of Soft Law: Development and Change in International Law, 38 Int'l & Comp. l..Q. 850, 851 (1989)).

[143] *The Gods Strike Back: A Special Report on Financial Risk*, The Economist, 17 February 13, 2009.

[144] Scott, Hal S., The Global Financial Crisis, 172 (Foundation Press 2009).

[145] United States Federal Reserve Board Governor Daniel Tarullo recently cited the following continuing issues for debate: "First, there is a considerable continuing disagreement over the key features of some of the proposals, even when the basic idea is accepted. The significant differences over the best form of resolution mechanism provide one example. Second, as also mentioned earlier, some ideas that may be promising ideas in concept – such as special charges calibrated to the systemic importance of a firm – are not easy to develop and put into practice effectively. Until more detailed proposals are generated, judgments on the likely efficacy of these ideas will obviously be difficult to make. Third, many participants in the public policy debate who would agree with some form of this consensus agenda nonetheless believe that it falls short of what is needed to ensure financial stability." Governor Daniel K. Tarullo, Remarks at the Institute of International Bankers Conference on Cross-Border Insolvency Issues: Supervising and Resolving Large Financial Institutions November 10, 2009) (transcript available at www.federalreserve.gov).

[146] Scott, supra note 145.

concerning for global institutions conducting varied financial activities across developed and emerging country borders.

In response to many of these concerns, IOs need to embrace their role as producers of soft law and strive to work in cooperation with host-governments to tailor more specific rules and standards for the particular details of that host-nation. Unfortunately, since international cooperation is so difficult in this area, IOs must play a positive role in developing standards that are broad enough to be accepted widely, while ensuring that such standards, even when viewed in a vacuum, are adequate protection to effectively regulate the financial activities in any adopting nation. Globalization is calling for a level playing field.

5. Implications for Globalization and Global Standards

As indicated by the regulatory responses to the current crisis so far, as well as the regulatory responses to the previous crises as described, international standard setting bodies remain at the ready to deliver a host of new standards that they believe will ensure an increased risk sensitivity as well as a stable environment for financial transactions and sufficient reserves if something like this happens again in the future.

However, while these international standard setting bodies create what they see as viable and necessary standards for international banking and finance, these standards are not delivered from the IOs with a legally binding effect. These standards are merely "soft law" until implemented by each country's home legislature or regulator.

Although there is a tendency to attribute international legal significance to these international standards, most experts and policymakers affirm that the international standards adopted by these organizations are not legally binding in any sense. For

example, as an international legal matter, the Basel Capital Accord and its amended versions, Basel II and now Basel III, are not legally binding in any way. The Capital Accord has been analyzed and classified as another form of "soft" law.[147]

Many advanced and emerging economies have incorporated the Basel Capital Accord standards into their regulatory frameworks. As such, the Basel rules can only be enforced to the extent that they are incorporated into the framework of each country's supervisory laws. The benefits received by the countries that have adopted this include strengthening the soundness of their commercial banking sector, raising their credit rating in international financial markets, and achieving a universally recognized international standard.[148] The IMF and World Bank have also required the use such capital standards in approving financial assistance as part of IMF Financial Sector Assessment Programs and World Bank Financial Sector Adjustment Programs as well as for approving licenses to conduct banking activities.[149]

Therefore, these standards reflect important international norms that already influence and shape state behavior and are an effective form of legally nonbinding international "soft law" that has significant public policy relevance in the global financial governance debate.[150] These IOs have been characterized as "networks" of technical experts; but, their role is much larger than narrow technical experts, as they influence the

[147] Alexander, supra note 10 at 874.
[148] Id.
[149] Id at 875. "The IMF and World Bank have also required many countries to demonstrate adherence or a realistic effort to implement the Basel Capital Accord in order to qualify for financial assistance a as part of IMF Financial Sector Assessment Programs and World Bank Financial Sector Adjustment Programs. Moreover, as a condition for obtaining a bank license, all G10 countries require foreign banks to demonstrate that their home country regulators have adopted the Capital Accord and other international agreements. International reputation and market signals are also important in creating incentives for non-G10 countries to adopt the Capital Accord. Many non-G10 countries (including developing countries) have found it necessary to require their banks to adopt similar capital adequacy standards in order to attract foreign investment as well as to stand on equal footing with international banks in global financial markets."
[150] Id. at 869.

development of broader economic policy and their negotiations and standard setting process is really a form of financial diplomacy.[151]

Their goal is to create broad international standards that govern the operations of financial market participants, as well as the markets themselves. To date, their focus has been on those markets with an important impact on the broader macroeconomy. This is evidenced by the creation of the G20 and the newly minted Financial Stability Board, formerly the Financial Stability Forum. "The G20, the FSB, and the G10 committees are all playing high profile roles in economic and financial policymaking and in influencing the development of international financial regulation."[152]

However, IOs such as the G20 and the FSB have begun to afford greater recognition of emerging market economies in developing new international standards to promote the integrity of the global financial markets. The economic resilience of emerging market economies, as well as low-income countries, is vital to achieving the aims of IOs such as the G20.[153] This is the case even more so now as a result of this most recent crisis because many of the emerging market economies have not had felt most dramatic effects of this current crisis in the way that the advanced western economies have.

The strong growth already occurring in emerging economies are important reminders that they are increasing in size, power and influence in the global marketplace. For example, almost half of economic growth now comes from developing countries.[154]

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[151] Id. at 877-878.
[152] Id.
[153] Ngozi N. Okonjo-Iweala, Remarks at the World Bank – Korea Conference on Post Crisis Growth and Development: Why the G20 Should be Interested in the Development of the G160+ (June 5/6 2010) (transcript available at www.g20.org).
[154] Id.

As such, emerging and developing economies will demand more attention, especially from IOs.

IV. Challenges created by Globalization and Financial Crisis

As the most recent crisis and past crises have demonstrated, great challenges emerge in both domestic and global markets in responding to systemic crises and their aftermath. These challenges manifest themselves on both legal and economic levels. Legal and regulatory challenges emerge as governments and market participants try to identify what went wrong, when it went wrong and why it went wrong. Moreover, we find significant implications from the economic perspective as many such crises involve domestic debt or domestic financial institution crises.

An especially difficult legal challenge is to develop internationally flexible, effective and competitive regulations that protect the safety and soundness of institutions and financial systems on a global basis. Another challenge comes in developing laws and regulations which can keep pace with financial innovation without hindering its pace or evolution.

1. National Sovereignty and Political Influence

In response to the growing cross-border flow of goods, services, ideas, and people, domestic governments and regulators have sought to enhance their management and surveillance of cross-border economic activities by coordinating their economic and financial policies with other nations through IOs and multilateral institutions.[155] However, the greatest difficulty in drafting national legislation or implementing new regulations, especially those developed from general standards created by IOs, is

[155] Alexander, supra note 10 at 866.

accounting for national sovereignty. "Regulation of financial markets is a valued national prerogative."[156]

Political interference in the decision making process for domestic financial regulators is still a consistently disturbing experience. "Recent crises, including Asia, Russia, Turkey and Latin America, have demonstrated the problem of making a bad situation worse."[157] In each of these recent financial crises, policy makers have sought to intervene in the work of regulators – often creating with disastrous results. Scholars increasingly recognize that this political interference has caused or even worsened financial instability.[158]

> "In East Asia in 1997-98, political interference in the regulatory and supervisory process postponed recognition of the severity of the crisis, delayed action, and, ultimately, deepened the crisis. In Korea, for example, a lack of independence impeded supervision. While the country's commercial banks were under the authority of the central bank (the Bank of Korea) and the Office of Banking Supervision, Korea's specialized banks and nonbank financial institutions were regulated by the Ministry of Finance and Economy. The ministry's weak supervision encouraged excessive risk taking by the non-banks, which helped lead to the 1997 crisis. Korea subsequently reformed its supervisory system, both to give it more autonomy and to eliminate the regulatory and supervisory gaps."[159]

Similarly, Indonesia's banking sector weaknesses stemmed from poorly enforced regulations and the reluctance of supervisors to take action against politically well-connected banks. Even after the collapse of the Suharto government, political

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[156] Schooner and Taylor, supra note 7 at 292.
[157] Mwenda, Kenneth Kaoma, Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator 29-30 (The World Bank 2006).
[158] The jury may still be out in deciding the fate of the political meddling that has occurred in the United States and Europe in the wake of the most recent crisis which began in 2007. Since then, and before the conclusion of the financial crisis, legislation has been passed in the U.S and in European countries that would limit financial activities, limit compensation of financial executives, require increased capital cushions, and limit the trading activity in certain, more "risky" products, among many other new requirements and limitations.
[159] Mwenda, supra note 158 at 30 (citing Quintyn, M. and M.W. Taylor, *Should Financial Sector Regulations be Independent?*, Economic Issues 32 (IMF 2004)).

interference persisted and continued to undermine bank restructuring efforts.[160] The lack of independence of financial supervisors in Japan's Ministry of Finance weakened the Japanese financial sector and contributed to prolonged banking sector problems.[161]

In each of these cases, political pressures weakened oversight of the financial sector leading up to the crisis. Political interference also delayed recognition of the severity of the crisis, slowed needed intervention, and raised the overall and eventual cost of the crisis for taxpayers. This was particularly true in countries where financial services regulators lacked independence.[162]

Despite the expected meddling of national governments and politically-charged entities and individuals, IOs creating standards to be implemented at the domestic level must continue to recognize that "regulation is first and foremost the responsibility of national regulators who are the first line of defense against market instability."[163] Further, the enforcement of regulatory standards remains a national or regional affair and will likely remain as such in the near term.[164]

Overall, these international organizations should focus their actions on "support[ing] market discipline; avoid[ing] potentially adverse impacts on other countries, including regulatory arbitrage; and support[ing] competition, dynamism, and innovation in the marketplace."[165]

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[160] Id. at 31.
[161] Id.
[162] Mwenda, supra note 158.
[163] Zagaris, Bruce, *G-20 Summit on Financial Markets and World Economy Sets Stage for New Regulatory Controls and Enhanced Enforcement Cooperation,* Int'l Enforcement Law Reporter, Vol. 25, No. 2 (2009).
[164] Scott, supra note 14 at 173.
[165] Zagaris, supra note 164.

2. Global Nature of Financial Markets Demands International Standards

Deeper international cooperation among regulators, strengthening of international standards, and consistent implementation of such standards is necessary for protection against adverse international, regional, and global developments affecting international financial stability.[166] One of the major themes of any reform and development of international standards must be to reinforce and increase international cooperation and integration. Such coordination will permit emerging market economies, with adequate political and diplomatic support, to emerge as global players, thereby increasing competition, efficiency and global financial access. Many of these IOs have already recognized the importance of emerging market economies having a seat at the table with greater representation.[167]

As IOs recognize the increasingly global nature of financial markets and develop international standards, two troubling implications have been identified.

> "First, many governments not actively involved in the standard-setting process are suffering an involuntary loss of sovereignty, as they have not been involved in the negotiation and design of the international standards. This loss is at odds with the general presumption in international law that governments are sovereign unless they decide to cede their sovereignty. Moreover, the growing obligation for States to adopt the Basel standards without representation in the standard-setting process calls into question the accountability and legitimacy of the Basel Committee. Perhaps, the G10's effective monopoly on decision making should be ended by allowing other countries that are also representative of the global financial system to have a seat at the table."[168]

> "Second, as a matter of economic policy, if those designing the standards maintain the fiction that they are voluntary when in fact they are not, the content of the standards is likely to be suboptimal for economic growth and financial development, as is demonstrated with the recent financial

[166] Id.
[167] Id.
[168] Alexander, supra note 10 at 881.

> crisis. Future research should elaborate what role international economic law should play in enhancing the institutional structure of decision making in order to achieve financial stability and development objectives. Moreover, the catastrophic financial crisis that has plagued Western financial markets from 2007 to the present raises important issues regarding the governance structure of the G10 committees and in particular the standard-setting competence of the Basel Committee, whose regulatory standards have completely failed in protecting the global financial system and in providing an efficacious, prudential regulatory model for future financial development."[169]

However, as noted above, developing international financial standards as soft law has some advantages. Soft law is flexible and allows for consideration of specific national conditions or attributes in implementing the standards. For instance, the Basel Core Principles for Bank Supervision are sensitive to the fact that bank regulatory structures differ greatly among nations.[170] Moreover, the growing importance of international financial standards and their acceptance for domestic regulatory systems has demonstrated the importance of international financial soft law.[171]

3. National Regulator's Sphere of Influence

Another challenge for emerging markets is what significance national regulators will give to internationally agreed upon principles. Will it matter if these have been "widely accepted" enough to rise to the level of "customary international law?"[172] National regulators have a limited sphere of influence. [173] To the extent that IOs engage in providing guidance to the financial markets and their participants, without the limits of statutory authority or regulatory process, national regulators may seek other means of competing with such international bodies, especially in terms of enforcement

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[169] Id.
[170] Alford, Duncan E., *Core Principles for Effective Banking Supervision: An Enforceable International Financial Standard?*, 28 B.C. Int'l & Comp. L. Rev. 237, 285 (2005).
[171] Alexander, supra note 10 at 869.
[172] Customary International Law is generally understood to be the consistent practice of states that they follow out of a sense of legal obligation (See section 102(2) of the Restatement of International Law).
[173] See Scott, supra note 145.

mechanisms used to patrol domestic markets. As noted above, it appears that the enforcement of regulation will remain a domestic undertaking for at least the near term.[174]

Domestic regulators can and should strengthen their coordination and cooperation across all segments of financial markets, including with respect to international capital flows.[175] As markets become increasingly integrated, this coordination must be viewed as positive and the role of these IOs must be effective at creating the framework. However, IOs are not well suited to prescribe the detailed minutia of regulations for domestic regulators to implement, and domestic regulators must therefore cooperate to assure a level playing field for global financial institutions.

National regulatory spheres of influence need not be minimized, but rather should be cooperative and integrated as a means of engaging in effective and efficient supervision and regulation.

4. Crisis Challenges

Financial liberalization, privatization, and implementation of market-based reforms in many emerging market economies have been identified as causes of the growth of financial sector activity in emerging economies in the 1990s. However, "the 1990s also witnessed the Tequila crisis of 1994 ('the first time that Latin America experienced an important impact generated by financial globalization'), the trans-nationalization of finance, the tele-information revolution, the Asian (1997) and Russian (1998) crises, and the Brazil and Argentinean crises (starting in 1999)."[176]

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[174] Id.
[175] See Zagaris, supra note 164.
[176] Norton, Joseph J., *An Interim Filling the Gap in Multilateral, Regional, and Domestic Hard Law Deficiencies. Respecting Financial Services Integration within the Americas*, 12 Law & Bus. Rev. Am.

Given the global nature of the current financial crisis, the response to the crisis must be global as well. As former Federal Reserve Vice Chairman Donald Kohn noted in October 2009, "…chief among the lessons learned from the past two years is that in an integrated global financial system we cannot make those decisions in isolation; we must collaborate internationally if we are to build a more resilient financial system for the future."[177]

And today, global inter-bank funding markets have become a source of contagion. Short-term funding markets in both the United States and Europe were "disrupted when conduits drew on bank lines of credit to replace maturing securities, and banks turned to dollar-denominated money markets to raise needed funds."[178] As the financial crisis deepened, banks hoarded liquidity and became more concerned about the exposure of their counterparties in the interbank market to losses.[179]

Financial crises will inevitably occur. Therefore, the key goal is to limit their destructive consequences without undermining commercial and financial activity in the process. Moreover, the integration of financial markets, as we have seen recently, can create huge obstacles when crisis emerges. However, calls for protectionist measures to be implemented are ill-founded.

153, 167 (2006) (citing Committee on the Global Financial System, Foreign Direct Investment in the Financial Sector of Emerging Market Economies, (Bank for International Settlements (2004) and Juan F. Rojas Penso, General Secretary of the Latin American Integration Association, Address Delivered at the Panel Latin American and Caribbean Options in Light of the International Financial Crisis: The Effects of the Crisis on Integration (Oct. 2 1999)).

[177] Vice Chairman Donald L. Kohn, Remarks at the Federal Reserve Bank of Boston 54th Economic Conference: International Perspective on the Crisis and Response (October 23, 2009).

[178] Id.

[179] Id.

V. Challenges for Emerging Markets and Financial Development

1. Role of Emerging Markets

Global financial markets underwent significant changes during the past decades, and they continue to do so. The global financial system expanded substantially since the early 1970s and boomed during the 1990s. Financial intermediation through both financial institutions and securities markets expanded at a remarkable rate, and the spectrum of financial services and instruments reached new dimensions. Regions like Asia and Latin America were strongly influenced by these global developments, and what happened in domestic capital markets was to a large extent a reaction to global forces linked to financial globalization and innovation.[180]

Over the course of the last two decades, the world's advanced financial markets have invested heavily in emerging markets, such as Brazil, Russia, India and China. Until relatively recently, emerging markets did not have an adequate infrastructure and economic capability to compete with the globally developed markets in America and Western Europe.

However, the pace and comprehensive nature of economic globalization has brought emerging markets to the forefront of global economic policy agendas. At the 2009 G20 Summit in Pittsburg, the G20 leaders agreed to shift voting power substantially within the IMF towards emerging markets and developing countries, thereby "securing the place of emerging markets at the top table of global economic policy"[181] Moreover, the G20 leaders endorsed a similar reform package for the World Bank.[182] The FSB has

[180] de la Torre, *supra* note 4 at 80.
[181] *Cosmetic Surgery?*, The Economist, October 3, 2009, at 88.
[182] Id.

also expanded to include emerging market members of the G20.[183] However, despite their recent elevation to the global economic policy debate, their actual decision-making power remains unclear.[184]

As national boundaries are increasingly opened through multilateral agreements and the increasing entry by multinational banks as a consequence of financial integration and emerging international soft law, financial systems are integrating more emerging and developing economies globally.[185] However, the challenge for emerging markets is to implement internationally recognized and accepted standards through national laws, regulations, and institutions.

The reality is that equity and corporate bond markets in many emerging market economies have remained highly illiquid and segmented, with trading and capitalization focused on a few firms. Stock markets in many developing countries, particularly in Latin America and Eastern Europe, have seen listings and liquidity decrease, as a growing number of firms have cross-listed and raised capital in international financial centers such as New York and London.[186]

Many of the emerging market economies' regional banking systems are shallow and the scope of their activities is very narrow. For example, Latin American banks operate within an environment of structural factors that increase the typical bank's aversion to lending.[187]

After the recurring financial crises of the 1990s, scholars began linking the incidence of financial crises with financial liberalization reforms. There is an important

[183] Id.
[184] Id.
[185] Norton, *supra* note 177 at 172.
[186] de la Torre, *supra* note 4 at 1.
[187] Norton, supra note 177 at 169.

link between financial liberalization, especially competition, and financial sector development and economic growth.[188] Therefore, the role of emerging markets is to generate the benefits of financial liberalization and competition and limit the risks of financial crisis.[189] This is where IOs must engage and play a positive and effective role. For example, emerging market economies must be able to call on the benefits of international standards as a way to efficiently and effectively reduce risks to their financial systems.

2. Complications for Emerging Markets

The participation of banks acting internationally (without having a commercial presence in other jurisdictions through subsidiaries, branches, or representative offices) or multi-nationally (maintaining a commercial presence) in other financial systems has created a web of complex economic and legal relationships that have increased the risk of contagion among the participant institutions and economies. Repeated episodes of international financial crises and contagion have demanded the establishment of international standards.[190]

These efforts were initially aimed at determining the responsibilities among regulators, supervisors, and central banks but have evolved to focus on the activities of banks and financial institutions "and the determination and adequate management of all risks involved in the provision of banking and financial services as well as on the new complexities created by the domestic and global activities of the financial conglomerates."[191]

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[188] Weber, supra note 27 at 433.
[189] Weber, supra note 27 at 432.
[190] Norton, supra note 177 at 158.
[191] Id. at 158-159.

The increasing use of international capital markets is having both positive and negative effects on domestic emerging market economies. For example, financing in international markets tends to be longer-term and international financing requires greater transparency and offers diversification for investor opportunity. This is widely beneficial for emerging markets as their integration into these sources of longer-term, more stable funding create a large amount of good will and respect in the international financial community for security in those markets. However, financing in international capital market can be more volatile, especially as risk premiums increasing substantially during crises. Moreover, foreign bond financing tends to be denominated in a foreign currency, thereby exposing issuers and investors to currency risk. Because of these attributes, many critics associate financial globalization with crisis.[192]

Another complication for emerging markets is the presence of very large integrated global financial institutions, especially in the traditional banking sector. Traditionally the banking sectors of emerging markets are the main source of financial intermediation so there are moments of concern when large foreign banks attempt to enter and integrate into these markets.

3. Example: Latin America's Challenge

In Latin America, foreign ownership of banks appears to strengthen domestic financial systems at a microeconomic level. This is because foreign banks tend to maintain greater asset liquidity and rely less on deposit financing, to show stronger loan growth than private domestic banks, to provision more aggressively against bad loans, and to have higher loan recovery rates.[193] These larger multinational banking institutions

[192] de la Torre, supra note 4 at 22.
[193] Norton, supra note 177 at 172

also engage in more efficient financial intermediation with greater economies of scale, maintain higher risk-based capital ratios, and are more willing to tolerate lower returns in the near term as they seek to build up longer-term institutional strength.[194]

That said, the supply of credit remains low in these markets because foreign banks are more cautious than domestic banks when extending credit in the region, and their response to crises is typically pro-cyclical, intensifying the effects of monetary tightening.[195] In addition, "foreign banks have adopted a more pragmatic approach, adapting to the features of the Latin American banking markets that register large spreads in the process of banking intermediation, rather than imposing their own dynamic on the determination of capital costs."[196]

The incorporation of these larger foreign banks into the architecture of emerging markets can produce positive effects. Foreign bank entry offers emerging market host country institutions the ability to learn from larger, multinational banks, work with them (or be bought by them, which still brings capital to the country), and compete for customers with them, but more than anything else, it offers financial institutions in these economies the ability to diversify their financial activities beyond traditional banking. To do this, they will need positive guidance and generally accepted international standards by which to enter alternative financial markets and forms of intermediation.

In the late 1980s, in the wake of the region's external debt crisis, many Latin American economies implemented what was known as the "Washington Consensus." The Washington Consensus called for fiscal adjustment, trade liberalization, financial deregulation, opening to foreign investment, and the privatization of many public

[194] Id. at 173.
[195] Id. at 172-173.
[196] Id.

enterprises. However, recently, this approach has come under criticism as ineffective at achieving economic growth and for ignoring the legal effects of institutional changes.[197] This more recent development is troubling and will have damaging effects for the region's potential integration into the global financial architecture if the core of the Washington Consensus is reversed.

4. Standards for Domestic and International Development in Emerging Markets

As the global banks have played larger roles in emerging economies with higher levels of macroeconomic and financial instability has increased, they have become exposed to heavy losses in times of crisis. In 1997, IOs began work on a strategy to adopt and implement that would outline sound principles and practices to strengthen financial systems and to foster international financial stability.[198]

The core goal of preserving international financial stability has changed the functions of multilateral institutions such as the IMF, the World Bank as well as IOs such as the G20 and FSB. These institutions have engaged in a decade-long struggle to develop a set of standards and principles to create an international financial architecture. However, as these institutions have discovered, especially over the last few years, financial markets and especially financial products have become so complex that they challenge the bounds of comprehension. As these products and markets become more complex, international standards struggle to keep pace and result in even more complex standards, for example the Basel II capital rules. Their complexity, at the outset, was praised, but has resulted in more complex financial institution capital calculations, balance sheets and corporate governance.

[197] Id. at 174- 175.
[198] Id. at 159.

The proliferation of international standards in the financial services area has already permeated the advanced economies and is gaining traction in many emerging markets.[199] What these emerging market economies do with these standards is the key moving forward.

Emerging market economies should look to the IOs as they develop standards for implementation. The increased use of such standards to guide regulators in a common direction will create an efficient and effective legal and institutional environment for financial institutions and investors. Investor and financial institution confidence will increase and ultimately, the capital markets will expand and diversify the economies of the emerging markets. In turn, the size of these economies will increase, which "appears to be an important factor for the development of these markets, because it generates economies of scale and scope as well as network externalities and provides a more fertile ground for the achievement and sustainability of sufficiently liquid markets."[200] These economies of scale are critical in creating an adequate infrastructure for capital markets because the costs of establishing clearing and settlement systems and developing the legal framework for issuing and trading are mostly fixed.[201]

Also in larger economies, more information is readily available, which reduces information costs for both local and foreign investors. Moreover, larger economies tend to have larger firms, which are more likely to meet the minimum size threshold necessary to achieve adequate liquidity.[202]

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[199] Id.
[200] de la Torre, supra note 4 at 16.
[201] Id. at 92.
[202] Id.

The legal and broader institutional environment plays an important role in the development of financial markets. Laws and enforcement mechanisms that protect investors, clearly define property rights, and support private contractual arrangements are crucial for the adequate functioning of financial markets and must be developed in a way that fosters appropriate and sustainable economic growth.[203] "A large emphasis exists regarding the role of legal institutions in explaining differences in financial development across countries.[204] "Empirical evidence demonstrates that regulations that protect creditors and minority investors are associated with deeper and more active financial markets, increased valuations, a lower concentration of ownership and control, and greater dividend payouts."[205]

5. Challenges and Consequences for Emerging Markets

Globalization has advanced with increased cross-border capital flows, tighter links among financial markets, and greater commercial presence of foreign firms around the world. An important element of this globalization trend has been the internationalization of financial services, which has meant the use of international financial intermediaries by local issuers and investors. For example, many firms from emerging market economies cross-list their shares in global markets.[206] Moreover, as we have seen in reviewing the financial crises of the 1990s, and as the IMF points out with respect to the recent financial crisis in the United States and other developed economies,

[203] Id. at 89.
[204] Id.
[205] Id.
[206] Id. at 72.

"countries that had improved policy fundamentals and reduced vulnerabilities in the pre-crisis period reaped the benefits of these reforms during the crisis."[207]

However, emerging market economies face a number of country-specific and economy-specific challenges as globalization occurs. Traditional methods of financial intermediation are being pushed aside, sometimes by force, from foreign financial institutions entering the market and offering greater return, transparency, diversification or investor protection. And, as many consumers around the world have experienced over the last few years, protection and diversification are very important. Structural reforms and legal reforms are required if emerging market economies are to improve the environment for global finance.

A. Structural and Legal Reform

Structural reforms were implemented, for example in Latin America, with the aim of gaining macroeconomic stability in the region. Latin American economies also opened the capital account in order to attract more foreign direct investment.[208]

As a consequence of the1980s external debt crisis, there was political will to implement structural reforms throughout Latin America. International financial institutions, such as the IMF and the World Bank, began to play a supervisory role by conditioning their loans upon economic policy reform of the debtors.[209]

Therefore, in more recent years, financial regulation and supervision have been strengthened through the local implementation of international standards of banking supervision. As anticipated, such decisions have fostered a significant commercial

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[207] Moghadam, Reza, *How Did Emerging Markets Cope in the Crisis?*, 1 (IMF 2010) (referring only to the coping of the emerging markets with respect to this recent financial crisis in the U.S. and developed economies).
[208] Norton, supra note 177 at
[209] Id. at 165-166

presence of foreign banking institutions of non-member countries in Latin America and the Caribbean.[210]

However, challenges remain. For example, the inefficient judiciaries of some Latin American economies undermine the legal certainties needed to foster greater financial intermediation. These countries are based on civil law instead of the western common law theory. Generally, "Latin American domestic legal frameworks do not consistently support enforceability of creditor's rights, and the insolvency laws in the region do not protect financial creditors efficiently."[211]

Reforming the legal infrastructure supporting business should be an important component of reforms in many emerging market economies. But there is little agreement about what constitutes feasible legal reform and legal reform is only one issue for these economies.[212]

Another feature of the Latin American economies is market concentration, particularly of banks. Due to the financial crises of the 1990s, many banks in Latin American economies were bought, dismantled or failed, which led to an even greater increase in bank concentration in countries such as Nicaragua, El Salvador, Chile, Guatemala, and Colombia. However, Latin America as a whole did not experience an increase in bank concentration as large as that observed in other developing countries.[213]

However, there is evidence that a more concentrated banking system may actually improve access to credit for small firms. As demonstrated, banking system concentration does not necessarily lead to less competition in countries with easier entry and fewer

[210] Id. at 172.
[211] Id. at 169.
[212] Id.
[213] Id. at 170

restrictions on bank activity. More concentrated access to financial markets also contributes to the highly concentrated pattern of growth characterized by many of Latin American and Caribbean countries.[214]

B. Implementation of International Standards

Another challenge for emerging markets, which is really a subset of the structural and legal reforms, is the implementation of international standards through domestic processes. For example, the recent privatization processes in emerging market economies in Latin America aimed at improving economic efficiency of banking activities. But a dynamic analysis of banks' performance before and after the privatization process conducted by the referred scholars, shows mixed results here. The conclusion reached is that these processes of privatization specifically have not yielded the profitability and efficiency sought. In the same vein, "the IADB has found some new evidence indicating that, at least in the case of Latin America, public banks may play a useful role in reducing credit pro-cyclicality."[215]

Therefore, the question is where to draw the line on financial liberalization. If the benefits of deregulation are not as positive as hoped for, and the use of public banks can benefit economies, then where is the balance struck? Unfortunately, in the economies where public banks compete with private banks, investors may be more cautious to engage the private banks because they will essentially be in direct competition with the government of the host country. This is not where most investors seek to place their funds.

[214] Id. (citing Unlocking Credit: The Quest for Deep and Stable Bank Lending (IADB 2005)).
[215] Id.

"One important feature of the current globalization process is that it is characterized by segmentation across countries and firms."[216] This segmentation may increase the gap between those countries and firms able to internationalize and the rest, creating a very significant challenge for emerging market economies and regions. In all, expectations about the structural and legal reform process and policy options in emerging market economies needs to be revisited because even with the strong capital market growth of the 1990s, Latin American capital markets remain underdeveloped when compared to markets in industrial and East Asian countries."[217]

C. Did the Reforms and Implementation of International Standards Help in the Recent Global Financial Crisis?

Generally, while the effects of the current crisis on emerging markets seems to have varied, countries that entered the crisis with relatively good structural and policy fundamentals are recovering faster and may be constrained in their policy options due to accommodative policies in advanced economies.[218] An IMF study found that:

> The initial impact of the crisis was less pronounced in emerging markets that had better pre-crisis external vulnerability indicators. Reserve holdings helped protect emerging markets from the sharp rise in global risk aversion but these benefits diminished at very high levels of reserve holdings; countries that entered the crisis with more policy space and les binding financing constraints were able to react more aggressively with fiscal and monetary policy; recover from the crisis was faster in emerging markets that gave a bigger fiscal stimulus, had stronger pre-crisis fundamentals, and had faster growing trading partners; there is considerable heterogeneity in the policy challenges facing emerging markets as they exit from the crisis."[219]

In the wake of the crisis, emerging markets did turn to the IMF for financial support. However, "increases in lending resources as well as reforms to the lending

[216] de la Torre, supra note 4 at 22-23.
[217] Id.
[218] Moghadam, supra note 208 at 1-4.
[219] Id. at 1.

framework enabled the IMF to quickly react to global developments"[220] Moreover, as the crisis scenarios have grown bigger and have had broader effect, global coordinated responses, including the availability of large financing arrangements through the IMF and other IOs, has created the opportunity to adjust quickly.[221]

VI. Reform and Emerging Market Integration – Look to International Organizations

Generally, "countries with higher income levels, a better enforcement of laws, greater financial openness, and better growth opportunities tend to see more activity in international markets."[222] Moreover, better economic fundamentals help to develop local markets, increase the internationalization of stock issuance and trading and make financial firms operating in those countries more attractive to investors. [223]

Many of the most recent emerging market reforms in the wake of financial crisis came in the early 1990s. However, in the second half of 1990s, strong global trends emerged towards financial development and internationalization. One may argue that this correlation between the reforms increased the status and attractiveness of emerging markets, thereby increasing their access to international finance and development.[224]

Therefore, "firms that internationalize win: internationalization boosts their total trading, reduces their cost of capital, and helps them to expand. But non-internationalized (domestic) firms lose. The liquidity of their shares falls as others internationalize."[225] Internationalization might allow firms to access funds with lower costs and with longer maturities, as well as help supply funds to savings-scarce countries,

[220] Id. at 4.
[221] Id. at 1-4.
[222] de la Torre, supra note 4 at 113-115.
[223] Id at 113-115, 119.
[224] Id. at 122.
[225] Id. at 128-129.

where the marginal product of capital is relatively high. Moreover, the internationalization process could enhance transparency and monitoring in domestic capital markets and reduce information costs.[226]

When considering a reform of the financial framework, the legal and regulatory structure should be designed to protect consumers and investors in the marketplace, as well as to build financial confidence in the system. Moreover, a new design should establish transparent and efficient markets to increase financial stability and protect, to the extent possible, against systemic risks.[227]

1. Legal Reform and the Role of International Organizations

"There is no quick fix in this post-crisis world—no silver bullet that would inoculate an ever-changing world from the inevitable next crisis."[228] But this same crisis may be avoided in the future. Regulators must avoid a backward looking fix that addresses the problems that gave rise to the last crisis. "Such a myopic approach invariably misses the excesses that sow the seeds of the next crisis."[229] Instead, a broad fix should both contain both regulatory reforms and a new approach to monetary policy. Only then, will there be a meaningful chance for a safer and sounder post-crisis world."[230]

Banking is one of the most regulated industries within any nation's economy and as international trade has increased in size and importance, domestic banking systems

[226] Id. at.129.
[227] Mwenda, supra note 158 at 89.
[228] Roach, Stephen, *The Post-Crisis Fix: Regulatory or Monetary Policy Remedies?*, Morgan Stanley (2010) (available at www.morganstanley.com).
[229] Id.
[230] Id.

have been forced to become more international.[231] Therefore, in an increasingly interconnected world, regulators all need to be on the same page in policy setting. "Systemic risks cannot be managed effectively at the national level. They are best addressed by robust *global* policy architecture."[232] Otherwise, a fragmented approach to global risk management and regulation will develop, creating opportunities for "regulatory arbitrage" that will only exacerbate global inefficiencies and imbalances.[233] "Recent G-20 summits in London and Pittsburgh suggest that global leaders want to get serious about establishing a new global policy and regulatory architecture."[234]

Beyond meetings and policy papers, a new international framework needs to be established that explicitly incorporates international policy coordination into the global architecture. This demand is where emerging markets may see the greatest benefits. As these economies look to rebuild and expand in the wake of this crisis, they will look to a means to become more stable, robust and attractive to investors worldwide.

Utilizing the IOs to further develop regulations and policy at the national level can do this, but these IOs need to play an active and constructive role in creating a global architecture.[235] If emerging markets attempt regulatory reform or improvement without this guidance, the result will not be as beneficial, and as demonstrated by previous cases, will only lead to a fragmented and inefficient result. "In particular, the Asian financial

[231] Alford, Duncan, E., *The Lamfalussy Process and EU Bank Regulation: Another Step of the Road to Pan-European Regulation?*, 25 Ann. Rev. Banking & Fin L. 389, 391 (2006).
[232] Roach, supra note 229.
[233] Id.
[234] Id.
[235] Id.

crisis that affected Southeast Asia brought to the forefront weaknesses in the banking sector of Southeast Asia and the issue of banking reform."[236]

"The Asian financial crisis also provided a glaring example for the Chinese and Indian economies to correct course and set into motion policy changes that could help them avert a similar disaster." [237] Although China and India were spared, Chinese and Indian banking sectors faced problems similar to those of their Southeast Asian neighbors.[238]

Improving the international financial architecture would disproportionately benefit emerging market economies. Unfortunately, the economic and geopolitical power to address the flaws in the international financial architecture reside with the advanced economies, who are the economies with the least incentive to worry about it, except in those rare occasions when their financial centers are threatened by contagion, as they are now.[239]

2. Benefits of Integration and a Global Policy-Making Architecture

One approach to increasing integration is by promoting economic and financial integration through the unilateral openness of national capital accounts, by liberalization of rules of entry to foreign banks, and, significantly, by adoption of soft law international standards in the banking and financial services area.

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[236] Pasricha, Anshu S.K., *On Financial Sector Reform in Emerging Markets: Enhancing Creditors' Rights and Securitizing Non-performing Loans in the Indian Banking Sector – An Elephant's Tale*, 55 Buffalo L. Rev. 325, 327 -238 (2007) (citing The Asian Financial Crisis, or Asian Contagion, as it is Popularly called, Sebastian Edwards, Contagion, Revised Version of 1999 World Economy Lecture, University of Nottingham, Oct. 28, 1999)(2000) and Saez, Lawrence, Banking Reform in India and China, 6 Int. J. Fin Econ. 235, 235 (2001)).
[237] Id. at 328-329.
[238] Id.
[239] de la Torre, supra note 4 at 152.

> "As a consequence of the economic crises of the 1980s and 1990s, Central and South American countries carried out individual domestic structural reforms to that end. They often were implemented under the guidance and monitoring of multilateral international institutions (e.g., the International Monetary Fund (IMF), World Bank, and Inter-American Development Bank (IADB)), whose mandates were evolving towards these kinds of roles within the international financial arena.
>
> The adoption, implementation, and compliance of certain economic policies prescribed as the solution to the underlying structural failures of the developing countries of the region was under way. In turn, this environment has promoted a de facto financial integration through the allowed activities of banks, mainly from the United States but also Spanish banks, acting internationally and multi-nationally in the region."[240]

Failure to account for global dimensions of financial activity, and thus systemic financial stability, would be a major impediment for global rebalancing in a post crisis environment.[241] National governments began crafting their own domestic, and sometimes protectionist, approaches to global issues raised as a result of the credit crisis that began in 2008. The inefficient nature of such activity "reflects the often dangerous presumption on the part of national regulators that the best global policies are the sum of the best national policies."[242]

Moreover, despite the growth in international banking, national governments remain "very hesitant to enter into international agreements that would require them to cede regulatory control of banks incorporated or operating within their jurisdictions."[243] Unfortunately, an analogy is made to indicate that a transfer of regulatory control over the domestic banking system amounts to a transfer of sovereign power.[244]

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[240] Norton, supra note 177 at 156.
[241] Roach, supra note 229.
[242] Id.
[243] Alford, supra note 232 at 391.
[244] Id.

A. Why Seek International Cooperation?

Despite reasons for national governments to avoid international cooperation, the increasing size of financial institutions with cross-border operations is demanding some level of cooperation if countries, especially emerging market economies are going to attract and retain the foreign capital inflows they are experiencing. Large financial institutions operate internationally to provide financial products, including insurance, securities, and traditional banking products, across the financial spectrum to retail and corporate customers.[245] Nevertheless, national regulators have maintained a nationalistic identity, despite the size and complexity of the institutions they may actually supervise.

"Regional integration affects the financial system, as the frontiers of states are no longer a critical boundary of activity."[246] Nations are no longer the sole dominant actor in international law, as corporations are strongly influencing the decision of nations. IOs can exert an immense impact on the international legal scene. Moreover, specific case law and legal decisions have been "accumulating through non-judicial international dispute settlement systems."[247] Some national governments have even begun to converge on "soft law" measures intended to minimize systemic disruptions, such as the Core Principles for Effective Banking Supervision."[248]

Experiences of IOs, such the IMF and the EU, should be drawn upon when we examine beneficial functions and feasibility for financial integration. "Law provides an important foundation for the sound operation of any market. But law cannot operate

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[245] Id.
[246] Yokoi-Arai, Mamiko, *Comparative Perspective: Legal and Political Effects of Financial and Monetary Regional Integration in Asia,* 12 Law & Bus. Rev. Am. 47, 48 (2006).
[247] Id.
[248] Alford, supra note 232 at 393 (citing Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision (Sept. 1997).

separately from the society on which it is based. Law needs to be viewed in the context of what is socially desirable."[249] "Law carries a society's idea of its own future from the past into the future."[250]

B. Example: EU Development and Use of the Lamfalussy Process

The Lamfalussy process engaged in by the European Union as a means to regional integration has been the subject of many reviews, both outside and within the European Union. Based on the reviews to date, this process has worked reasonably well. However, "nearly all observers also agree that because the Lamfalussy process is so new, it is too early to assess whether it is truly effective."[251] The Lamfalussy process began with the integration of securities regulation in 2002 and expanded to banking, investment fund and insurance regulation only in early 2004. This is not a long enough time horizon by which to measure its effectiveness in the EU.[252]

> The "Lamfalussy framework" consists of four levels: Level 1: framework principles that the Commission proposes to the Council of Ministers and to the European Parliament for co-decision. Level 2: the European Securities Committee and the Committee for European Securities Regulators will assist the European Commission in the definition of details. Level 3: cooperation and networking among EU securities regulators to ensure common standards for implementing the legislation developed at Levels 1 and 2. Level 4: cooperation between the Member States, their regulators; and the private sector in order to ensure issuance of national legislation and regulations."[253]

Overall, the Euro region, until the latest crisis, has fared better in its ability to withstand economic shocks. And, European corporations benefit from lower costs of

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[249] Yokoi-Arai, supra note 247 at 66-67.
[250] Id.
[251] Alford, supra note 233 at 406 (citing Burcak Inel, Assessing the First Two Years of the New Regulatory Framework for Financial Markets in Europe, 18 J. Int'l Bank L. 363 (2003).
[252] Id.
[253] Barresi, Rosa Giovanna, *The Impact of Monetary Union and the Euro on European Capital Markets: What May be Achieved in Capital Market Integration,* 28 Fordham Int'l L. J. 1257, 1280 (2005).

doing business in with EU member-states.[254] Nonetheless, some work will be needed in light of the emerging sovereign debt crisis permeating segments of the EU if the region is to "attain the level of integration at which U.S. bond and equity markets have been operating in the recent years."[255]

However, no matter what the outcome of the current state of financial markets and EU member-states the Lamfalussy process may not be then end of the road to integration, but rather only "another step in the trend of greater financial integration and regulatory convergence within the European Union."[256]

It has been offered that the "next step may be the creation of a dual banking system similar to that of the United States." In the United States' dual-banking system, national banks and state-chartered banks operate under two separate, but related, bodies of law. Moreover, each category of financial institution in the United States is likely to have a different regulatory authority.[257]

C. Latin America's Future as a Region

"Financial reforms in the 1990s generated significant transformations and developments in the banking sector in Latin America."[258] Such transformations were largely based on the Washington Consensus of deregulation and financial liberalization. They were implemented through a reduction of state intervention "by basically procuring

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[254] Id. at 1318.
[255] Id. at 1318-1319.
[256] Alford, supra note 232 at 390.
[257] The regulatory authority in the United States depends on the charter of the financial institution and the activities such institution engages in with respect to the financial markets. For example, at the state and federal level, there are more than ten regulatory authorities that financial institutions may report to, or whose regulations they are subject to. Moreover, there are large divergences when non-depository financial institutions, such as mortgage banks are considered. These institutions will generally be subject to state laws, but the departments of each state which may exert authority over such an institution, in 50 states, plus the District of Columbia, may well exceed 100. There is another debate whether such a convoluted structure is the optimal approach. However the whole of the United States financial architecture is up for debate this year as the United States Congress considers an almost wholesale restructuring.
[258] Norton, supra note 177 at 166.

the elimination of interest rates controls, mandatory reserves, limits to international transactions, and rules on providing credits to specific sectors."[259]

Unfortunately, the future integration process in Latin America should be gradual and will need to consider the creation of legitimate, hard law, removals of barriers to trade and access, coordination of national policies, and a deeper integration ruled by international standards and codes embodied in soft law and requiring coordination of domestic policies.[260] IOs creating widely accepted and utilized standards will afford these emerging economies a chance to craft law that can bring the financial liberalization and privatization processes full circle in terms of reaping the benefits such policies can produce.

Such a convergence process also will need to bring together different legal systems. Due to political and social climates (consider the contrast between the current conditions in Mexico, Brazil and Venezuela), these legal systems offer different protections for creditors' and investors' rights and promote development of financial systems to very different degrees.[261]

> "As a consequence, governments in the Latin American region will need to work together towards harmonizing rules applicable to domestic and foreign financial and banking services providers, with the aim of avoiding regulatory arbitrage. These governments also will have to cope with linking efficient and inefficient judiciary systems, which may produce forum shopping and significantly impact the flow of Foreign Direct Investment to the countries in the Hemisphere. All these circumstances call for domestic and supranational strong institutions."[262]

This kind of integration and convergence cannot be achieved in any meaningful way without the use of IOs, such as the G20 and FSB, who must develop the building

[259] Id. at 167.
[260] Id.
[261] Id.
[262] Id.

blocks for these nations to converge on general standards of protection and development. Then, these organizations must assist nations to integrate their domestic, and more detailed, approaches with not only their regional partners, but also the rest of the financial world.

3. Integrating Financial Development

Financial markets and the financial sector of any nation can have both positive and negative impacts on economic development. Recent financial crises discussed herein had a dramatic and devastating effect on the economic growth of many emerging market and developing economies. Not only have the effects brought financial transactions and markets in these economies to the brink of collapse, but they have also brought national regulators and governments to their knees.

These drastic effects can be limited with the development of a system of international standards for sound financial systems. The call for such a development at the national level is common in the aftermath of financial crisis, but, given the interconnectedness of financial markets and participants, an international baseline should be established so that the financial sector can be a positive force in emerging markets.

Domestic financial sectors support healthy economic growth by allocating financial resources to support consumer, commercial and general industry expansion. The financing provided allows corporations to produce more, at a lower cost, and with greater efficiency. The financial industry has a very positive role to play in providing the financing and intermediation necessary for economic development of and economy. Given this role, and the increasing level of globalization, it is necessary to take the development to an international level. However, the current system of international

financial standards "has not yet taken sufficient account of development needs and opportunities."[263]

However, the Millennium Development Goals ("MDGs"), which represent a majority view of incorporating developing into an international financial architecture, are being taken into account by international institutions such as the IMF and the World Bank in pursuing their respective mandates.[264]

This kind of recognitions should be increased. As international standards are developed and revised, financial and economic development should be given greater consideration and assessments by the IMF and the World Bank should look at overall development in addition to financial stability.[265]

4. The Most Recent Work of International Organizations

For a greater part of the 1980s and 1990s, financial regulators and policymakers strived to implement policies of financial liberalization and deregulation in emerging economies. As financial globalization introduced new market participants, global capital became increasingly mobile and significant. At the same time, domestic financial regulators continued efforts to ensure the health and stability of their banking and financial markets and to support continued development in their economies.

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[263] Weber, supra note 27 at 430-431.
[264] Id. at 431-432. "In addition, these goals have begun to filter through to the system of international financial standards. Specifically, the IMF has already taken steps to incorporate many of the indicators in the Special Data Dissemination Standard and the General Data Dissemination System. Furthermore, due to their focus on poverty alleviation, the World Bank and the Asian Development Bank consider these issues across their various activities, including in the financial sector. The World Bank is also beginning to use the FSAP/ROSC process to highlight developmental needs and to support its overall efforts in the financial sector."
[265] Id.

Recent financial crises have challenged emerging market economies to rethink development and the role of financial markets.[266] The fear today is that financial integration and interconnectedness is not the crown jewel to strive for, but rather that interconnectedness exposes economies to greater, more widespread and devastating contagion. However, it is the free market policies of efficiency and market allocation principles that should be enhanced while converging on internationally accepted standards to play by.

In response to the financial crisis that swept East Asia in 1997 and 1998, the region has been accelerating the pace of regional integration, especially since the creation of and as a result of the activities of the Association of Southeast Asian Nations (ASEAN). The Asian financial crises focused financial and monetary arrangements on seeking greater safety and soundness of the financial systems as well as an alternative to IMF and other international program assistance. Moreover, a significant component of Asia's regional development was the strong political will to establish the institutional progress which was lacking in the past.[267]

In the decades since the Latin American and East Asian crises, the Group of Seven (G7, Group of Ten (G10) and more recently, the Group of Twenty (G20) have held summits and global policy conferences to deal with the increasingly global nature of finance, as well as how to respond to its most challenging moments when financial crisis emerges.

The G10 has established several committees whose secretariats are based at the Bank for International Settlements (BIS) which "resolved not to adopt legally binding

[266] Pasricha, supra note 237 at 325 -327.
[267] Yokoi-Arai, supra note 247 at 48.

international standards in a public international law sense, but rather to influence domestic regulatory law, practices and standards by adopting what has become known as "international soft law."[268]

A. Basel Capital Standards

At the BIS, the Basel Committee has adopted Basel I, Basel II and will soon provide the Basel III framework for globally recognized bank capital standards. Basel II aimed to make regulatory capital more sensitive to the market risks that banks face. What resulted was a set of standards and capital requirements that allowed banks, under specific conditions, to hold less regulatory capital for credit, market, and operational risk exposures.[269] Presumably, the outcome is what Basel III will attempt to remedy because the current global credit crisis has revealed that banks are exposed to significant liquidity risks, especially in their off-balance sheet exposures, and this requires drastic changes to the Basel II framework.[270]

In developing these standards, the Basel Committee claimed 'the legitimacy of the international standards it adopts derives from a communiqué issued by the G7 Heads of State in 1998 that encouraged emerging economies to adopt "strong prudential standards" and "effective supervisory structures."'[271]

In order to achieve general acceptance, the IMF and World Bank are expected to play a "surveillance role" in overseeing their member-states' adherence through the organizations' financial conditionality and support programs. "In addition, because most G10 countries are members of the European Union, they are required by EU law to

[268] Alexander, supra note 10 at 869.
[269] Id. at 871.
[270] Id.
[271] Id. at 874-875.

implement the Capital Accord into domestic law."[272] The only G10 countries not required by their local law to implement the Capital Accord are Canada, Japan, and the United States. This extended application of the Basel Committee's standards to non-G10 countries has raised questions regarding the accountability of its decision-making structure and its suitability for application in developing and emerging market economies."[273]

B. Global Regulatory Standards

Since the beginning of the crisis in 2007 and 2008 IOs such as the G20, the FSB and the Basel Committee have been feverishly working to develop new standards of capital (such as Basel III) and financial regulation and supervision on a global scale. This most recent work has resulted in a number of policy initiatives and agreements on financial market regulatory coordination. However, it remains to be seen how well national risk regulators work with these IOs.[274]

Significantly, the G20 has identified successful reform as being developed in connection with the principles of free market economics and the rule of law. This may create challenges for emerging economies struggling with complete acceptance of such principles. However, "these principles are essential to economic growth and prosperity and have lifted millions out of poverty, and have significantly raised the global standard of living."[275] Moreover, the G20 has specifically identified the need to improve financial sector regulation, and thereby "avoid over-regulation that would hamper economic

[272] Id.
[273] Id.
[274] *The Gods Strike Back: A Special Report on Financial Risk*, The Economist, February 13, 2009.
[275] G20 Declaration of the Summit on Financial Markets – November 2008

growth and exacerbate the contraction of capital flows, including to developing countries."[276]

To accomplish this, the G20 engaged its global leaders for a Summit on Financial Markets where the G20 outlined a number of actions it will seek in the immediate term and medium term in order to reinforce international cooperation.[277] For example, the G20 has called for the establishment of supervisory colleges to collaborate on supervision of multinational financial institutions with cross border operations in the immediate term.[278] Moreover, in the medium term, the G20 has called for an information collection effort from national regulators in order to seek convergence in regulatory practices.[279]

Also as a result of the 2008 G20 Summit, the leaders of these advanced economies agreed to basic sets of principles (see below) and standards by which to approach a new international financial architecture.[280] Additionally, the G20 nations

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[276] Id.
[277] Id.
[278] Id. In the immediate terms, the G20 has called for "supervisors to collaborate to establish supervisory colleges for all major crossborder financial institutions, as part of efforts to strengthen the surveillance of crossborder firms. Major global banks should meet regularly with their supervisory college for comprehensive discussions of the firm's activities and assessment of the risks it faces." Secondly, the G20 has called for regulators to take all steps necessary to strengthen cross-border crisis management arrangements, including on cooperation and communication with each other and with appropriate authorities, and develop comprehensive contact lists and conduct simulation exercises, as appropriate."
[279] Id.. In the medium term, the G20 has called for "authorities, drawing especially on the work of regulators, to collect information on areas where convergence in regulatory practices such as accounting standards, auditing, and deposit insurance is making progress, is in need of accelerated progress, or where there may be potential for progress." Moreover, the G20 has also called for "authorities to ensure that temporary measures to restore stability and confidence have minimal distortions and are unwound in a timely, well-sequenced and coordinated manner."
[280] Id.. Against this background of deteriorating economic conditions worldwide, the G20 agreed "that a broader policy response is needed, based on closer macroeconomic cooperation, to restore growth, avoid negative spillovers and support emerging market economies and developing countries. As immediate steps to achieve these objectives, as well as to address longer-term challenges, we will: (i) Continue our vigorous efforts and take whatever further actions are necessary to stabilize the financial system; (ii) Recognize the importance of monetary policy support, as deemed appropriate to domestic conditions; (iii) Use fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability; (iv) Help emerging and developing economies gain access to finance in current difficult financial conditions, including through liquidity facilities and program support. (v) Encourage the World Bank and other multilateral development banks (MDBs) to use their full capacity in support of their development agenda, and we welcome the recent introduction of new facilities by the

declared that they would seek to implement reforms to strengthen financial markets and national regulatory regimes in order to avoid future crises. "Regulation is first and foremost the responsibility of national regulators who constitute the first line of defense against market instability." [281]

The G20 also committed to implementing policies "consistent with the following common principles for reform:

1. Strengthening Transparency and Accountability: We will strengthen financial market transparency, including by enhancing required disclosure on complex financial products and ensuring complete and accurate disclosure by firms of their financial conditions. Incentives should be aligned to avoid excessive risk-taking.
2. Enhancing Sound Regulation: We pledge to strengthen our regulatory regimes, prudential oversight, and risk management, and ensure that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances. We will exercise strong oversight over credit rating agencies, consistent with the agreed and strengthened international code of conduct. We will also make regulatory regimes more effective over the economic cycle, while ensuring that regulation is efficient, does not stifle innovation, and encourages expanded trade in financial products and services. We commit to transparent assessments of our national regulatory systems.
3. 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.
4. Reinforcing International Cooperation: We call upon our national and regional regulators to formulate their regulations and other measures in a consistent manner. Regulators should enhance their coordination and cooperation across all

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World Bank in the areas of infrastructure and trade finance; and (vi) Ensure that the IMF, World Bank and other MDBs have sufficient resources to continue playing their role in overcoming the crisis." The G20 also stressed the IMF's important role in crisis response, welcome its new short-term liquidity facility, and urge the ongoing review of its instruments and facilities to ensure flexibility.

[281] Id. The G20 also noted that "our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability. Regulators must ensure that their actions support market discipline, avoid potentially adverse impacts on other countries, including regulatory arbitrage, and support competition, dynamism and innovation in the marketplace. Financial institutions must also bear their responsibility for the turmoil and should do their part to overcome it including by recognizing losses, improving disclosure and strengthening their governance and risk management practices."

segments of financial markets, including with respect to cross-border capital flows. Regulators and other relevant authorities as a matter of priority should strengthen cooperation on crisis prevention, management, and resolution.

5. Reforming International Financial Institutions: We are committed to advancing the reform of the Bretton Woods Institutions so that they can more adequately reflect changing economic weights in the world economy in order to increase their legitimacy and effectiveness. In this respect, emerging and developing economies, including the poorest countries, should have greater voice and representation. The Financial Stability Forum (FSF) must expand urgently to a broader membership of emerging economies, and other major standard setting bodies should promptly review their membership. The IMF, in collaboration with the expanded FSF and other bodies, should work to better identify vulnerabilities, anticipate potential stresses, and act swiftly to play a key role in crisis response."[282]

In 2009, the April 2 G20 Communiqué, leaders pledged to establish "the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires."[283] The Communiqué sets forth the goals of strengthened regulation and supervision. They must promote propriety, integrity and transparency; guard against risk across the financial system; minimize rather than increase the financial and economic cycle; reduce reliance on inappropriately risky sources of financing; and discourage excessive risk taking.[284] In addition, "regulators and supervisors must protect consumers and investors, support market discipline, avoid adverse impacts on other countries, reduce the potential for regulatory arbitrage, support competition and dynamism, and ensure innovation in the marketplace."[285]

More recently at the June 5, 2010 G20 meetings in Korea, the G20 again acknowledged that the global recovery continues and that significant challenge remain, but that the G20 will, of course, remain committed to current recovery efforts and to

[282] Id.
[283] Zagaris, Bruce, *G-20 Summit on Financial Markets and World Economy Sets Stage for New Regulatory Controls and Enhanced Enforcement Cooperation*, Int'l Enforcement Law Reporter, Vol. 25, No. 2 (2009).
[284] Id.
[285] Id.

accelerate such efforts.[286] The G20 significant role in the recovery is not exclusive. G20 members welcome action from the European Union, the European Central Bank and the IMF, among others in order to "pursue well-coordinated economic policies."[287] Among the number of agreements and commitments the G20 made in Korea,[288] they agreed that they were "committed to reach agreement expeditiously on stronger capital and liquidity standards as the core of our reform agenda and in that regard fully support the work of the Basel Committee on Banking Supervision and call on them to propose internationally agreed rules to improve both the quantity and quality of bank capital and to discourage excessive leverage and risk taking by the November 2010 Seoul Summit," which are then expected to be "phased in as financial conditions improve and economic recovery is assured, with the aim of implementation by end-2012."[289]

Moreover, the Financial Stability Board has outlined its commitment to "strengthening adherence to international financial standards."[290] They are working to encourage "consistent implementation of international standards is necessary to protect against adverse cross-border, regional and global developments affecting international

[286] G20 Communiqué (5 June 2010)
[287] Id.
[288] Id at ¶ 4.. G20 members stated, in part, in the Communiqué that "we: agreed further progress on financial repair is critical to global economic recovery; emphasized the need to reduce moral hazard associated with systemically important financial institutions and reinforced our commitment to develop effective resolution tools and frameworks for all financial institutions on the basis of internationally agreed principles; agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution; committed to accelerate the implementation of strong measures to improve transparency, regulation and supervision of hedge funds, credit rating agencies, compensation practices and OTC derivatives in an internationally consistent and non-discriminatory way; expressed the importance we place in achieving a single set of high quality, global accounting standards and urged the International Accounting Standards Board and the Financial Accounting Standards Board to redouble their efforts to that end; and recognized the need to work together so as to foster the wide-spread application of the overarching principles of propriety, integrity and transparency in the conduct of international business and finance.
[289] Id.
[290] FSB Framework for Strengthening Adherence to International Standards (9 January 2010).

financial stability."[291] Further, to accomplish this task, they are in the process of "finalizing procedures to encourage the adherence of all countries and jurisdictions to international standards, including identifying non-cooperative jurisdictions and assisting them to improve their adherence."[292]

6. What IOs Can Offer

Financial market regulators must be independent bodies. This entails four aspects: regulatory independence, supervisory independence, institutional independence and budgetary independence. All of these are aspects of national regulatory systems. However, what IOs offer, especially to emerging market economies who have yet to achieve such independent financial regulators, is the ability to coordinate how such independence should look in light of international standards for regulation.

For example, one suggestion moving forward to avoid financial crisis is to add a "financial stability" provision to the policy mandates of central banks.[293] Moreover, a financial stability mandate would also empower central banks to take on the new and important responsibility of systemic risk regulators, as many financial scholars are calling for. This is one of the new areas of focus in the post-crisis debate on which there appears to be a broad consensus.[294] "But the key here, like in so many macro issues, lays in execution—specifically, the mechanism by which systemic risks are identified and addressed."[295]

Systemic risks are systemic because they engulf an entire domestic financial system and then move on to create spillover effects across financial institutions, markets,

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[291] Id.
[292] Id.
[293] Roach, supra note 229.
[294] Id.
[295] Id.

products and economies.[296] Therefore, taking this consensus and creating a general framework by working with advanced and emerging economies creates a positive role for IOs to play in getting such consensus across the finish line and into action as domestic regulation implemented and practiced in substantially the same manner.

VIII. Conclusions

Emerging market economies survived the most recent financial crisis with relatively few scars for a number of reasons. First, they learned from previous crises in the emerging world in the 1980s and 1990s in Asia and Latin America that retaining increased levels of capital will assist in protecting the institution when crisis does arrive. Second, emerging markets remained highly focused on domestic and regional banking, which limited exposures to many of their western counterparts. Third, many of these banking firms were heavily state-controlled, and as such, were not exposed to higher leverage ratios. Finally, banks' tendency to be highly risk-averse in these emerging market economies likely salvaged emerging market firms.

The recent crisis may have also validated the belief in these emerging market economies that rapid expansion on a global scale, as exemplified by western financial institutions, is not a prudent approach to developing stable banking systems in their countries. However, significant differences remain between many of the emerging and developed economies and western capitalist economies who remain severely distressed; namely the level of state involvement in the actual governance and ownership of the banking and financial institutions.[297]

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[296] Id.

[297] While the level of government involvement has increased substantially since the outset of the crisis in western economies, I do not expect this to continue to be the case in these capitalist systems, as it has been

So what remains necessary for emerging market economies is to develop some sense of international standards for their expansion and integration into global marketplaces where stability can be achieved across varied types of economies, whether capitalist, closed, or otherwise mixed. The first step is that IOs such as the IMF, the G20 and the FSB must play a positive, proactive role in developing useful and enduring[298] international standards for financial stability and regulation that provide advanced, emerging and developing economies some levels of certainty by which to engage in the international marketplace. "Crisis prevention and management capabilities are significantly enhanced by the broad agenda proposed by the new international financial architecture proponents."[299]

Converging law and economics is a means to develop efficient and effective regulatory regimes to engage emerging markets, foster increased global banking integration and minimize potential crisis in the future. In this area, twelve areas of basic reform have been identified by Frederic Mishkin, which include prudential supervision, legal and judicial system reform, entry of foreign banks, sequencing liberalization policies and market-based discipline, among others.[300] All of these areas benefit in a

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and will likely continue to be in many emerging economies, namely the BRIC nations or Brazil, Russia, India and China.

[298] While it is not expected that any international regulatory standards developed at a certain point in time will not require updating and/or revision, what I intend to indicate here is that the standards developed must not be created to address or to prevent a particular type of crisis because, in my view, that creates unnecessary levels of reactive regulatory oversight when the horse has left the stable, so to speak.

[299] Guira, supra note 119 at 506.

[300] Mishkin, Frederic S., Financial Policies and the Prevention of Financial Crises in Emerging Market Countries, 94 (Martin Feldstein ed., University of Chicago Press 2003). The following twelve basic areas of financial reform are identified by Mr. Michkin: (1) prudential supervision; (2) accounting and disclosure requirements; (3) legal and judicial systems; (4) market-based discipline; (5) entry of foreign banks; (6) capital controls; (7) reduction of the role of state-owned financial institutions; (8) restrictions on foreign-denominated debt; (9) elimination of too-big-to-fail policies in the corporate sector; (10) sequencing financial liberalization; (11) monetary policy and price stability; and (12) exchange rate regimes and foreign exchange reserves.

context where IOs can exist as strong proponents of the success of basic financial reforms and integration.

We are currently experiencing a 'fractured' globalization.[301] Integration of financial markets can deliver benefits in a truly liberal world of equal actors; however, in a world of unevenness, crisis will certainly occur unless institutions are designed properly.[302] IOs need to be there to assist in the design.

International organizations must play a key role in the continuing globalization of banking and financial services. Through IOs, both advanced and emerging markets can reform their institutions and practices to encourage cross-border activity at reduced risk levels. Certainty and security will manifest themselves through the increased international capital flows brought about by a new international financial architecture, embracing soft law concepts, where economies compete based on economic fundamentals, not based on regulatory or supervisory inconsistencies.

[301] Khan, supra note 94 at 171.
[302] Id.