Chicago Journal of International Law

Volume 11 | Number 1 Article 9

6-1-2010

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Eric J. Pan

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Eric J. Pan*

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* Associate Professor of Law and Director, The Samuel and Ronnie Heyman Center on Corporate Governance, Benjamin N. Cardozo School of Law, New York, NY. E-mail: epan@yu.edu. The author wishes to thank Kevin Browning, Val Myteberi, Arielle Katzman, Brian Lederman and Eddie Hynes for invaluable research assistance.

I. INTRODUCTION

The limited role international organizations and networks played in preventing and responding to the global financial crisis is a case of expectations falling short of reality. As David Zaring has noted in this journal, the "international financial architecture," which consists of the universe of specialized international organizations, economic treaties and regulatory networks pertaining to financial regulation, was mostly ineffective or at best marginally useful in helping to manage the financial crisis.[1] Instead, the international response to the crisis relied on state-to-state negotiations by political leaders, most notably through the G20.[2] The fact that it took agreements at the ministerial and heads-of-government level to coordinate a response to the crisis is a rebuke to those who argue that transgovernmental networks[3] and soft law instruments can sustain a robust framework for regulatory cooperation among states.[4]

At the same time, dependence on high politics[5] and state-centric forums like the G20 to prevent and manage future financial crises is deeply unsatisfying from both the financial law and international law perspectives. While the G20 was effective in spurring joint action by states,[6] there are reasons to be skeptical

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1 See David Zaring, International Institutional Performance in Crisis, 10 Chi J Intl L 475 (2010).

2 See id at 495–501. The G20 is a forum focused on international economic development composed of the finance ministers, central bank governors and heads of government of nineteen countries and the EU. The nineteen countries are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK and US.

3 See text accompanying notes 40–66.

4 See, for example, Anne-Marie Slaughter, A New World Order (Princeton 2004); David Zaring, Informal Procedure, Hard and Soft, in International Administration, 5 Chi J Intl L 547 (2005); Daniel C. Esty, Good Governance at the Supranational Scale: Globalizing Administrative Law, 115 Yale L J 1490 (2006). See also Kal Raustiala, The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law, 43 Va J Intl L 1 (2002) (arguing that transgovernmental networks must work in concert with international organizations).

5 "High politics" typically refers to those issues that tend to be of great national interest, particularly issues related to national and economic security. As states are less willing to compromise on these issues, international cooperation is more difficult to achieve without serious political bargaining by high state officials. See, for example, Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 Yale J Intl L 113, 122–23 (2009). Areas of "low politics," such as banking, securities law, and antitrust tend to be less encumbered. See Kal Raustiala, *Transnational Networks: Past and Present*, 43 Intl Law 205, 208 (2009).

6 See, for example, The London Summit, *London Communiqué of the Leaders of the G20* ("*G20 London Communiqué*") (Apr 2, 2009), online at http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/ (visited Mar 22, 2010); *The Pittsburgh Summit 2009*, G20 Leaders' Statement ("G20 Pittsburgh Statement") (Sept 24–25, 2009), online at http://www.pittsburghsummit.gov/mediacenter/129639.htm (visited Mar 22, 2010).

that the G20 will retain its high level of activity once the immediate threat of the crisis dissipates and international cooperation in the area of financial regulation loses its political urgency.[7] Likewise, it is unclear whether the G20 will regain its vigor and effectiveness if a future crisis develops. For financial law scholars, the G20, both in its existence and in the types of actions it puts forward, represents only a temporary solution to an on-going problem of regulation of international financial markets and institutions. A regulatory vacuum remains to be filled. For international law scholars, the G20 offers little advancement of international legal norms in promoting cooperation among states and their regulatory agencies. Having witnessed its shortcomings, we should consider ways to bolster the international financial architecture to fill this regulatory vacuum and to strengthen the international legal framework for regulatory cooperation.

The path forward depends first on recognizing two problems with how legal scholars viewed the international financial architecture before the crisis. International law scholars frequently noted that the international financial architecture relied to a great extent on informal transgovernmental networks as opposed to formal international organizations or other treaty-based mechanisms.[8] Thus, the international financial architecture appeared to provide convincing empirical support for such scholars' claims about the effectiveness of transgovernmental networks in promoting regulatory cooperation among states.[9]

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7 Divergent positions on remedial measures inevitably impair cooperative efforts between the political leaders who comprise the G20. For example, last Fall's summit in Pittsburgh produced an unequivocal resolve that more rigorous oversight was necessary to curb future crises. However, political pressures limited any ability to agree upon a proper solution. While the US fought for very high capital requirements, particularly on large institutions posing systemic risks, European leaders balked, seeing the US plan as disproportionately favorable to US financial institutions, which are generally less intimately intertwined with the local economy than European banks. See Damian Paletta and Alessandra Galloni, *Europe, US Spar on Cure for Banks*, Wall St J A1 (Sept 23, 2009). See also Anna Fifield, *G7 Warms To Idea of Bank Levy*, Fin Times online (Feb 6, 2010), online at http://www.ft.com/cms/s/0/f64999e2-134a-11df-9f5f-00144feab49a,dwp_uuid= 729ab242-9cb1-11db-8ec6-0000779e2340.html (visited May 3, 2010) (describing breakdown in regulatory coordination among the G7 states after the 2009 G20 meetings).

8 See, for example, Zaring, 5 Chi J Intl L at 554–92 (cited in note 4) (discussing the achievements of the Basel Committee on Banking Supervision and International Organization of Securities Commission); Anne-Marie Slaughter, *Governing the Global Economy through Government Networks*, in Michael Byers, ed, *The Role of Law in International Politics* 177 (Oxford 2000); Raustiala, 43 Va J Intl L at 28–35 (cited in note 4) (discussing the rise of transgovernmental networks in international securities regulation).

9 But see Stavros Gadinis, *The Politics of Competition in International Financial Regulation*, 49 Harv Intl L J 447 (2008) (arguing that successful cases of international coordination in the realm of financial regulation can be best explained by domestic interest group preferences and states' relative position in a particular market for financial services); Verdier, 34 Yale J Intl L 113 (cited in note 5) (expressing skepticism that the accomplishments of transgovernmental networks has more to do with a convergence of interests than the effectiveness of the networks themselves).

In fact, the international financial architecture proved incapable of preventing or managing the causes and effects of the recent financial crisis. The reason why is the second problem. Financial law scholars (and, for that matter, regulators and policymakers) did not speak out more strongly before the crisis about the limitations of the international financial architecture. Specifically, financial law scholars focused their attention on the coordination and harmonization of rules and standards in areas of accounting, securities, and capital adequacy, but left unresolved the problems of prudential supervision of cross-border financial institutions and systemic risk regulation.[10] The failure of states to provide for an international legal regime capable of conducting prudential supervision of cross-border financial institutions proved to be one of the reasons why the international financial architecture was unable to prevent financial instability in the US from becoming a global financial crisis.

In response to the recent financial crisis, national regulators and financial law scholars now agree on the greater importance of prudential supervision and systemic risk regulation.[11] Regulatory reform efforts proposed in the US, EU and other major jurisdictions emphasize more intensive oversight of financial institutions by regulatory supervisors, requiring real-time access to information, better knowledge of financial institutions' activities throughout the world, and broader exercise of discretion by such supervisors.[12]

What is required is an international legal framework that can provide such intensive supervision of cross-border financial institutions and macroeconomic systems. Unfortunately, transgovernmental networks do not provide the level of cooperation needed to effect cross-border supervision. This is not to say that transgovernmental networks lack value. They remain useful in building consensus among regulators about key principles and standards. Effective global financial regulation, however, requires more powerful international legal frameworks and instruments that go beyond transgovernmental networks.

This Article advocates an international administrative law model for financial regulation. It advocates the creation of an international body that has

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10 See Eric J. Pan, *Four Challenges to Financial Regulatory Reform*, Benjamin Cardozo School of Law Working Paper No 280 (Dec 2009), online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1521504 (visited Mar 22, 2010) (explaining the importance of supervision to the financial crisis).

11 See, for example, Group of Twenty, *G20 Leaders' Declaration, Summit on Financial Markets and the World Economy* ("G20 Washington Communiqué") (Nov 15, 2008), online at www.g20.org/Documents/g20_summit_declaration.pdf (visited May 3, 2010) ("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.").

12 See name of source text accompanying notes 119–32.

the power and resources to supervise cross-border financial institutions, demand action by national supervisors, promulgate supervisory standards, conduct inspections, and initiate enforcement proceedings. Acknowledging possible objections to an international administrative law model, particularly those related to the protection of state sovereignty and democratic accountability, this Article argues that the formation of an international administrative agency is better suited to the problem of global financial regulation and should garner support from key states. This Article admires in particular the structural reform proposals being adopted by the EU and the creation of new European System of Financial Supervisors. While recognizing that the EU represents a unique phenomenon in international law, this paper argues that the international community should look to the EU experience for a model of greater international cooperation.

The development of a new international administrative law regime to govern financial regulation and supervision has significant implications for the development of international law. While this Article focuses primarily on financial regulation and describing an international legal framework for global financial supervision, the model proposed would be applicable to any regulatory problem that involves oversight, enforcement, and inspection of private actors by a public body. To the extent international administrative law regimes can assume a greater role in the regulation of key economic and social sectors—as they must in a globalizing society—they represent new and prolific sources of international law.

Part II of the Article examines the current international financial architecture. It offers an account of the limitations of the architecture. Part III discusses the problem of financial supervision. It explains how the financial crisis showed the inadequacy of frameworks for supervising cross-border financial institutions and the limitations of the current international financial architecture. Part IV sets forth an international administrative law model for financial regulation. It addresses common objections to the international administrative law model and considers the possibility that such an international legal regime can be established. The Conclusion reflects on how the development of new international legal tools to solve the financial regulatory problem may influence the future development of international law.

II. INTERNATIONAL FINANCIAL ARCHITECTURE

The current international financial architecture consists broadly of five different types of international legal frameworks, as depicted in Table 1. These frameworks range from formal international organizations, as epitomized by the International Monetary Fund (IMF) and World Bank, to periodic state-to-state contact groups, like the G8 or G20, to transgovernmental networks, to informal bilateral and regional arrangements between national regulators, and to private standards setting bodies.

A review of the different legal frameworks that make up the international financial architecture shows that regulatory cooperation takes place predominantly through the transgovernmental networks, but these networks rely heavily on political bargains struck at the level of state-to-state contact groups. Consequently, the international financial architecture provides a suboptimal regulatory framework for the international financial markets, generating a need for stronger international regulatory bodies.

	International Organizations	State-to-State Contact Groups	Trans-governmental Networks	Bilateral and Regional Networks	Private Standards Setting Bodies
Examples	IMF World Bank WTO	G20/Gn8	FSB Basel IOSCO IAIS OECD	FMRD	IASB ISDA
Characteristics	Treaty-based; large secretariat; limited policymaking; policy administration	Political; no secretariat; policymaking	MOU/ Informal; small secretariat; information sharing; policy coordination; policy administration	MOU/ Informal	Private sector experts
Regulatory Tasks	Sovereign loans; economic development and technical assistance; international trade; market access	Crisis response; creation of networks	Rules and standards related to banking, securities, insurance, foreign investment	Market access; rules and standards; mutual recognition	Technical standards
Examples of Achievements		Creation of Basel and FSB	Basel II; international disclosure standards for cross-border offerings	IFRS accounting roadmap	IFRS; ISDA Master Agreement

IMF = International Monetary Fund

WTO = World Trade Organization

G20 = Group of Twenty
G8 = Group of Eight
FMRD = US-EU Financial Markets Regulatory Dialogue
FSB = Financial Stability Board
Basel = Basel Committee on Banking Supervision
IOSCO = International Organization of Securities Commissions
IAIS = International Association of Insurance Commissioners
OECD = Organization of Economic Cooperation and Development
IASB = International Accounting Standards Board
ISDA = International Swaps and Derivatives Association

Table 1 – International Financial Architecture

A. International Organizations

Much has changed since the leading economic powers, meeting in Bretton Woods, New Hampshire in 1944, conceived of three international organizations to manage the international economy—the IMF, World Bank, and International Trade Organization (implemented in spirit through the General Agreement on Tariffs and Trade and eventually as the World Trade Organization (WTO)).[13] The international financial markets have become to a great extent private markets. The main sources and distributors of capital are now private entities, whether commercial banks, retail and institutional investors, or private investment funds. States now participate in the international financial markets as if they were private actors. Governments market their debt to private investors.[14] They submit themselves to the judgment of private credit rating agencies that opine on governments' credit worthiness.[15] They rely on private investment

13 See, for example, Orin Kirshner, *Introduction* in Orkin Krishner, ed, *The Bretton Woods-GATT System: Reptrospect and Prospect After Fifty Years* ix (ME Sharpe 1996) ("Put simply, the IMF, the World Bank, and the GATT were created to address the global problems of the 1920s and 1930s, not the problems we face today."). See also Simon Reisman, *The Birth of the World Trading System: ITO and GATT*, in Orin Kirshner, ed, *The Bretton Woods-GATT System* 82 (ME Sharpe 1996) (describing the conception of the ITO and the rise of GATT).

14 See, for example, Treasury Direct, online at http://www.treasurydirect.gov (visited Mar 22, 2010) (offering US Treasury securities directly to private investors as well as providing information on how to purchase through the more traditional route of using a bank or broker).

15 See, for example, Hiroko Tabuchi and Bettina Wassener, *Japan's High Debt Prompts Credit Rating Warning*, NY Times (Jan 26, 2010) online at http://www.nytimes.com/2010/01/27/business/global/27yen.html (visited Mar 22, 2010) ("A leading credit rating agency *threatened* Tuesday to downgrade Japan's rating *unless* the world's second largest economy took more steps to rein in its mounting public debt.") (emphasis added); Standard & Poor's Ratings,

banks to provide underwriting and other financial advisory services.[16] They hire private law and consulting firms to provide transaction advice.[17] Governments also are active as investors in the private markets. Government investment funds—particularly the so-called sovereign wealth funds—participate in the capital markets right next to, and sometimes in combination with, private investment funds.[18] As the international financial markets have become private markets, the most pressing international finance questions facing the international community have shifted from how to facilitate state-based financing and maintain a stable foreign exchange regime to how to regulate cross-border transactions by private firms and persons and ensure the safety and soundness of the financial institutions and intermediaries that operate the financial markets.

The objectives of the IMF and World Bank were to encourage monetary policy cooperation, ensure currency convertibility, extend credit for post-war recovery efforts and provide loans and other financial and technical assistance to member countries.[19] Both institutions are international organizations.[20] They have formal powers set forth by treaty,[21] enjoy large, permanent staff, and have

Sovereign Ratings List, online at http://www.standardandpoors.com/ratings/sovereigns/ratings-list/en/us/?sectorName=Governments&subSectorCode=39 (visited Mar 22, 2010) (providing Standards & Poors credit ratings for all government issued debts).

16 See, for example, Louise Story, Landon Thomas Jr., and Nelson Schwartz, *Wall St Helped to Mask Debts Shaking Europe*, NY Times A1 (Feb 14, 2010) (describing financial services and advice provided by certain US-based investment banks to Greece and other European countries).

17 See, for example, Amy Kolz, *Nice Work . . . If You Can Get It*, American Lawyer 104 (Jan 2009) (describing the sizeable business enjoyed by law firms that represent sovereign wealth funds); White & Case LLP, Press Release, *Public Investment Fund of Saudi Arabia to Buy SAR10 Billion of Notes from Sabic in Largest Saudi Corporate Note Issue of 2009* (Jan 6, 2010), online at http://www.whitecase.com/press-01062010/ (visited Mar 22, 2010) (detailing a transaction in which a US law firm collaborated with a Saudi attorney to advise the Public Investment Fund of Saudi Arabia on its purchase of notes issued by a Saudi corporation).

18 See Richard A. Epstein and Amanda M. Rose, The Going-private Phenomenon: The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow, 76 U Chi L Rev 111, 117 (2009).

19 See Kirshner, *The Bretton Woods-GATT System* at x–xi (cited in note 13).

20 International organizations generally share the same three characteristics. See Jose E. Alvarez, *International Organizations as Law-makers* 4–7 (Oxford 2005); Chittharanjan F. Amerasinghe, *Principles of the Institutional Law of International Organizations* 9 (Cambridge 2d ed 2005). First, all international organizations must be formed by an agreement between states, usually, but not always, taking the form of a multilateral treaty or convention. Second, international organizations must have an organ or body capable of acting independently of their constituent states. This requirement is sometimes referred to as having a "legal personality." See Henry G. Schermers and Neils M. Blokker, *International Institutional Law* 26, 34 (Martinus Nijhoff 4th ed 2003). Finally, international organizations must be established under international law. See id at 36–37.

21 The Articles of Agreement of the International Monetary Fund ("IMF Agreement") were conceived on July 22, 1944 at the United Nations Monetary Fund Conference in Bretton Woods, New Hampshire. The International Monetary Fund was founded on December 27, 1945 when

the ability to make policy through organs composed of representatives from member states.[22]

The third major international organization in the international financial architecture is the WTO. What has distinguished the WTO from the IMF and the World Bank has been its successful enforcement of international legal principles of trade liberalization through a robust dispute resolution system. The success of the WTO's dispute resolution system to adjudicate claims between states and ensure compliance of its decisions represents a major international law achievement. The WTO, through the General Agreement on Trade and Services (GATS), also has a direct role to play in the setting of market access rules for the provision of cross border financial services. However, the GATS affords little assurance that market access will be linked to uniformly high standards of prudential supervision.[23]

Despite their vast legal powers, sizeable bureaucracies and substantial resources, the IMF, World Bank and WTO play only a supporting role in the management of the international financial system.[24] The main reason for their limited role is that they lack the necessary legal powers and expertise to serve as financial regulators. A financial regulator must have the capacity to monitor markets and market participants, the expertise to identify problems and formulate regulatory responses, the authority to promulgate rules and standards, and the ability to implement and enforce such rules and standards. The IMF and World Bank arguably possess the technical expertise and resources to serve as financial regulators,[25] but they lack the legal competence.[26] Likewise, the WTO,

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the Articles went into force. See also Joseph Gold, *Legal and Institutional Aspects of the International Monetary System* 238–291 (IMF 1979).

22 The IMF, for example, has two governing bodies: the Board of Governors and the Executive Board. See IMF Agreement Art I, § 1 (cited in note 21). The Board of Governors, composed of a representative from each member state, is the highest ranking decision-making body at the IMF. See id, Art I, § 2. The Executive Board is responsible for carrying out the functions of the IMF. See id, Art I, § 3(a). Members elect the directors who serve on the Executive Board with five seats reserved to the states with the largest contribution quotas. See id, Art XII, §3(b)(i)–(ii).

23 See Joel P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 Colum J Transnatl L 37 (1995) (discussing how GATS would require countries to provide market access to foreign financial service providers at the expense of tough prudential regulatory requirements on foreign supervised financial institutions); Sydney J. Key, *Trade Liberalization and Prudential Regulation: The International Framework for Financial Services*, 75 Intl Affairs 61 (1999) (discussing the need to accompany any liberalization of trade in financial services with common agreements on regulatory and supervisory standards).

24 See Zaring, 10 Chi J Intl L at 488–94 (cited in note 1).

25 See *Report of the Working Group on Strengthening Financial Systems* (Oct 1998) (recommending the IMF be charged with banking system surveillance, drawing upon expertise from the World Bank); International Monetary Fund, *Declaration of G7 Finance Ministers and Central Bank Governors* (Oct 30,

through GATS, arguably has potential legal authority to regulate the provision of cross-border financial services, but lacks the technical competence.[27] Further, all three international organizations are hampered by the inflexibility of their treaty regimes and plenary bodies to broaden their legal authority and engage in the active rulemaking and supervisory acts necessary to regulate private financial transactions and actors.[28]

B. State-to-State Contact Groups

With international financial institutions unable to fill the role of global financial regulator, a diverse group of legal frameworks has emerged to carry out different aspects of the role.[29] As shown in Table 1, this group consists broadly of four different types of legal frameworks. The first framework is one that can be best described as "state-to-state" contact groups. Prime examples of state-to-state contact groups are the various "G-groups." G-groups refer to the regularly scheduled meetings of ministers and heads of government of the largest and wealthiest countries of the world. Such groups include the G7, G8, G10 and most recently the G20.[30] G-groups do not operate pursuant to any legal instrument. Their decisions are entirely consensual and take the form of political statements as opposed to legally binding agreements. Through repeated

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1998), online at http://www.imf.org/external/np/g7/103098dc.htm (visited Mar 22, 2010) (expressing support for IMF surveillance of the international financial sector).

26 Some argue that the IMF has the ability to monitor financial systems pursuant to Article IV of the IMF Article of Agreement. See, for example, Christopher Brummer, *How International Financial Law Works (And How it Doesn't)* 63–64, online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1542829 (visited Mar 22, 2010). The problem with this approach is that Article IV does not permit the IMF to conduct surveillance of private firms, which would be necessary for prudential supervision and systemic risk regulation.

27 See Kern Alexander, The GATS and Financial Services: Liberalisation and Regulation in Global Financial Markets, in Kern Alexander and Mads Andenas eds, The World Trade Organization and Trade in Services 561, 564, 568 (Martinus Nijhoff 2008); Rolf H. Weber and Douglas W. Arner, Toward a New Design for International Financial Regulation, 29 U Pa J Intl L 391, 426–27 (2007) (discussing limitations of GATS in opening access to cross-border financial services).

28 For an analysis of the problems that face treaty-based regimes attempting to serve as administrative agencies, see Eric J. Pan, *Authoritative Interpretation of Agreements: Developing More Responsive International Administrative Regimes*, 38 Harv Intl L J 503 (1997). See also Debra P. Steger, *The Future of the WTO: The Case for Institutional Reform*, 12 J Intl Econ L 803 (2009) (arguing for a management or executive body in the WTO that would permit for greater and more efficient rulemaking powers).

29 See Joseph J. Norton, Comment on the Developing Transnational Network(s) in the Area of International Financial Regulation: The Underpinnings of a New Bretton Woods II Global Financial System Framework, 43 Intl Law 175, 180–81 (2009).

30 See, for example, Andrew Baker, *The Group of Seven: Finance Ministries, Central Banks and Global Financial Governance* 3–4, 19–37 (Routledge 2006); Carlos M. Peláez and Carlos A. Peláez, *International Financial Architecture* 66–67 (Palgrave 2005).

interaction, the G-groups represent a powerful state-centric network.[31] And they play a crucial role in the international financial architecture by providing the necessary political agreements to empower a number of less formal legal networks to serve as de facto regulators of the global financial system.

For example, in 1974 the G10[32] established the Basel Committee on Banking Supervision (Basel Committee), in response to the foreign exchange settlement crisis caused by the failure of the Herstatt Bank in Germany.[33] The initial purposes of the Basel Committee were to facilitate the exchange of information between the bank regulators of the Basel Committee members and to issue guidelines concerning the proper handling of banking crises. In 1999, the G7 reacted to the Asian and Russian financial crises by creating the Financial Stability Forum (FSF).[34] The FSF's purpose was "to ensure that national and international authorities and relevant international supervisory bodies and expert groupings [could] more effectively foster and coordinate their respective responsibilities to promote international financial stability, improve the functioning of the markets and reduce systemic risk."[35] In response to the recent financial crisis, the G20 replaced the FSF with the Financial Stability Board (FSB).[36] The G20 charged the FSB with a "strengthened mandate"[37] compared to the FSF, so it would assume a "central role in coordinating [the] agenda" to further global financial supervision and regulation.[38] This agenda includes strengthening systemic risk regulation, implementing counter-cyclical capital requirements, developing common principles for remuneration and dealing with tax havens and non-cooperative jurisdictions.[39] Thus, G-groups rely heavily on informal regulatory networks like Basel and FSB to carry out the task of developing global standards.

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31 See generally id.

32 G10 consists of Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, UK and US.

33 See Joseph D. Becker, *Transnational Insolvency Transformed*, 29 Am J Comp L 706 (1981).

34 See University of Toronto G8 Information Centre, *Communiqué of G7 Finance Ministers and Central Bank Governors* ¶ 15 (Feb 20, 1999), online at http://www.g8.utoronto.ca/finance/fm022099.htm (visited Mar 22, 2010).

35 Id. See also Financial Stability Board, History, online at http://www.financialstabilityboard.org/about/history.htm (visited Mar 22, 2010).

36 See *London Communiqué of the Leaders of the G20*, ¶¶ 15–16 (cited in note 6).

37 See id, ¶ 15.

38 The London Summit, *Explanatory Guide to the Communiqué*, online at http://www.londonsummit.gov.uk/en/summit-aims/communique-explanation/ (visited Mar 22, 2010).

39 See id.

C. Transgovernmental Networks

Many of the frameworks set up by the G-groups fall within the third category of legal frameworks identified in Table 1: transgovernmental networks. Anne-Marie Slaughter and David Zaring define transgovernmental networks as the links between sub-state actors, such as regulatory agencies, that "allow domestic officials to interact with their foreign counterparts directly, without much supervision by foreign offices or senior executive branch officials . . . ."[40] Transgovernmental networks derive strength not from treaties or other state-to-state agreements. Instead, transgovernmental networks operate through frequent interaction between these sub-state actors, encouraging information sharing, development of common concepts, and cooperation in solving mutual problems.[41] As Kal Raustiala noted, these networks "are 'transgovernmental' because they involve specialized domestic officials directly interacting with each other, often with minimal supervision by foreign ministries. They are 'networks' because this cooperation is based on loosely-structured, peer-to-peer ties developed through frequent interaction rather than formal negotiation."[42]

Transgovernmental network theory is rooted in the belief that globalization has rendered the traditional approaches of domestic actors and regulators inadequate to deal with certain issues in which states have become increasingly interdependent, such as financial and environmental regulation.[43] In order to effectively regulate and manage these issues, states are "disaggregating into . . . separate, functionally distinct parts" such as courts, regulatory agencies, and even legislatures.[44] As these parts begin to interact on a regular basis with their foreign counterparts, they develop a network where they take it upon themselves

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40 Anne-Marie Slaughter and David Zaring, *Networking Goes International: An Update,* 2 Ann Rev of L and Soc Sci 211 (2006).

41 Transgovernmental network theory relies heavily on the existence of epistemic communities whose members share normative beliefs and a common policy enterprise. Members of epistemic communities share information, interpret such information, and ultimately form networks and institutionalize their relationships to coordinate policy. See Peter M. Haas, *Introduction: Epistemic Communities and International Policy Coordination,* 46 Intl Org 1, 3–4 (1992).

42 Raustiala, 43 Va J Intl L at 5 (cited in note 4). Transnational law, the law governing the "relationships between nonstate actors" has been studied since at least the 1950s. See Slaughter and Zaring, 2 Ann Rev of L and Soc Sci at 213 (cited in note 40). In the 1970s the term "transgovernmental relations" was coined by international relations scholars to define "relationships between government officials 'that are not controlled or closely guided by the policies of the cabinets or chief executives of those governments . . . .'" Id at 212–13 (quoting Robert Keohane and Joseph Nye, *Transnational Relations and World Politics* 428 (Harvard 1972)).

43 See Slaughter, *A New World Order* at 8–11 (cited in note 4); see also Raustiala, Va J Intl L at 11–16 (cited in note 4) (citing "technological innovation," "the rise of the regulatory state," and "globalization" as the root cause of the "rise of networks.")

44 See Anne-Marie Slaughter, *The Real New World Order,* Foreign Affairs 183, 184 (Sept/Oct 1997).

to share information, agree on common principles and generate legal norms. The more successful transgovernmental networks manage a convergence of national rules and standards to develop global rules and standards that are in turn implemented into local law. Governments and international organizations can facilitate the development of transgovernmental networks by providing fora for sub-state entity interaction and institutional support for information dissemination.

Although transgovernmental networks can stand alone, they also complement the efforts of traditional international organizations by facilitating convergence or "deeper cooperation through more formal international agreements" and enhancing compliance with existing international agreements.[45] In addition, transnational governmental networks serve as aggregators of information and clearinghouses for the sharing of technical expertise, influencing the development of future treaties and international agreements. Recognizing the expertise of transgovernmental networks, states and international organizations look to such networks for help in developing new policies.[46]

Three noteworthy examples of financial regulatory transgovernmental networks are the Basel Committee, the International Organization of Securities Commissions (IOSCO) and the FSF.[47] The Basel Committee provides a forum for regular cooperation on banking supervisory matters with the objective to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.[48] Its membership consists of representatives of national banks and finance departments from twenty-six countries and Hong Kong.[49] These members make decisions by consensus.[50] It has a small secretariat staffed primarily by regulators on temporary assignment from member states. Basel's noteworthy achievements include the Basel Concordat,[51] Core Principles

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45 See Slaughter and Zaring, 2 Ann Rev of L and Soc Sci at 225 (cited in note 40).

46 The IMF, for example, embraced the 1997 Basel Core Principles for Surveillance of Banking and Surveillance Systems and urged its members to adopt the principles, even though many of the members were not members of Basel. See David Folkerts-Landau and Carl-Johan Lindgren, *Toward a Framework for Financial Stability* (IMF 1998).

47 For more information about Basel and IOSCO as examples of transgovernmental networks, please see Zaring, 5 Chi J Intl L at 554–69 (cited in note 4).

48 Id.

49 History of the Basel Committee and its Membership, online at http://www.bis.org/bcbs/history.htm (visited Apr 23, 2010).

50 Zaring, 5 Chi J Intl L at 555 (cited in note 4).

51 Basel Committee, *Principles for the Supervision of Banks' Foreign Establishments* ("Concordat") (May 1983), online at http://www.bis.org/publ/bcbsc312.htm (visited Mar 22, 2010).

for Effective Supervision,[52] and the Revised Framework on International Convergence of Capital Measurement and Capital Standards (Basel II).[53] Despite its lack of formal legal powers, Basel has been effective in setting forth principles and promulgating standards that have been widely accepted and implemented by bank regulators around the world, including regulators of countries that are not members of Basel.[54]

The IOSCO is an affiliation of national securities regulators and private securities regulators with a four-fold mandate: (1) promote high regulatory standards; (2) exchange information on past experiences to promote development of domestic markets; (3) establish standards for and surveillance of international securities transactions; and (4) provide mutual assistance for enforcement activities.[55] Like Basel, IOSCO has no formal legal powers and a minimal staff. It is effectively a series of meetings of regulators where members pass non-binding resolutions by consensus.[56] As in the case of Basel, IOSCO has been successful in promulgating standards that have found wide acceptance among national regulators. For example, through IOSCO, regulators agreed on a common standard of international disclosure for cross-border offerings.[57] IOSCO continues to produce numerous papers and reports on a wide range of issues affecting the international securities markets including market surveillance, hedge fund regulation and auditing standards.

The FSF is another example of a transgovernmental network. The FSF's objective was to bring together national financial stability regulators,

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52 Basel Committee, *Core Principles for Effective Banking Supervision* (Sept 22, 1997), online at http://www.bis.org/press/p970922.htm (visited Mar 22, 2010).

53 Basel Committee, *Basel II: International Convergence of Capital Measurement And Capital Standards: a Revised Framework* (June 2004), online at http://www.bis.org/publ/bcbs107.htm (visited Mar 22, 2010).

54 See, for example, *Implementation of the New Capital Adequacy Framework in Non-Basel Committee Member Countries* (Bank for International Settlements Financial Stability Institute Occasional Paper No 4, July 2004), online at http://www.bis.org/fsi/fsipapers04.htm (visited Mar 22, 2010) (reporting that at least 88 jurisdictions that are not members of the Basel Committee intend to implement Basel II).

55 See International Organization of Securities Commissions ("IOSCO"), *General Information on IOSCO*, online at http://www.iosco.org/about (visited Mar 22, 2010); IOSCO, *Structure of the Organization*, online at http://www.iosco.org/about/index.cfm?section=structure (visited Mar 22, 2010).

56 See Zaring, 5 Chi J Intl L at 565 (cited in note 4).

57 See, for example, IOSCO, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers* (Sept 1998), online at http://www.sec.gov/about/offices/oia/oia_corpfin/crossborder.pdf (visited Mar 22, 2010). See also Securities and Exchange Commission, *International Disclosure Standards Release No 34-41936* (Sept 30, 1999), online at http://www.sec.gov/rules/final/34-41936.htm (visited Mar 22, 2010) (adopting revised Form 20-F containing disclosure requirements proposed by IOSCO).

international regulatory bodies, international financial institutions, and market infrastructure experts to cooperate on measures that would promote the stability of the international financial system.[58] In November 2008, the leaders of the G20 nations called to expand the membership of the FSF,[59] and the Forum was reestablished as the FSB in April 2009.[60] The FSB currently is comprised of fifty-two national regulatory agencies representing twenty-four nations along with twelve international agencies charged with financial stability regulation and standard-setting.[61]

The contributions of the FSF and FSB have been largely informational and advisory. For example at its first meeting in April 1999, the FSF established a Working Group on Offshore Financial Centers, which submitted its report to the full FSF membership in April 2000.[62] Based on this group's findings, the FSF issued its own report the next month in which it listed five criteria for evaluating jurisdictions: (1) cross-border cooperation on information exchange; (2) underlying supervision; (3) degree of due diligence in financial institutions; (4) availability of information about beneficial ownership; and (5) availability of data on financial activities.[63] Another example is the Working Group on Market and Institutional Resilience established by the FSF in 2008. This Working Group focused regulating risk-management practices, valuation, risk disclosure and accounting, credit rating agencies, and prudential oversight.[64] The Working Group's charge was to evaluate these issues with a view to diagnosing the causes of systemic instability, identifying weaknesses for policymakers to address, and

58 See Financial Stability Board, *About the FSB: History*, online at http://www.financialstabilityboard.org/about/history.htm (visited Mar 22, 2010) (cited in note 35).

59 See G20, *Washington Communiqué* (cited in note 11).

60 See G20, *London Communiqué* (cited in note 6).

61 See Financial Stability Board, Links to FSB Members, online at http://www.financialstabilityboard.org/members/links.htm (visited Mar 22, 2010). Besides IOSCO and the Basel Committee, the international institutions sitting on the board are the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the Organization for Economic Coordination and Development, the World Bank, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems, the International Association of Insurance Supervisors, and the International Accounting Standards Board.

62 See Financial Stability Forum, *Report of the Working Group on Offshore Centres* (Apr 5, 2000), online at http://www.financialstabilityboard.org/publications/r_0004b.htm (visited Mar 22, 2010).

63 See id, ¶ 7.

64 See Financial Stability Forum, *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience* (Apr 7, 2008), online at http://www.financialstabilityboard.org/list/fsb_publications/tid_110/page_2.htm (visited Mar 22, 2010).

recommending solutions.[65] Since its reconstitution, the FSB has already released over fourteen publications by February 2010, primarily dealing with systemic risk issues exposed during the recent financial crisis.[66] As in the case of Basel and IOSCO, the FSB uses its power as a hub of regulatory expertise to influence regulatory actions in member states. It does not rely on, nor appears to need, formal legal powers to carry out its function.

D. Bilateral and Regional Networks

In addition to transgovernmental networks, two other legal frameworks play an important role in regulating the international financial markets. One framework may be best described as bilateral and regional networks.[67] Bilateral and regional networks refer to close cooperative arrangements between two or more states to address specific regulatory problems. These cooperative arrangements often involve both political and regulatory representatives and tackle issues that have not been addressed by the relevant transgovernmental networks. These bilateral and regional networks produce commitments by states to assume certain regulatory stances even though they do not rely on states entering into any binding agreements. Instead, parties tend to rely on soft law instruments ranging from memoranda of understanding to oral commitments and joint press releases. These bilateral and regional networks frequently achieve more substantial results on a wider range of issues because they involve discussions of a smaller number of states.

Two examples that illustrate the operation of such bilateral and regional networks are the US-EU Financial Markets Regulatory Dialogue (FMRD)[68] and the US-Australia memorandum of understanding on the mutual recognition of broker-dealers (US-Australia MOU).[69] The FMRD originated from an agreement

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65 Id.

66 See Financial Stability Board, Publications, online at http://www.financialstabilityboard.org/list/fsb_publications/index.htm (visited Mar 22, 2010).

67 See, for example, Julia Black and David Rouch, *The Development of the Global Markets as Rule-Makers: Engagement and Legitimacy*, 2 Law and Fin Markets Rev 218, 219–20 (2008) (discussing the impact of bilateral and regional dialogues on cross-border standards setting).

68 See Olivier Girard, Financial Regulation: Is Transatlantic Cooperation Still Relevant?, 4 Euredia 577 (2009); Kern Alexander, Eilís Ferran, Howell Jackson and Niamh Moloney, A Report on the Transatlantic Financial Services Regulatory Dialogue 647–73 (Olin Center for Law, Economics, and Business Discussion Paper No 576, Jan 2007), online at http://www.law.harvard.edu/programs/olin_center/papers/576_Jackson_et%20al.php (visited Mar 22, 2010).

69 See Securities and Exchange Commission, *Press Release: SEC, Australian Authorities Sign Mutual Recognition Agreement* (Aug 25, 2008), online at http://www.sec.gov/news/press/2008/2008-182.htm (visited Mar 22, 2010). For a perspective on the significance of this new approach to cross-border regulation, see Eric J. Pan, *The New Internationalization of US Securities Regulation: Improving the Prospects for a Trans-Atlantic Marketplace* (Benjamin Cardozo School of Law Working

made at a state-to-state contact group, in this case the 2002 US-EU Summit.[70] The FMRD consists of a series of formal and informal meetings between senior policymakers and regulators from the US and the European Commission.[71] The agenda for these meetings consists of sharing information about the development of regulatory policy in each other's jurisdictions, resolving regulatory conflicts, and promoting regulatory convergence and harmonization.[72] Issues addressed by the FMRD include agreeing on a process to converge US Generally Accepted Accounting Principles with International Financial Reporting Standards (IFRS), the establishment of a supervisory authority in the US Securities and Exchange Commission (SEC) to oversee non-bank financial conglomerates to match EU requirements on financial conglomerate supervision, and new rules governing deregistration by foreign private issuers.[73] The FMRD produces an intense level of cooperation between the US and the EU across a broad range of financial regulatory issues.

A different, but equally useful example of a bilateral and regional network is the US-Australia MOU. In 2008, the SEC held discussions with its counterparts in Australia, Canada and the EU regarding the regulation of broker-dealers.[74] The discussions' purpose was to negotiate a mutual recognition arrangement, pursuant to which broker-dealers, including stock exchanges, would be permitted to offer services to investors in the other jurisdiction based upon the strength of the supervision of the broker-dealer's home regulator. The

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Paper No 217, 2008); Howell E. Jackson, *Toward a New Regulatory Paradigm for the Trans-Atlantic Financial Market and Beyond: Legal and Economic Perspectives* (2008), online at http://www.law.harvard.edu/faculty/workshops/open/papers0708/jackson.paper.pdf (visited May 3, 2010).

70 See Girard, 4 Euredia at 579 (cited in note 68).

71 See id.

72 See US Treasury, Remarks by US Assistant Secretary of the Treasury for International Affairs Randal K. Quarles, *The US-EU Positive Economic Agenda on Financial Markets Issues* (Dec 10, 2002), online at http://www.ustreas.gov/press/releases/po3677.htm (visited Mar 22, 2010); Girard, 4 Euredia at 580 (cited in note 68).

73 See Girard, 4 Euredia at 579 (cited in note 68).

74 See, for example, Press Release: SEC, Australian Authorities Sign Mutual Recognition Agreement (cited in note 69); Securities and Exchange Commission, Press Release: Schedule Announced for Completion of US–Canadian Mutual Recognition Process Agreement (May 29, 2008), online at http://www.sec.gov/news/press/2008/2008-98.htm (visited Mar 22, 2010); Securities and Exchange Commission, Press Release: Statement of the European Commission and the US Securities and Exchange Commission on Mutual Recognition in Securities Markets (Feb 1, 2008), online at http://www.sec.gov/news/press/2008/2008-9.htm (visited Mar 22, 2010). For a perspective on the significance of this new approach to cross-border regulation, see Pan, Working Paper No 217 at 73 (cited in note 69); Ethiopis Tafara and Robert J. Peterson, A Blueprint for Cross-Border Access to US Investors: A New International Framework, 48 Harv Intl L J 31 (2007).

SEC completed discussions only with Australia. What makes the US–Australia MOU constitute a network is that this non-binding agreement governs an on-going and dynamic relationship between two regulators. As a basis for mutual recognition, the regulators must agree that broker-dealers will be held to equivalent standards of conduct and regulation. Regulators must perform comparability studies to evaluate the effectiveness of each other's supervision. To the extent differences exist, regulators must converge or harmonize their requirements.[75] More importantly, a mutual recognition arrangement requires continuous sharing of information and on-going regulatory cooperation.[76] As part of the arrangement, the US and Australia entered into two additional memoranda of understanding to govern closer enforcement and supervisory cooperation.[77] By arranging for cooperative supervision and enforcement, the US-Australia MOU is distinct from other mutual recognition arrangements that limit themselves to single determinations concerning the adequacy of foreign regulatory requirements. An example of such a limited mutual recognition arrangement is the US-Canada Multijurisdictional Disclosure System. Pursuant to system, Canadian issuers are permitted to offer securities in the US based upon disclosure documents prepared in accordance with Canadian

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75 With respect to exchanges, the foreign regulatory regime must ensure that its exchanges have rules and procedures that prevent fraud and manipulation (including insider trading), put into place surveillance, audit and internal control systems, follow the principle of best execution of customer orders, and have in place certain enforcement and disciplinary mechanisms similar to those required of US self-regulatory organizations. Foreign exchanges also must maintain appropriate systems to ensure continuity of market operations, meet the same standards of price transparency and offer fair access to all qualified broker-dealers. Foreign broker-dealers likewise will be expected to meet the same standards as their US counterparts. They will be expected to meet similar standards of competency, satisfy similar financial responsibility requirements (including the maintenance of sufficient capital reserves, safeguarding of customer funds and keeping of records), and follow similar sales practice standards (including ensuring best execution of customer orders and providing sufficient disclosure to customers about trades).

76 Another example of such level of cooperation is the decision by the European Commission to recognize the adequacy of the auditor oversight systems in Canada. See European Commission, *Commission Decision on the Adequacy of the Competent Authorities of Certain Third Countries Pursuant to Directive 2006/43/EC*, online at www.europolitics.info/pdf/gratuit_en/265787-en.pdf (visited May 3, 2010).

77 See Securities and Exchange Commission, Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Enforcement of Securities Laws (May 3, 2008), online at www.sec.gov/about/offices/oia/oia_mutual_recognition/australia/enhanced_enforcement_mou.pdf (visited Apr 13, 2010); Securities and Exhange Commission, Memorandum of Understanding between the US Securities and Exchange Commission and Australian Securities and Investments Commission Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms (Aug 25, 2008), online at www.sec.gov/about/offices/oia/oia_mutual_recognition/australia/enhanced_enforcement_mou.pdf (visited May 3, 2010).

requirements.[78] As such mutual recognition arrangements do not demand on-going cooperation between regulators, they fall short of establishing a network.[79]

Bilateral and regional networks are significant because they provide for a more intensive level of regulatory cooperation than either state-to-state contact groups or transgovernmental networks.[80] Bilateral and regional cooperation may provide the initial step to the emergence of a more ambitious international administrative law regime. The optimal conditions for cooperation between regulators occur when there already exists a mutual understanding between regulators that comes about through familiarity with each other's regulatory frameworks, markets, and regulatory approaches. Thus, it is more likely for regulators to cooperate in an effective manner if they focus on developing bilateral, as opposed to multilateral, cooperative relationships. Consider, for example, how an agreement between the US and the UK pressured other countries to accept an international capital adequacy standard. In the mid-1980s the US and UK became frustrated with and eventually abandoned efforts to negotiate a single capital adequacy standard through the G10. They instead entered into a bilateral agreement on capital adequacy. Given the size of the US and UK banking markets, the other G10 countries recognized that the US-UK capital adequacy standard would become the de facto global standard. As a result, within a year of the announcement of a US-UK agreement, the rest of the G10 joined negotiations to produce the first Basel Accord.[81]

In the current environment, the development of the FMRD into a robust bilateral framework between the US and the EU would greatly enhance the prospect for the development of more powerful international regulatory regimes.[82] Given the size of the US and EU financial markets, any cooperative regulatory framework relationship that develops between the US and EU likely

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78 See Securities and Exchange Commission, Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, 56 Fed Reg 30036 (1991).

79 Of course, the fact regulators may enter into such mutual recognition arrangements may reflect the fact that a network already exists.

80 See, for example, Girard, 4 Euredia at 586 (cited in note 68) (noting that the work of the FMRD is very technical can be better handled through bilateral forums like the FMRD than larger bodies like the FSB).

81 See Ethan Barnaby Kapstein, Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence, 46 Intl Org 265 (1992).

82 The importance of bilateral regulatory cooperation between the US and EU has been noted by George A. Bermann in *Regulatory Cooperation Between the European Commission and US Administrative Agencies*, 9 Admin L J 933 (1996).

would set the dominant framework for regulation of cross-border institutions for the rest of the world.[83]

E. Private Standards Setting Bodies

A final type of legal network is the private standards setting body. Private standards setting bodies consist entirely of multijurisdictional, non-state actors. They play a key role in the international financial architecture by providing highly technical regulation in regulatory spaces that have either been ceded by national regulators or have fallen outside the scope of national regulation. In many cases, the power of private standards setting bodies stems from states' willingness to recognize or endorse these private standards.[84]

Two prominent, yet different, examples of such networks are the International Accounting Standards Board (IASB) and the International Swaps and Derivatives Association (ISDA). Part of a private, non-profit corporation, IASB plays a key role in the international financial architecture by overseeing the development and interpretation of IFRS.[85] IFRS is the most widely accepted accounting standards in the world, with more than one hundred countries allowing or requiring companies to prepare their financial statements in accordance with IFRS.[86]

ISDA is a global trade association representing the leading participants in the over-the-counter (OTC) derivatives industry. Operating as a New York not-for-profit corporation, ISDA has 850 member institutions from fifty-eight

83 Girard, 4 Euredia at 586–87 (cited in note 68) (arguing that it is in the interest of the US and EU to develop common positions in the FMRD and then push these positions in international fora like the FSB and G20).

84 See, for example, *G20 Washington Communiqué* (cited in note 11) (requesting IASB to develop a global accounting standard).

85 See Andreas M. Fleckner, *FASB and IASB: Dependence Despite Independence*, 3 Va L & Bus Rev 275, 281-83 (2008).

86 International Accounting Standards Board, *Global Convergence of IFRSs*, online at http://www.iasb.org/Use+around+the+world/Global+convergence/IFRS+global+convergence.htm (visited Mar 22, 2010). "[T]he remaining major economies have established timelines for convergence with, or adoption of, IFRSs." Id. The US has even demonstrated receptiveness to use of IFRSs, permitting foreign issuers to abide by these standards and expressing the possibility of extending it to domestic issuers. See Securities and Exchange Commission, *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to US GAAP*, 17 CFR §§ 210, 230, 239, 249 (2008). See also Securities and Exchange Commission, *Press Release: SEC Proposes Roadmap Toward Global Accounting Standards to Help Investors Compare Financial Information More Easily* (Aug 27, 2008), online at http://www.sec.gov/news/press/2008/2008-184.htm (visited Mar 22, 2010).

countries spanning six continents.[87] ISDA's purpose is to develop standards and practices to help decrease sources of risk in the conduct of OTC derivative transactions.[88] One of ISDA's most important contributions to the international financial architecture is the development of the ISDA Master Agreement. First published in 1987 and subsequently revised in 1992 and 2002, the ISDA Master Agreement mitigates legal uncertainty and credit risk by creating international contractual standards for a range of privately negotiated derivatives transactions.[89] In addition to its Master Agreement, the ISDA publishes Confirmations (to document the economic terms of the transactions), Definitions, Credit Support documents, User's Guides, and Protocols (to amend the Master Agreement).[90] Together the IASB and the ISDA provide valuable regulatory services. They are effective because they draw upon the expertise of private actors to supply regulatory solutions that are especially important to private actors.

F. International Financial Architecture as Work-in-Progress

I make four observations about the international financial architecture. First, the vast majority of international regulatory activity takes place through networks of regulators and market participants, meeting on a regular basis in organized forums. In these forums, they develop rules and standards that participating members then implement at home. The most important networks are transgovernmental networks because of the number of regulators that participate in the networks, the breadth of issues these networks address and the willingness of participating and non-participating regulators to carry out the networks' recommendations.

Second, while transgovernmental networks have been critical in producing financial regulation, they do not actually regulate the international financial system. Transgovernmental networks are inherently passive entities. They

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87 Membership includes the majority of the world's major institutions that deal in privately negotiated derivatives, in addition to many businesses, governmental entities and other end users of over-the-counter derivatives. Members are classified as primary (dealer firms), associate (service providers), and subscriber (end-users). See International Swaps and Derivatives Association ("ISDA"), About ISDA, online at http://www.isda.org/ (visited Mar 22, 2010); ISDA, *FAQs in the International Swaps and Derivatives Association and the OTC Derivatives Business* ("ISDA FAQs") 1, 8, online at http://www.isda.org/media/pdf/resourcesfaqs.pdf (visited Mar 22, 2010).

88 About ISDA (cited in note 87).

89 ISDA, *Opinions and Legislation*, online at http://www.isda.org/ (visited Mar 22, 2010). The ISDA Master Agreement incorporates counterparty risk mitigation practices such as netting, allows for collateralization, and addresses issues related to bankruptcy and insolvency, such as netting, valuation and payment on early termination. See ISDA FAQs at 6 (cited in note 87).

90 ISDA FAQs at 7 (cited in note 87).

function by waiting for consensus to develop concerning the convergence or harmonization of rules and standards. With small or even non-existent secretariats, these networks do not have the resources, technical competence or authority to initiate actions unless they have the strong support of the most significant parties. The decision to pursue new regulation often takes place at the behest of states that make their desires known through political agreements brokered at state-to-state contact groups. The G-groups have been integral in the establishment of several transgovernmental networks and directed most of the major initiatives of the Basel Committee and FSF/FSB. Transgovernmental networks' main contribution to the international financial architecture, which is by no means insignificant, is to pool together technical expertise, ensure the sharing of information and provide a framework for regulatory cooperation when the political will appears.

Third, given their limitations, transgovernmental networks cannot assist in one of the most pressing problems of financial regulation: the supervision of financial institutions. Transgovernmental networks can only provide support to national supervisors by suggesting supervisory standards and issuing technical guidance. The actual responsibility for supervision stays with the national regulators.

Finally, crisis management remains entirely in the hands of state-to-state contact groups. Only the G-groups have the ability to demand action as their power stems from the ability of political leaders to recognize an immediate problem and marshal their combined national law making authority to prepare a response. But the G-groups offer only ad hoc assistance in the regulation of the financial markets. Like cartoon superheroes, the G-groups are crime fighters, stepping in to restore law and order only after the villain has begun wrecking havoc on the city, but they are not crime preventers. The task of protecting the safety and soundness of the financial system is the responsibility of the national prudential supervisors and systemic risk regulators. This is an uncertain condition for the international financial system.

III. THE PROBLEM OF SUPERVISION

A. Supervision as a Distinctive Form of Regulation

International law scholars who analyze the performance of transgovernmental networks should distinguish between rulemaking and standards setting, on the one hand, and supervision, on the other. This distinction is important because one of the main achievements of transgovernmental networks has been to drive convergence and harmonization of national rules and standards in the areas of banking, securities, and insurance. Basel I and Basel II, for example, are successful instances where a transgovernmental network has been able to produce a broadly accepted set of regulatory standards. The recent financial crisis, however, demonstrated that the real need for regulatory action is in the area of supervision.

The financial crisis stemmed from a series of governance and operational failures at various financial institutions: a breakdown in underwriting standards for subprime mortgages; erosion of market discipline by parties involved in the mortgage securitization process; flaws in credit rating agencies' assessments of subprime mortgages; risk management weaknesses at large financial institutions; and failure by financial institutions to mitigate these risk management weaknesses.[91] Avoiding such failures in the future requires regulators to focus more intensely on the supervision of large financial institutions.[92]

Supervision is very different from rulemaking and standards setting.[93] Common rules and standards pertaining to financial institutions include capital requirements, disclosure and reporting obligations, and consumer protection rules. Supervision, on the other hand, is the process by which regulators monitor the behavior of financial institutions and service-providers to ensure, at a minimum, that such actors adhere to applicable rules and standards and to evaluate the soundness of such institutions' management practices with regard to

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91 The President's Working Group on Financial Markets, *Policy Statement on Financial Market Developments* (Mar 2008), online at https://treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf (visited Mar 15, 2010). See also HM Treasury, *Reforming Financial Markets* 1, 35 (July 2009), online at http://www.hm-treasury.gov.uk/d/reforming_financial_markets080709.pdf (visited Mar 15, 2010). Weakness of risk management is also a failure of corporate governance and the disinterested nature of boards of directors toward the management of non-legal risk. See Eric J. Pan, *A Board's Duty to Monitor*, 54 NY L Sch L Rev 719 (2010).

92 See Nout Wellink, *Beyond the Crisis: the Basel Committee's Strategic Response*, 13 Banque de France Financial Stability Review 123, 124 (Sept 2009), online at http://www.banque-france.fr/gb/publications/telechar/rsf/2009/etude13_rsf_0909.pdf (visited Mar 15, 2010) ("The financial crisis has exposed many examples where bankers have strayed from the basic principles of sound risk management and underwriting practices and where supervisors did not sufficiently probe and follow-up on these weaknesses.").

93 See Rosa M. Lastra, *The Governance Structure for Financial Regulation and Supervision in Europe*, 10 Colum J Eur L 49 (2003) (noting that the terms "regulation" and "supervision" are often used interchangeably despite the fact they represent different concepts); Cynthia Crawford Lichtenstein, *The Fed's New Model of Supervision for "Large Complex Banking Organizations": Coordinated Risk-Based Supervision of Financial Multinationals for International Financial Stability*, 18 Transnatl Law 283, 287–88 (2005) (discussing the difference between rulemaking and supervision); Andrew Crockett, Gen Manager of the Bank for Intl Settlements, *Banking Supervision and Regulation: International Trends*, Remarks at the 64th Banking Convention of the Mex Bankers' Assn (Mar 30, 2001), online at http://www.bis.org/speeches/sp010330.htm (visited Mar 16, 2010) ("[O]ne of the important trends has been, and continues to be, a move away from regulation, and towards supervision—a move, in other words, away from compliance with portfolio constraints, and toward an assessment of whether the overall management of a financial firm's business is being prudently conducted.").

controlling risk. Without supervision, rules and standards lose meaning.[94] Historically, regulators approached the task of supervision in a passive manner, conducting examinations and inspections on a periodic basis and without deep involvement in the internal operations of the financial institution.[95]

As the financial markets have grown more complex, regulators have had to devote more resources to supervision.[96] Financial innovation now makes it too easy for financial institutions to incur large trading losses in very short time (as the recent financial crisis painfully illustrated).[97] As a result, periodic examinations of financial institutions by regulators to check on compliance with generalized rules and standards are insufficient to prevent financial institutions from assuming excessive risk.[98] Instead, prudential supervision must consist of more intensive (and intrusive) oversight of financial institutions by regulators. Regulators must devote more resources to evaluating the quality of a financial institution's assets and assessing banks' internal models and the soundness of financial institutions' risk management practices.[99] Such evaluation depends less on the regulator's interpretation of applicable rules and standards and more on her understanding of the financial institution and her ability and willingness to exercise independent judgment in evaluating the financial institution's operations.[100] Rules and standards, such as capital adequacy requirements or

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94 Key, 75 Intl Affairs at 69 (cited in note 23).

95 See, for example, Lisa M. DeFerrari and David E. Palmer, *Supervision of Large Complex Banking Organizations*, 87 Fed Res Bull 47, 48 (Feb 2001) (describing the Federal Reserve's historical practice of limited and periodic supervision of banks and bank holding companies).

96 See Frederic S. Mishkin, Prudential Supervision: Why Is It Important and What Are the Issues?, in Frederic S. Mishkin, ed, Prudential Supervision: What Works and What Doesn't 1, 13–14 (Chicago 2001).

97 See id at 14.

98 See id; DeFerrari and Palmer, 87 Fed Res Bull at 49–51 (cited in note 95) (describing the Federal Reserve's developing Large Complex Banking Organizations supervision program).

99 One of the implications is that the requirements for supervisors will be more demanding:

> Supervisors have to understand all aspects of a financial firm's business, and to foresee the multiple sources of risk it is likely to confront. This means that supervision is becoming a more demanding profession, and the skills required of supervisors are becoming greater and more diverse. Accounting and legal training, while important, are no longer enough. Supervisory authorities are going have to seek also staff with backgrounds in economics and business management. Supervisors are becoming more like consultants, whose task is to understand the bank's business and draw management's attention to underappreciated sources of risk.

Crockett, Remarks (cited in note 93).

100 It is important to recognize that financial supervisors play a different role than prosecutors or other enforcement agents. If a financial institution is found to be not in compliance with relevant rules or standards, the supervisor often has the authority to take a variety of formal or informal actions to steer the financial institution toward safer practice. Prudential supervisors are not

reporting obligations, may be drafted to limit or deter risk-taking by financial institutions. By contrast, supervision relies to a greater extent on the ability and willingness of regulators to investigate and question the internal decision-making and risk management processes of financial institutions even in the absence of a clear violation of a rule or standard.[101] Furthermore, the new approach to supervision also requires a level of expertise and performance by the supervisor that may not be easily translated into broad supervisory standards.[102]

The proposed regulatory responses of the leading financial economies to the recent financial crisis confirm their belief that the causes of the recent financial crisis demand more intensive supervisory oversight of financial institutions. The UK Financial Services Authority (FSA),[103] for example, recently announced its new "Supervisory Enhancement Programme" (SEP).[104] The FSA initially developed the SEP to improve its previous strategy of passive regulation and market self-discipline to ensure the safety and soundness of financial institutions. Instead, the FSA has proposed a strategy of review and second-guessing, consisting of FSA supervisors questioning, and in some cases overruling, the decisions of senior management of financial institutions.[105] The SEP emphasizes FSA personnel exercising independent judgment of future risks. In practice, the SEP would include "mystery shopping and branch visits,"[106] "dedicated supervisors on each major firm,"[107] "a compulsory and irreducible programme of regular meetings with the senior management,"[108] vetting new candidates for positions of significant influence in financial

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always in an adversarial relationship with the financial institutions and often share common interest with those entities they regulate.

101 Former Federal Reserve Governor Laurence Meyer in 2000 already sounded the alarm concerning the diminishing relevance of capital adequacy rules because of financial innovation. See Laurence H. Meyer, *Supervising Large Complex Banking Organizations: Adapting to Change*, in Frederic S. Mishkin, ed, *Prudential Supervision: What Works and What Doesn't* 97, 97–98 (Chicago 2001).

102 See DeFerrari and Palmer, 87 Fed Res Bull at 53 (cited in note 95).

103 The UK has a single regulator to supervise and regulate its entire financial system. In the future, the UK may divide supervisory responsibility between the FSA and the Bank of England. See Pan, *Four Challenges of Financial Regulation* at 6 (cited in note 10).

104 See Financial Services Authority, *A Regulatory Response to the Global Banking Crisis*, Discussion Paper 09/2, § 11 Supervisory Approach at 183–96 (March 2009), online at www.fsa.gov.uk/pubs/discussion/dp09_02.pdf (visited Mar 15, 2010).

105 See id, ¶ 11.14 ("In the future the FSA's supervisors will seek to make judgments on the judgments of senior management and take action if in their view those actions will lead to risks to the FSA's statutory objectives. This is a fundamental change. It is effectively moving from regulation based on facts to regulation based on judgments about the future.")

106 Id, ¶ 11.22.

107 Id, ¶ 11.24.

108 FSA, *A Regulatory Response* at 190, Box 11.1.

institutions,[109] and "greater focus on testing outcomes as well as the firms' systems and controls."[110] This approach relies heavily on the judgment and discretion of the supervisors.

It is useful to note how the FSA conceives of its role as supervisor to be distinct from the rulemaking and standard-setting work it conducts within the international financial architecture. In terms of the development of standards, the FSA is a participant in a multinational process. "The FSA designs policy in partnership globally with international bodies [transgovernmental networks], other regulators [bilateral and regional networks], central banks and finance ministers."[111] Further, the development of common supervisory standards is an important part of the work the FSA handles at the international level. In fact, a key part of the SEP is the benchmarking of the FSA's supervisory approach with the supervisory approaches of other countries, especially those of Canada, Spain, and the US.[112] On the other hand, the FSA makes clear that the international legal frameworks do not extend to supervision: "On policy formulation, the FSA is a participant in the process . . . . The FSA is, however, responsible for delivering effective supervision and recognizes that it is fully accountable for that delivery."[113]

While US regulators have been less specific than the UK about how they will modify their regulatory approach to respond to the recent financial crisis, the few statements that have been made to date echo the FSA's proposal to emphasize supervision over rulemaking and standards setting. For example, the US Treasury Department's White Paper on Financial Regulatory Reform (US Treasury White Paper), recommends "a more robust consolidated supervisory regime" for any firm whose combination of size, leverage, and interconnectedness could pose a threat to financial stability if it failed.[114] While the proposed supervisory improvements are set forth in the form of supervisory standards, the nature of the standards are such that they will be applied differently to each financial institution and therefore depend heavily on the judgment and discretion of the supervisory authority. For example, the new supervisory regime will demand that the risk management practices of the target financial institution be in proportion to the risk, complexity, and scope of its

109 See generally id (cited in note 104).

110 See id at 190, Box 11.1.

111 See id, ¶ 11.8.

112 FSA, A Regulatory Response, ¶ 11.25.

113 Id, ¶¶ 11.8, 11.9 (cited in note 104).

114 The US Department of the Treasury, *Financial Regulatory Reform A New Foundation: Rebuilding Financial Supervision and Regulation* ("*Treasury White Paper*") 1, 22 (June 2009), online at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf (visited Mar 15, 2010).

operations.[115] The US Treasury White Paper specifically notes that the Fed and other supervisory authorities will determine how to conduct continuous, on-site supervision of banking firms, what regular information supervisors must obtain from firms, and the extent to which supervision of smaller, simpler banking firms should differ from supervision of larger, more complex firms.[116]

B. The Struggle to Supervise Cross-Border Financial Institutions

Both the FSA and the Treasury Department's proposals concerning supervision highlight two challenges for the international financial architecture. First, to what extent will the international financial architecture be able to participate in the supervision of cross-border financial institutions? Second, how should the international financial architecture structure the relationship between national supervisors? In both cases, the most important member of the international financial architecture pertaining to banking regulation and supervision is the Basel Committee (Basel).[117]

The first challenge goes to the heart of Basel's capacity to carry out financial supervision. As a transgovernmental network, Basel cannot engage directly in the supervision of cross-border financial institutions. The actual task of supervision is vested in the national supervisory authorities. Instead, the role of Basel is to facilitate cooperation among its members by exchanging information on national supervisory issues and approaches, with a view of promoting common understanding. In 1996, the G7 urged Basel to promulgate a set of standards for banking supervision—another example of regulatory convergence taking place as a result of a political agreement by a state-to-state contact group.[118] In 1997, Basel produced the Core Principles for Effective Banking Supervision (Core Principles), which it revised in 2006.[119] The Core

115 See id at 25.

116 See id at 29.

117 In addition, the Basel Committee works with IOSCO and IAIS in the Joint Forum on Financial Conglomerates to promulgate regulatory standards for financial institutions that provide services across banking, securities, and insurance lines, offering a good example of how transgovernmental networks also form networks with each other.

118 See Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* 1 (Sept 1997), online at http://www.bis.org/publ/bcbs30a.pdf?noframes=1 (visited Mar 15, 2010).

119 See Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* 1 (Oct 2006), online at http://www.bis.org/publ/bcbs129.pdf (visited May 3, 2010). Basel has also issued guidance with IOSCO and IAIS on the supervision of financial conglomerates. See Joint Forum on Financial Conglomerates, *Supervision of Financial Conglomerates* (Feb 1999), online at http://www.iaisweb.org/__temp/Supervision_of_Financial_Conglomerates___table_of_contents_and_intro.pdf (visited Mar 15, 2010).

Principles consist of twenty-five principles that Basel believes all member states should implement to have effective supervisory systems.[120] What is striking about the Core Principles, especially when viewed in the context of the recent financial crisis, is how distant the standards are from the actual task of supervising a financial institution. The Core Principles are broad and vague. They offer little direct guidance on how supervisors should evaluate risk management and internal control systems or monitor senior management, especially when overseeing complex, global banks (and financial institutions). For example, Principle 15 suggests that "supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor, and control/mitigate operational risk and that these policies and processes should be commensurate with the size and complexity of the bank."[121] Implementing this principle effectively in an international realm, however, depends on each national authority's interpretation and ability to coordinate its own efforts with those of other countries.

Basel does wield a great deal of influence over supervision indirectly through its formulation of capital adequacy standards. More stringent capital adequacy requirements can be a substitute for additional supervision. Through Basel II, the Basel Committee lays down very specific requirements for the capital that banks must maintain. These requirements, in turn, constrain the ability of banks to take on risk.[122] Consider, for example, two consultative documents put forward by Basel in December 2009 proposing reforms to bank capital and liquidity regulation.[123] The first document, "capital proposals," revised the definition of capital, raising the quality, consistency, and transparency of the capital base, with the goal of ensuring that the banking system is in a better position to absorb losses on both a going concern and a gone concern basis. These proposals tightened and simplified the definition of the so-called Tier 1 and Tier 2 capital to prevent banks from counting certain higher risk assets as part of their capital reserve and require banks to change how they measure risk when calculating existing capital.[124] The second document,

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120 See the Basel Committee, *Core Principles* at 2–5 (Oct 2006) (cited in note 119).

121 Id at 4.

122 See João A. C. Santos, Bank Capital Regulation in Contemporary Banking Theory: A Review of the Literature, 10 Fin Markets Institutions & Instruments 41 (2001).

123 Basel Committee on Banking Supervision, *Strengthening the Resilience of the Banking Sector consultative Consultative Document* (Dec 2009), online at http://www.bis.org/publ/bcbs164.pdf?noframes=1 (visited Mar 15, 2010); Basel Committee on Banking Supervision, *International Framework for Liquidity Risk Measurement, Standards and Monitoring Consultative Document* (Dec 2009), online at http://www.bis.org/publ/bcbs165.pdf?noframes=1 (visited Mar 15, 2010).

124 See Basel Committee, *Strengthening the Resilience of the Banking Sector* at 23 (cited in note 123). When the Basel Committee adopted Basel II, it expressly chose not to address or change the

"liquidity proposals," introduced a prescribed leverage ratio, which will help contain the build-up of excessive leverage in the banking system. These proposals mandate that all internationally active banks comply with a minimum liquidity coverage ratio and a net stable funding ratio.[125] In addition, banks must make reports to their supervisors using a standard set of metrics.[126] This standardization of reporting information is meant to help supervisors better understand banks' risk profiles.[127] While these proposals will facilitate supervision of financial institutions, they still do not remove from regulators the ultimate responsibility of exercising oversight.

Given that Basel cannot directly supervise cross-border financial institutions, the second challenge it faces is helping to coordinate supervision among national regulators. Cross-border financial institutions pose a particularly difficult challenge to national financial supervisors. Cross-border financial institutions operate in multiple jurisdictions, and they can easily shift assets and liabilities between these jurisdictions. Individual national supervisors naturally struggle to monitor financial institutions' operations across jurisdictions. The Basel Concordat attempted to solve this problem by setting forth the principle of consolidated home country supervision.[128] According to this principle, the primary responsibility for the supervision of a cross-border financial institution lies with the financial institution's home regulator.[129] Host regulators rely on that home regulator to ensure the safety and soundness of the entire financial institution. The principle of consolidated home country supervision also serves to reduce barriers to financial institutions seeking to expand into new jurisdictions as the institution is subject to oversight and regulation by only one supervisor.

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components of capital, reserving that task for a later date. The "capital proposals" now do that, with the most significant changes to Tier 1 Capital, now predominantly in the form of common shares and retained earnings. See H. Rodgin Cohen, *Basel Committee Proposes Strengthening Bank Capital and Liquidity Regulation*, Harvard L Sch Forum (Jan 7, 2010), online at http://blogs.law.harvard.edu/corpgov/2010/01/07/basel-committee-proposes-strengthening-bank-capital-and-liquidity-regulation/ (visited Mar 15, 2010).

125 A minimum liquidity coverage ratio requires an adequate amount of high-quality assets that can be converted into cash to cover a bank's liquidity needs for 30 days. A net stable funding ratio requires adequate medium- and long-term funding assets to cover a bank's long-term obligations. See Basel Committee, *International Framework for Liquidity* at 2–3 (cited in note 123).

126 Bank for International Settlements Press Release, *Consultative Proposals to Strengthen the Resilience of the Banking Sector Announced by the Basel Committee* (Dec 17, 2009), online at http://www.bis.org/press/p091217.htm (visited Mar 15, 2010).

127 Id.

128 Basel Committee on Banking Supervision, *Principles for the Supervision of Banks' Foreign Establishments* 1, 4 (May 1983), online at http://www.bis.org/publ/bcbsc312.pdf (visited Mar 15, 2010).

129 Id at 7.

The principle of consolidated home country supervision conflicts with national supervisors' inclination to protect their home markets first. Consequently, there is the risk that home supervisors may make supervisory decisions designed to protect customers, depositors, and counterparties in their home market at the expense of those parties located in foreign markets.[130] During times of crisis, the division of supervisory responsibilities among national supervisors becomes increasingly unstable as host supervisors begin to doubt the effectiveness of the home country supervisor. For instance, the Icelandic Financial Supervisory Authority (IFSA) had responsibility for supervising the consolidated operations of Icelandic banks and their branches in foreign countries immediately before the recent financial crisis. Regulators in host jurisdictions relied on the IFSA, as home country supervisor, to monitor the soundness of these banks. When it became known that several large Icelandic banks were close to failure, the host jurisdictions, particularly the UK, demanded a role in overseeing the operations of the Icelandic banks in their respective countries and questioned the competency of the IFSA in continuing to serve as the consolidated supervisor.[131] Since the Iceland incident, the FSA

130 Implicit in the principle of home country supervision is the notion that a bank's capital will be transferred between jurisdictions as necessary to meet local demands. During the recent financial crisis, however, concerns about multi-jurisdictional demands on a failing bank's dwindling assets incited host regulators to freeze assets to ensure sufficient capital remains to pay off local obligations. See, for example, HM Treasury Press Release, *Landsbanki, Heritable, and Kaupthing Singer and Friedlander* (Oct 9, 2008), online at http://www.hm-treasury.gov.uk/press_103_08.htm (visited Mar 15, 2010). Such acts undermine the home country regulator's ability to offer credible supervision of the bank.

131 UK officials have expressed concern with the principle of home country supervision after the collapse of several Icelandic banks put at risk billions of pounds of deposits made by UK residents. See, for example, Verena Ross, FSA Director of Strategy and Risk, Speech at the Chatham House Conference on Global Financial Regulation, *Lessons from the Financial Crisis* (Mar 24, 2009), online at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0324_vr.shtml (visited Mar 15, 2010):

> The failure of the Icelandic banks has demonstrated that current arrangements, and in particular the current home/host framework of sharing supervisory responsibility are unsustainable. As a reminder, the current arrangements combine branch passporting rights, home country supervision and purely home-country based deposit insurance. This setup, using the Icelandic banking crisis as an example meant that Landsbanki was free to operate in the UK as a branch over which the FSA only had limited powers, as responsibility for its prudential supervision rested with the Icelandic regulator. UK depositors were also later dependent on the Icelandic deposit insurance scheme, with resources that proved inadequate and requiring the intervention of the UK authorities.

has called for host country supervisors to play a more significant role in supervising local branches of foreign financial institutions.[132]

Basel attempts to solve the problem of cross-border supervision by converging or harmonizing national supervisory standards into international standards such as the Core Principles and Basel II, and introducing the concept of home country supervision to eliminate supervisory gaps. The recent financial crisis showed that this approach was not entirely effective. A stronger international law regime is needed to avoid previous supervisory failures.

IV. AN INTERNATIONAL ADMINISTRATIVE LAW MODEL FOR CROSS-BORDER SUPERVISION

A. An International Administrative Law Agency

An international law regime must address four issues. First, it needs to promote cooperation and information sharing between national supervisors, especially during times of impending financial crises when a national supervisor may be reluctant to share information that reveals its mistakes or poor performance. Second, it must address differences in supervisory powers between national supervisors. Third, it must secure sufficient resources to perform the technical work required of a financial supervisor. Fourth, to the extent it relies on national supervisors to carry out the decisions made at the international level, the regime needs a means to make decisions that have the support of all of its members.

To this end, one proposal to improve cooperation by national supervisors is to replace consolidated home country supervision with a college of supervisors.[133] The college would consist of representatives of each host country regulator with a lead role reserved for the home country regulator. The success of such an arrangement depends on the willingness of national supervisors to share information with each other, the efficiency of decision-making, and the ability to enforce implementation of college decisions. Past attempts at having a college of supervisors oversee multi-jurisdictional financial institutions have had mixed results, and ironically the push to strengthen home country supervision stemmed from the perceived failures of one such college of supervisors.[134] Thus,

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132 See UK Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Financial Crisis* 100–01 (Mar 2009), online at http://www.fsa.gov.uk/pubs/other/turner_review.pdf (visited Mar 15, 2010).

133 See id at 97–99 (endorsing the Financial Stability Forum's proposal for colleges of supervisors to regulate cross-border financial institutions).

134 Bank of Credits and Commerce International ("BCCI") was overseen by a college of supervisors, consisting of representatives from several countries in which BCCI operated, including the UK,

there are reasons to be skeptical that colleges of supervisors will generate the level of cooperation needed to effectively oversee large, cross-border financial institutions.

The proposal for a college of supervisors is really an expression of a desire to combine the supervisory power of national regulators with the multi-jurisdictional perspective of an international legal regime. If we were to pursue this desire to the furthest extent, the better approach would be to concentrate supervisory authority in an international body. This international body—rising above the jurisdictional limitations of national supervisors and equipped with the necessary information gathering and oversight powers needed of a prudential supervisor—would assume responsibility for supervising cross-border financial institutions. The reason for its development echoes those reasons that drove the emergence of transgovernmental networks: the globalization of financial markets and financial services providers has rendered the tools and methods of domestic supervisors (and by extension those of transgovernmental networks) inadequate to handle the supervision of cross-border financial institutions.[135]

Such a legal "body"—as opposed to a network—would be a new addition to the international financial architecture. If one were to imagine such a body, it would have five essential attributes that would make it more capable than a transgovernmental network. First, it must have operational independence from states. From such independence, the body gains the ability to initiate regulatory action. The effectiveness of this body depends on its ability to pursue a regulatory agenda that does not rely on key states first recognizing a problem and then choosing to propose a possible solution in an international forum. Such a process makes transgovernmental networks inherently reactive where action takes place primarily by virtue of state pressure. The ability to initiate action is essential for such a body to play any significant role in supervising financial institutions. Another aspect of independence from states is the ability

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Pakistan, Luxembourg, and the Cayman Islands. The Basel Committee faulted the college for absence of leadership and problems in coordination and communication between regulators about BCCI's international operations, and proposed new standards that emphasized the role of the home country to provide consolidated supervision. See Basel Committee on Banking Supervision, *Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishment* 3–7 (July 1992), online at http://www.bis.org/publ/bcbsc314.pdf (visited Mar 15, 2010). In 1997, the Basel Committee published the "Core Principles for Effective Banking Supervision," which provided more guidance on the supervision of multi-jurisdictional bank holding companies. The home country supervisor of the bank parent is responsible for monitoring the risk exposure and capital adequacy of the bank group. See Basel Committee, *Core Principles* (Sept 1997) at 40–41 (cited in note 118).

135 See Slaughter, *A New World Order* at 8–11 (cited in note 4). See also Raustiala, 43 Va J Intl L at 12–13 (cited in note 4) (citing "technological innovation," "the rise of the regulatory state," and "globalization" as the root cause of the "rise of networks.").

to make decisions. While states will be members of such an international body and state support for the body is a fundamental requirement for the body's authority and legitimacy, the body must have in place a decision-making process by which decisions can be made based upon less than unanimous support of states and where disagreements between states can be settled in a definitive manner.

Second, the body must be expert. In order to regulate financial institutions, the body must have the ability to learn, retain, and apply detailed knowledge of the operations of financial institutions and the markets in which they do business. Third, the body must have enforcement powers. It must have the means to enforce its supervisory directives as they are applied to financial institutions. In addition, it must have the ability to ensure that national regulators implement the body's decisions. Fourth, the body must have sufficient resources. The body must have a sizeable budget and a permanent staff. The possession of such resources is essential for the body to develop regulatory expertise and to initiate regulatory action. Fifth, the body must have a range of formal and informal regulatory tools at its disposal. Formal and informal tools are essential to the problem of supervision where the role of the supervisor is not to punish or sanction a financial institution but to ensure the financial institution operates in a sound and safe manner. Furthermore, the body must possess flexibility to identify and respond to supervisory problems in light of changing market conditions and continued financial innovation.

The body would share some of the characteristics of an international organization—a secretariat and sizeable permanent staff, independent resources and decision-making authority. It would also share some of the characteristics of many transgovernmental networks—technical and regulatory expertise derived from the hosting of frequent meetings between state and private regulators. For American lawyers, it is hard not to notice similarities between such a body and an administrative agency, especially with respect to its expertise, independence, and flexibility. In fact, one is reminded of James Landis' observation: "The administrative process is, in essence, our generation's answer to the inadequacy of the judicial and the legislative processes."[136] The sentiment behind his statement should be updated to reflect today's reality of global markets and powerful non-state actors: the international administrative process is, in essence, this generation's answer to the inadequacy of international organizations and transgovernmental networks that form the current international financial architecture.

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136 James Landis, *The Administrative Process*, excerpted in Peter H. Schuck, *Foundations of Administrative Law* 14 (Foundation Press 2d ed 2004).

In proposing an international administrative law model for cross-border supervision, some international law scholars argue that there already exists a framework for an international administrative law regime. Benedict Kingsbury and Richard Stewart, for example, describe the current international financial architecture as one part of an administrative state.[137] Administrative and regulatory functions traditionally carried out by state actors are now being carried out at the international level "through a great number of different forms, ranging from binding decisions of international organizations to nonbinding agreements in intergovernmental networks and to domestic administrative action in the context of global regimes."[138] Through these forms "we can observe . . . the exercise of recognizably administrative and regulatory functions: the setting and application of rules by bodies that are not legislative or primarily adjudicative in character."[139]

The recognition of the existence of these international legal networks by itself does not mean that there should be an international administrative law regime or that such an administrative law regime is sustainable. The legal basis for an international administrative law body, as described above, stems from the belief that an administrative space exists in international law.[140] An international legal body with administrative powers would occupy this space.

In referencing the work of Kingsbury and Stewart, it is helpful to note that they focus on describing the administrative nature of the international financial architecture as a whole, which they refer to as "global administrative law."[141]

137 See Nico Krisch and Benedict Kingsbury, *Introduction: Global Governance and Global Administrative Law in the International Legal Order*, 17 Eur J Intl L 1, 2 (2006). See also Richard B. Stewart and Michelle Ratton Sanchez Badin, *The World Trade Organization and Global Administrative Law*, Institute for International Law and Justice Working Paper 2009/7, 2 (2009).

138 Krisch and Kingsbury, 17 Eur J Intl L at 3 (cited in note 137).

139 Id.

140 Benedict Kingsbury, Nico Krisch, and Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 L & Contemp Probs 15, 26 (2005) ("We argue that current circumstances call for recognition of a global administrative space, distinct from the space of inter-state relations governed by international law and the domestic regulatory space governed by domestic administrative law, although encompassing elements of each."); Benedict Kingsbury and Stephan Schill, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law*, Institute for International Law and Justice Working Paper 2009/6, *5 (2009):

> The idea of a "global administrative space" differs from those orthodox understandings of international law in which the international is largely inter-governmental, and there is a reasonably sharp separation of the domestic and the international. In the practice of global governance, transnational networks of rule-generators, interpreters and appliers cause such strict barriers to break down.

141 The term "Global Administrative Law" is used, as opposed to "International Administrative Law," in order "to reflect the enmeshment of domestic and international regulation, the inclusion

This Article, on the other hand, insists on the term "international administrative law" to describe the more specific problem of an international body with certain administrative powers.

At first glance, the international administrative law model appears to challenge the traditional conception of international law where law is made entirely through inter-governmental processes.[142] In her early work describing transgovernmental networks, for example, Anne-Marie Slaughter suggested that transgovernmental networks marked the decline of liberal internationalism and the rise of an international legal regime dominated by supra-state and non-state actors.[143] But to depict an international administrative body as a state's rival ignores the fact that such a body would exist to provide states with a means of protecting their interests—in this case, their interest in ensuring a safe and sound financial system, protecting depositors, and maintaining liquidity—that would otherwise be beyond their control. Furthermore, the objects of regulation are entities that are themselves rivals to states—that is, multinational financial institutions. Thus, an international administrative law regime is quite consistent with liberal internationalism.

B. Case Study: European System of Financial Supervisors

One model for such an international legal body is the European System of Financial Supervisors (ESFS). The ESFS is a new European body tasked with coordinating and overseeing the supervision of cross-border financial institutions in the EU. In November 2008, the European Commission established an expert panel chaired by Jacques de Larosière, a senior official of the French Treasury, to study possible reforms of the EU financial regulatory system.[144] The panel's mandate was to study the causes of the recent financial crisis, identify weaknesses in Europe's supervision of its financial institutions,

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of a large array of informal institutional arrangements (many involving prominent roles for non-state actors), and the foundation of the field in normative practices, and normative sources, that are not fully encompassed within standard conceptions of international law." Krisch and Kingsbury, 17 Eur J Intl L at 5 (cited in note 137). See Kingsbury, Krisch, and Stewart, 68 L & Contemp Probs at 15, 16 (cited in note 140).

142 See Kingsbury and Schill, *Investor-State Arbitration as Governance* 2009 at 5 (cited in note 140).

143 See Slaughter, 2 Ann Rev of L and Soc Sci at 183–84 (cited in note 44). See also Slaughter and Zaring, Accepted Paper No 2007-12 at 224–25 (cited in note 40). Slaughter later conceded that transgovernmentalism did not represent the end of liberal internationalism. See Slaughter, *A New World Order* at 169 (cited in note 4).

144 See European Commission Press Release, *High Level Expert Group on EU Financial Supervision to Hold First Meeting on 12 November* (Nov 11, 2008), online at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1679 (visited Mar 16, 2010).

and recommend improvements to the EU supervisory system.[145] The de Larosière Report recommended the creation of two new European bodies, a European Systemic Risk Council (later renamed the European Systemic Risk Board) to monitor systemic risk events and the ESFS.[146] The European Commission endorsed the de Larosière Report in March 2009,[147] proposing in September 2009 legislation to establish the ESFS.[148]

The ESFS consists of a small steering committee and three European Supervisory Authorities (ESAs): the European Banking Authority, European Insurance and Occupational Pensions Authority, and European Securities and Markets Authority.[149] Each ESA in turn consists of a committee of representatives from the various national regulators and a permanent staff. The de Larosière Report recognized that national regulators are better able to effect

145 See id.

146 See The de Larosière Group, *Report of the High-Level Group on Financial Supervision in the EU* ("de Larosière Report"), 1, 46–48 (Feb 25, 2009), online at http://ec.europa.eu/commission_barroso/president/pdf /statement_20090225_en.pdf (visited Mar 16, 2010).

147 Commission of the European Communities, *Communication for the Spring European Council: Driving European Recovery*, 1 COM (2009) 114 final, 19 (Mar 4, 2009), online at http://ec.europa.eu/commission_barroso/president/pdf/press_20090304_en.pdf (visited Mar 16, 2010).

148 See generally Commission of the European Communitites, Proposal for a Regulation of the European Parliament and of the Council: On Community Macro Prudential Oversight of the Financial System and Establishing a European Systemic Risk Board, COM (2009) 499 final (Sept 23, 2009); Commission of the European Communities, Proposal for a Council Decision Entrusting the European Central Bank with Specific Tasks Concerning the Functioning of the European Systemic Risk Board, COM(2009) 500 final (Sept 23, 2009); Commission of the European Communities, Proposal for a Regulation of the European Parliament and of the Council: Establishing a European Banking Authority, COM(2009) 501 final (Sept 23, 2009); Commission of the European Communities, Proposal for a Regulation of the European Parliament and of the Council: Establishing a European Insurance and Occupational Pensions Authority, COM(2009) 502 final (Sept 23, 2009); Commission of the European Communities, Proposal of the European Parliament and of the Council: Establishing a European Securities and Markets Authority, COM(2009) 503 final (Sept 23, 2009); Commission of the European Communities, Proposal for a Directive of the European Parliament and of the Council: Amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC. 2003/41/EC, 2003/71/EC. 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC. And 2009/65/eC in respect of the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, COM(2009) 576 final (Oct 26, 2009).

149 These authorities would replace the current Committees of Supervisors, such as the Committee of European Securities Regulators, established as part of the Lamfalussy framework. The Committee of Wise Men, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets*, 1, 104 (Feb 15, 2001), online at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf (visited Mar 16, 2010). The structure of the ESFS indicates that the supervision of the European financial institutions still falls along institutional lines. See Pan, *Four Challenges to Financial Regulatory Reform* at 14–15 (cited in note 10).

the day-to-day supervision of European financial institutions given their closer position to the markets and institutions they supervise.[150] Consequently, the ESFS expects national regulators to have primary responsibility for the supervision of European financial institutions. But unlike a transgovernmental network, the ESFS's function is more than just to serve as a forum for coordinating initiatives of national regulators or promoting regulatory convergence and harmonization. Rather, the de Larosière Report recommended that EU member states vest with the ESFS certain powers and resources that would allow the ESFS to take a more proactive role in directing the supervision of European financial institutions.[151] In this respect, the ESFS represents a step toward an international administrative law body.

The powers and resources of the ESFS fall into five categories. First, the de Larosière Report recommended that the ESFS be given a larger budget and the ability to hire a permanent staff.[152] Significantly, its budget would be funded from either the financial industry or public sector contributions, implying that the ESFS would have the power to levy fees on financial institutions.[153] Such resources would enable the ESFS to have greater capacity to conduct supervisory activities on its own.

Second, the de Larosière Report recommended that the ESFS be given the power to participate directly in the supervision of certain financial institutions. Specifically, the ESFS would be empowered to have representation in any college of supervisors. This would allow the ESFS to participate alongside national regulators to monitor their performance, to aggregate all relevant information pertaining to financial institutions, and to take part in on-site inspections carried out by national regulators.[154] It is expected that supervisory colleges would be established for all major cross-border financial institutions in the EU.[155] In addition, the ESFS would be entirely responsible for licensing and

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150 See de Larosière Report at 47 (cited in note 146).

151 See, for example, id at 51. See also Commission of the European Communities, *Communication from the Commission: European Financial Supervision,* COM(2009) 252 final, 9 (May 27, 2009), online at http://ec.europa.eu/internal_market/finances/docs/committees/supervision/communication_may2009/C-2009_715_en.pdf (visited Apr 14, 2010) ("[T]he ESFS will combine the advantages of an overarching European framework for financial supervision with the expertise of local supervisory bodies that are closest to the institutions operating in their jurisdictions.").

152 See de Larosière Report at 51 (cited in note 146).

153 See id at 55.

154 See, for example, id at 47, 53.

155 See, for example, id at 51; *Communication for the Spring European Council* at 6 (cited in note 147).

supervising certain EU-wide institutions such as credit rating agencies and central counterparty clearing houses.[156]

Third, the ESFS would have the power to issue decisions and promulgate supervisory standards. Significantly, decisions of the ESAs would be made by qualified majority vote instead of by consensus, and such decisions would be binding on all member states.[157] Furthermore, the ESFS would have the power to make authoritative interpretations of framework legislation and implementing measures decided by the European Council, Parliament, and Commission.[158] This power of authoritative interpretation provides the ESFS with unusual flexibility to define its own powers and the scope of EU legislation.[159] The rulemaking powers of the ESFS are even greater and more immediate if there is a financial crisis.[160]

Fourth, the ESFS would have the power to resolve disputes between its members. After an attempt to resolve a disagreement through a conciliation process, each ESA may issue a decision to settle a dispute, and such decision shall be binding on all parties.[161]

Fifth, the de Larosière Report recommended that the ESFS have broad powers of surveillance, monitoring, and implementation. Its powers consist of: managing a peer review process where national regulators review the quality of each other's supervisory systems; collecting and aggregating information from national regulators concerning specific financial institutions; verifying the reliability of information shared between national regulators during crisis situations; and challenging the performance of any national regulator and issuing rulings to ensure the national regulator corrects all identified weaknesses.

The European Commission accepted the recommendations of the de Larosière Report because it recognized that "[n]ationally-based supervisory models have lagged behind the integrated and interconnected reality of today's European financial markets, in which many financial firms operate across

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156 See *Communication for the Spring European Council* at 11 (cited in note 147).

157 See de Larosière Report at 55 (cited in note 146). Qualified majority voting is defined in Article 205 of the EU Treaty. Standards promulgated by the ESFS would be binding on member states because the European Commission is required to endorse such standards by the adoption of Commission Regulations or Decisions. See Commission of the European Communities, *Commission Staff Working Document accompanying document to the Regulations Proposal for a Regulation of the European Parliament and the Council establishing a European Banking Authority, establishing a European Insurance and Occupational Pensions Authority, and establishing a European Securities Markets Authority*, SEC (2009) 1234 (Sept 23, 2009).

158 See *de Larosière Report* at 53 (cited in note 146).

159 See Pan, 38 Harv Intl L J at 505–06 (cited in note 28).

160 See *Communication for the Spring European Council* at 10–11 (cited in note 147).

161 See id at 10.

borders."[162] To ameliorate this problem, the European Commission has accepted that a new body is needed that would have powers enabling it to force coordination of supervision even in the face of disagreement from a minority of EU member states. Furthermore, the European Commission acknowledged that in order for the ESFS to be an effective European-level supervisor it had to be independent.[163] The ESFS's independence is partially safeguarded by its ability to raise its own funds hire permanent staff. But the Commission also reiterated the importance of the ESFS to be free of political pressure from member states.

Admittedly, the ESFS is a special case. The EU offers a unique legal environment for the development of such an administrative law body. Many of the powers of the ESFS, especially powers to issue binding decisions by qualified majority vote or settlement of disputes between members, derive from the obligations member states have assumed under the Treaty on EU. Furthermore, the EU member states share an unusually strong desire to cooperate given the EU's long history of striving to establish the free movement of goods and services in a single European market. Therefore, it is understandable for some to believe it unlikely that the ESFS could be replicated outside of the EU. Nonetheless, if successful, the ESFS would represent the most advanced international financial regulator in the global financial system. By its very existence, the ESFS offers a sharp contrast to existing legal frameworks in the international financial architecture and should be seen as a positive experiment in international administrative law.

C. Accountability and Legitimacy of an International Administrative Law Body

A common criticism of transgovernmental networks and global administrative law is that they lack accountability and legitimacy.[164] Traditionally, legitimacy of international norms arises from the consensual nature of international law—international rules apply only if there is state consent.[165] Transgovernmental networks undermine this process of legitimatization in two ways. First, the participants in the networks are generally sub-state actors who themselves may not be directly accountable to the public at home. Second, when

162 Commission of the European Communities, *Communication from the Commission* at 2 (cited in note 151).

163 See id at 13–14.

164 See, for example, Esty, 115 Yale L J at 1507–16 (cited in note 4) (contending that global administrative bodies suffer from legitimacy deficits due "to the lack of electoral underpinnings for decisionmaking at the international level"); Michael S. Barr and Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 Eur J Intl L 15, 16 (2006).

165 See Krisch and Kingsbury, 17 Eur J Intl L at 3–4 (cited in note 137).

transgovernmental networks generate a strong norm for states to implement any decisions made at the international level into domestic law, then states can no longer rely on procedural and judicial protections at home to ensure there is domestic accountability and legitimacy.

Defenders of transgovernmental networks, however, argue that transgovernmental networks have responded to concerns of accountability and legitimacy by adopting a variety of procedural protections. Barr, Miller and Zaring for example, have written about the efforts of Basel to make its decision-making process more transparent and open to public scrutiny.[166] They each note that Basel has adopted a notice and comment procedure for consultative documents.[167] IOSCO also seeks public comments on new proposals and frequently holds public meetings, encouraging the attendance of private groups. The only procedural protection that transgovernmental networks do not offer is judicial or administrative review, but such protection remains available in the domestic sphere.

The problem of accountability and legitimacy is even greater in the case of an international administrative law body, especially one focused on prudential supervision. One concern is the additional power of such a body relative to a transgovernmental network. States that have committed themselves to supporting such a body would be bound by its decisions with less opportunity to register disagreement. The other concern is that common procedural protections such as notice-and-comment and transparency are less helpful in the case of supervision. Notice-and-comment and transparency are of greatest benefit in rulemaking and standards setting. Supervision, on the other hand, offers less opportunity for public debate and deliberation. Given that supervisors ideally must respond decisively to fleeting market and institutional conditions, we must trust our supervisors to act wisely and fairly. As a result, there would appear to be even greater reason to question whether an international body conducting supervision could be accountable and remain legitimate.

There are three ways to answer these concerns, none of which completely addresses concerns of accountability and legitimacy, but which may offer some comfort. First, the international body bears the burden to operate in a transparent fashion. While prudential supervision must involve some degree of confidentiality, the standards of supervision should be openly disclosed and debated. The caveat to this proposal, however, is that supervision cannot be conducted "by the book." To avoid the phenomenon where regulated entities

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166 See Barr and Miller, 17 Eur J Intl L at 24–27 (cited in note 164); Zaring, 5 Chi J Intl L at 556 (cited in note 4).

167 See Barr and Miller, 17 Eur J Intl L at 24–27 (cited in note 164); Zaring, 5 Chi J Intl L at 556 (cited in note 4).

satisfy the language but not the spirit of the standards requires that supervisors have some discretion to apply relevant standards.

Second, the international body could broaden its membership to include representatives from non-governmental entities. Allowing outside groups to participate in deliberations would make the body more democratic. Here too, however, there are limits to how much non-governmental groups can participate in the body's activities. Non-regulators cannot participate in the actual supervisory process. Therefore, they would be restricted to assisting only in the development of supervisory standards.

Third, there should be strong political oversight of the international body. State-to-state contact groups, like the G20, should monitor and review decisions of the body. Of course, this would not be a significant change from current practice. The G-groups play a prominent role in directing the agendas of existing regulatory networks. The concerns with the effectiveness of such oversight are whether the G-groups have the inclination to provide sufficient oversight, and alternatively whether too much oversight by the G-groups may end up threatening the independence of the body.

To the extent possible, efforts should be made to institute procedures and promote transparency to address concerns of accountability and legitimacy. Ultimately, however, the legitimacy of an international administrative law body to oversee supervision of cross-border financial institutions will be determined by its success in maintaining a sound and safe financial system.

V. CONCLUSION

A new international legal framework is needed to address the absence of cross-border supervision. Existing regulatory networks showed themselves ill-equipped to address the causes and effects of the recent financial crisis. The appropriate regulatory response is to improve the supervision of financial institutions to avert future crises and respond to any that may arise. This Article suggests that the international financial architecture needs an administrative law body that has the resources, independence, and authority to manage the supervision of cross-border financial institutions. Such a body would be the natural heir to transgovernmental networks and other legal frameworks developed to address the intractable problem of regulating the global financial markets.

An international administrative law body would be a major international law innovation. Such a model could be applied to a vast array of regulatory challenges, especially in those areas where supervision of institutions and markets is vital. More importantly, an administrative law body would become a new source of international law. While this Article argues that there are many practical benefits to the creation of such an international administrative law regime, questions remain about the accountability and legitimacy of such a regime that go beyond this Article. This challenge shall be taken up in future research.