BANKING ON COOPERATION: THE ROLE OF THE G-20 IN IMPROVING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Arie C. Eernisse*

INTRODUCTION

Largely dormant in its first decade of existence, the Group of Twenty (G-20) in 2008 began to play an instrumental role in coordinating a global effort to adopt measures for the prevention of future economic crises.[1] U.S. President Barack Obama[2] and other world leaders[3] have declared that the G-20 is the new premier forum for international economic coordination, effectively replacing the Group of Eight (G-8).[4] Commentators have hailed the "landmark" achievements of the recent G-20 summits[5] and have said that the G-20 is "without question the new game in town in respect of global governance."[6] Since assuming its more powerful role, the G-20 has

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* Duke University School of Law, J.D. and LL.M in international and comparative law, expected 2012; Wesleyan University, B.A. 2007. I thank Professor Lawrence Baxter for his helpful comments and guidance. I also thank Kate Hunter, Catherine Lawson, Reed Lyon, and the staff of the journal for their assistance. This note is dedicated to my first son, Arie Jr., born in December 2011.

1. The G-20 is comprised of the following nineteen countries and the European Union: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the United Kingdom, and the United States. *What is the G-20?*, GROUP OF TWENTY [G-20], http://www.g20.org/about_what_is_g20.aspx (last visited Mar. 11, 2011).

2. Josef Ackermann, *The Global Financial System and the Challenges Ahead*, 35 FLETCHER. WORLD AFF. 127, 128 (2011); Sewell Chan, *Pressure on G-20 Economies to Back Up Lofty Rhetoric*, N.Y. TIMES, June 29, 2010, at B3.

3. *Leaders' Statement – The Pittsburgh Summit*, G-20, at 3 (Sept. 25, 2009), http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf [hereinafter *G-20 Pittsburgh Leaders' Statement*].

4. The G-8 includes Canada, France, Germany, Italy, Japan, the United Kingdom, the United States, and Russia. *What is the G-8?*, GROUP OF EIGHT [G-8], http://www.g20-g8.com/g8-g20/g8/english/what-is-the-g8-/what-is-the-g8-/what-is-the-g8.847.html (last visited Mar. 9, 2011). The last member, Russia, was added to the group as a full member in 1998 but still faced obstacles to its full integration. *See* MIRANDA LIN ET AL., RUSSIA AND THE G8: AN OVERVIEW OF RUSSIA'S INTEGRATION INTO THE G8, at 8, 10-11 (June 2006), *available at* http://www.g7.utoronto.ca/evaluations/csed/cs_integration.pdf. The elite group is still commonly referred to by some as the Group of Seven, or G-7.

5. Mario Giovanoli, *The International Financial Architecture and Its Reform After the Global Crisis*, *in* INTERNATIONAL MONETARY AND FINANCIAL LAW: THE GLOBAL CRISIS 3, 7 (Mario Giovanoli & Diego Devos eds., 2010).

6. Anthony Payne, *How Many Gs Are There in "Global Governance" After the Crisis? The Perspectives of the "Marginal Majority" of the World's States*, 86 INT'L AFFAIRS 729, 729 (2010).

articulated specific policy objectives, set deadlines for progress, and monitored the work of the main international financial regulatory bodies, especially the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS).[7] Meanwhile, member countries have begun implementing internationally consistent reforms at the domestic level.

In the aftermath of the 2008 Global Financial Crisis, the G-20 must continue to assert its leadership of the reform effort or risk squandering the gains it has made thus far.[8] With many financial regulatory challenges still ahead, now is an appropriate time to gauge the G-20's successes and failures and to assess its ability to accomplish its mandate of strengthening the international financial architecture and preventing future regulatory lapses.[9] Part I of this note will explore the interaction among the G-20, FSB, BCBS, and other international financial regulators, as well as evaluate the G-20's efforts to construct a coherent framework for financial reform. Part II will analyze the "hard" soft law nature[10] of G-20 declarations and argue that the G-20's current layered policymaking structure is preferable to alternative structures for international financial regulation. Part III will delve into more detail with regard to two key reforms—the adoption of a new capital and liquidity framework and the regulation of systemically important financial institutions (SIFIs)—and contend that these reforms, despite their flaws, are key examples of the G-20's ability to achieve success.

I. THE G-20'S FRAMEWORK FOR FINANCIAL REFORM

The politically powerful G-20 has marshaled the technical expertise of the FSB and BCBS to establish a framework for financial reform that stresses four approaches: (1) strong regulatory controls, (2) effective

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7. Scholars have employed various methods of classifying different types of international financial regulators. *Compare* Chris Brummer, *How International Financial Law Works (and How It Doesn't)*, 99 GEO. L.J. 257, 275-80 (2011) (bifurcating agenda-setting and standard-setting bodies), *with* Eric Pan, *Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks*, 11 CHI. J. INT'L L. 243, 247-48 (2010) (categorizing regulators into five different groups: international organizations, state-to-state contact groups, trans-governmental networks, bilateral and regional networks, and private standard-setting bodies).

8. *See* Nathalie Boschat & Ian Talley, *Recovery Redefines G-20 Challenge*, WALL ST. J., Feb. 14, 2011, at A4.

9. The G-20 describes its mandate in the following manner: "The G-20 is the premier forum for our international economic development that promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. By contributing to the strengthening of the international financial architecture and providing opportunities for dialogue on national policies, international co-operation, and international financial institutions, the G-20 helps to support growth and development across the globe." *What is the G-20?*, *supra* note 1.

10. I use the phrase "hard" soft law to mean requirements that are practically obligatory though not necessarily legally obligatory under domestic or international law. *See infra* Part II.

supervision, (3) enhanced methods for addressing resolution and systemic institutions, and (4) transparent international assessment and peer review.

A. Origins of the G-20, FSB, and BCBS

In the late 1990s, the Asian Financial Crisis exposed fissures in the international financial architecture that had uniquely harmed capital-absorbing Asian countries.[11] The G-7 formed the G-20 in an effort to give voice to a more diverse array of countries in high-level discussions on key economic and financial policies.[12] For the first decade of the G-20's existence, the G-20 was merely a forum for finance ministers and central bankers,[13] but when the Global Financial Crisis suddenly deepened in 2008, the G-20 transformed into a forum for heads of state to meet regularly and discuss pressing economic and financial issues.[14] Global leaders attended summits at Washington, D.C., in November 2008, London in April 2009, Pittsburgh in September 2009, Toronto in June 2010, Seoul in November 2010, and Paris in November 2011.[15] The G-20 had two main objectives:

11. Pedro Alba et al., *The Role of Macroeconomic and Financial Sector Linkages in East Asia's Financial Crisis*, *in* THE ASIAN FINANCIAL CRISIS: CAUSES, CONTAGION AND CONSEQUENCES 9, 9-11 (Pierre-Richard Agenor et al. eds., 1999).

12. *Communiqué – Meeting of G20 Finance Ministers and Central Bank Governors*, G-20, at para. 1, Annex (Dec. 16, 1999), http://www.g20.org/Documents/1999_germany.pdf; *see also* James H. Freis, Jr., *The G-20 Emphasis on Promoting Integrity in Financial Markets*, *in* INTERNATIONAL MONETARY AND FINANCIAL LAW: THE GLOBAL CRISIS, *supra* note 5, at 104, 106 (discussing reasons for establishing the G-20). The members of the G-8 represent 15 percent of the world's population and produce two-thirds of world GDP. *What is the G-8?*, *supra* note 4. By contrast, the members of the G-20 comprise two-thirds of the world's population and produce 90 percent of world GNP. Frequently Asked Questions, G-20, http://www.g20.org/about_faq.aspx (last visited Mar. 11, 2011).

13. *See* Communiqués, G-20, http://www.g20.org/pub_communiques.aspx (last visited Oct. 16, 2011) (listing various G-20 communiqués from 1999 through 2011 in .pdf form).

14. REBECCA M. NELSON, Cong. Research Serv., R40977, THE G-20 AND INTERNATIONAL ECONOMIC COOPERATION: BACKGROUND AND IMPLICATIONS FOR CONGRESS 2 (2010). Different reasons have been posited for the revival of the G-20 in 2008, and it seems equally plausible that European leaders sought to dilute U.S. power by inviting large emerging-market countries to the negotiating table or that the United States sought to dilute European power by inviting other non-European countries to the table. *See Not a Bad Weekend's Work*, THE ECONOMIST, Nov. 16, 2008, *available at* http://www.economist.com/node/ 12623258?story_id=12623258.

15. Prior to 2008, G-20 meetings were only attended by finance ministers, central bank governors, and their deputies. Such meetings still take place and now supplement the meetings of heads of state. Generally, finance ministers and central bank governors meet at least once a year, and their meeting is preceded by two deputies' meetings and extensive technical work. *What is the G-20?*, *supra* note 1. The first meeting of heads of state was at Washington in 2008. They met biannually in 2009 and 2010 and now meet annually, beginning with the 2011 meeting in France. *The G20 Seoul Summit Leaders' Declaration*, G-20, at 4 (Nov. 12, 2010), http://www.g20.org/Documents2010/11/ seoulsummit_declaration.pdf.

reignite the economic system through bailouts and stimulus packages and improve the regulation of global financial markets.[16]

In the late 1990s, the G-7 also created the Financial Stability Forum (FSF), an inter-governmental body whose original mandate was to improve financial sector surveillance and foster stability in the international financial system.[17] Like the G-20, the FSF remained in the shadows in its first decade of existence, but it rose to prominence after it issued a high-profile report on the Global Financial Crisis in April 2008.[18] To reflect the FSF's more central role in global financial policymaking, the G-20 in April 2009 gave the FSF a strengthened mandate and renamed it the Financial Stability Board (FSB).[19] In addition to other important duties, the FSB has the responsibility to "assess vulnerabilities affecting the global financial system and identify and review on a timely and ongoing basis the regulatory, supervisory and related actions needed to address them, and their outcomes."[20] The FSB performs its role by outlining substantive policy goals for financial regulators and coordinating the work of other standard-setting bodies.[21]

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16. Detlev F. Vagts, Editorial Comment, *The Financial Meltdown and Its International Implications*, 103 AM. J. INT'L L. 684, 685 (2009).

17. *See* Hans Tietmeyer, Financial Stability Board [FSB], *International Cooperation and Coordination in the Area of Financial Market Supervision and Surveillance*, at 1 (Feb. 11, 1999), *available at* http://www.financialstabilityboard.org/publications/r_9902.pdf (describing the reasons for establishing the FSF and what its role should be in supervising financial institutions).

18. Enrique Carrasco, *The Global Financial Crisis and the Financial Stability Forum: The Awakening and Transformation of an International Body*, 19 TRANSNAT'L L. & CONTEMP. PROBS. 203, 208 (2010). The G-7 finance deputies in 2007 tasked the FSF with analyzing the underlying causes of the crisis and making proposals to enhance market stability and resilience. *Id.* at 209. The FSF was busy in 2007 investigating the causes of the crisis, recommending measures that should be taken to resolve it, and developing strategies to prevent future financial crises with global repercussions. *Id.* at 205.

19. *See The Global Plan for Recovery and Reform*, G-20, at 3 (Apr. 2, 2009), http://www.g20.org/Documents/final-communique.pdf [hereinafter *G-20 London Leaders' Statement*] (noting that FSB membership will include all G20 countries, FSF members, Spain, and the European Commission).

20. *See* Financial Stability Board Charter, FSB, art. 2, http://www.financialstabilityboard.org /publications/r_090925d.pdf (last visited May 13, 2011) (listing new duties such as undertaking "joint strategic reviews of the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities and addressing gaps"; setting "guidelines for and support[ing] the establishment of supervisory colleges"; supporting "contingency planning for cross-border crisis management, particularly with respect to systemically important firms").

21. On its website, the FSB lists and briefly describes the following standard-setting bodies whose work it oversees, including BCBS, Committee on the Global Financial System, Committee on Payment and Settlement Systems, Financial Action Task Force on Money Laundering, International Association of Deposit Insurers, International Association of Insurance Supervisors, International Accounting Standards Board, International Auditing and Assurance Standards Board, International Monetary Fund, International Organization of Securities Commissions, Organization for Economic Cooperation and Development, and the World Bank. *Who Are the Standard-Setting Bodies?*, FSB, http://www.financialstabilityboard.org/cos/wssb.htm (last visited Apr. 19, 2011).

The Basel Committee, or BCBS, was established in 1974 by the central bank governors of the most advanced economies.[22] It meets four times a year and has four main working groups that also meet regularly every three or four years.[23] BCBS formulates non-binding, "broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements—statutory or otherwise—which are best suited to their own national systems."[24] BCBS introduced a capital measurement system in 1988 commonly referred to as the Basel Capital Accord and a revised framework for capital adequacy in 2004, dubbed Basel II.[25] In September 2010, BCBS introduced the more stringent Basel III capital and liquidity framework, which the G-20 adopted at Seoul.[26] BCBS also issued its influential Core Principles for Effective Banking Supervision in 1997 and followed that with a revision in 2006.[27] The Core Principles define twenty-five essential supervisory principles, such as ensuring that credit risk is properly managed (Principle 8) and that exposure to single counterparties or groups of connected counterparties is restricted (Principle 10).[28]

B. Establishing a Framework for Financial Reform

Although grand expectations of a Bretton Woods II did not materialize at the Washington Summit in November 2008,[29] G-20 leaders succeeded in creating the Washington Action Plan for improving financial regulation based on five principles of reform: (1) strengthening transparency and

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22. *History of the Basel Committee and Its Membership*, Bank for International Settlements [BIS], http://www.bis.org/bcbs/history.pdf (last visited Nov. 2, 2011). The BCBS' membership currently includes Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. *Id.*

23. *Id.* at 1.

24. *Id.*

25. G-10 Central Bank Governors and Heads of Supervision Endorse the Publication of the Revised Capital Framework, BIS, http:www.bis.org/press/p040626.htm (last visited Nov. 2, 2011).

26. *The G20 Seoul Summit Leaders' Declaration*, G-20, at 7-8 (Nov. 12, 2010), http://www.g20.org/Documents2010/11/seoulsummit_declaration.pdf [hereinafter *G-20 Seoul Summit Document*]. *See* discussion *infra* Part III.A.

27. *Core Principles for Effective Banking Supervision*, BIS, at 1-2 (Oct. 2006), http://www.bis.org/publ/bcbs129.pdf at 1 [hereinafter, *BIS Core Principles*].

28. *Id.* at 2-5.

29. At the Bretton Woods conference of 1944, the United States, Great Britain, and their allies agreed to form the International Monetary Fund and the World Bank to facilitate liberal trade and payments on the one hand and reconstruction and development on the other. ROBERT O. KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY 141-47 (1984).

accountability, (2) enhancing sound regulation, (3) promoting integrity in financial markets, (4) reinforcing international cooperation, and (5) reforming international financial institutions, most importantly the International Monetary Fund (IMF).[30] The basic idea was to subject "all financial markets, products, and participants (including hedge funds and other private pools of capital which may pose systemic risks)" to "appropriate oversight or regulation."[31] To implement the principles of reform, the Action Plan detailed immediate actions to be taken by March 31, 2009 and medium-term actions with no explicit deadlines.[32] A progress report issued roughly six months after the Washington Summit detailed forty-seven actions taken by that date (both from the immediate and medium-term categories).[33] This early record of commitment suggests that national leaders and standard-setting bodies were proactive about undertaking the duties outlined in the Action Plan.

At the London Summit, world leaders more explicitly acknowledged that "[m]ajor failures in the financial sector and financial regulation and supervision were fundamental causes of the crisis."[34] In addition to taking steps to stimulate growth and resist protectionism, the leaders agreed to take several critical steps to improve financial regulation and supervision, including establishing the FSB as a successor to the FSF with a strengthened mandate, extending regulation and oversight to all systemically important financial institutions, and improving capital standards for banks.[35] Collectively, the measures were designed to

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30. *Declaration – Summit on Financial Markets and the World Economy*, G-20, at 3 (Nov. 15, 2008), http://www.g20.org/documents/g20_summit_declaration.pdf [hereinafter *G-20 Washington Leaders' Statement*].

31. Giovanoli, *supra* note 5, at 10. After a meeting of finance ministers in March 2009, the G-20 issued a communiqué, along with an annex on establishing a framework for financial recovery and a progress report on the immediate actions of the Washington Action Plan and future steps to be taken, setting a precedent for follow-up that has been observed after subsequent summits. *See* Communiqués, *supra* note 13; *see also infra* note 33 (detailing the mechanics of a typical progress report).

32. *See generally G-20 Washington Leaders' Statement*, *supra* note 30.

33. *See generally Progress Report on the Actions of the Washington Action Plan*, G-20 (Apr. 2, 2009), http://www.g20.org/Documents/FINAL_Annex_on_Action_Plan.pdf. This progress report uses a four-column chart with the headings "Action Plan Number," "Washington Action Plan Text," "Progress," and "Next Steps." To illustrate, for Action Plan Number 9, which focuses on the Washington Action Plan goal of finding ways to mitigate procyclicality (the magnification of financial or economic fluctuations), the chart mentions under the "Progress" heading that "[t]he FSF and its members have formed three workstreams to study the forces that contribute to procyclicality in the financial system and examine possible options for mitigating them, drawing on a framework paper prepared by the BIS. These workstreams have focused on (i) bank capital, (ii) loan loss provisioning, and (iii) the interaction of valuation and leverage practices." *Id.* at 5.

34. *G-20 London Leaders' Statement*, *supra* note 19, at 3 (noting further that "[c]onfidence will not be restored until we rebuild trust in our financial system").

35. *See id.* at 3-4.

"promote propriety, integrity, and transparency; guard against risk across the financial system; minimize rather than increase the financial and economic cycle; reduce reliance on inappropriately risky sources of financing; and discourage excessive risk-taking."[36] The increased specificity of the policy prescriptions and agreements at London—for example, the requirement to extend regulation and oversight for the first time to systemically important hedge funds—made it clear that, in between the Washington and London Summits, progress had been achieved by standard-setting bodies in crafting more narrowly tailored solutions to promote targeted regulatory reform.

At Pittsburgh, leaders called on finance ministers and central bank governors to reach agreement on an international framework for reform in the following four specific regulatory areas: (1) "[b]uilding high quality capital and mitigating pro-cyclicality," (2) "[r]eforming compensation practices to support financial stability," (3) "[i]mproving over-the-counter derivatives markets," and (4) "[a]ddressing cross-border resolutions and [SIFIs] by end-2010."[37] Although it was clear by this time, the leaders declared that the G-20 was now the "premier forum for our international economic cooperation."[38] The G-20 was spearheading a bold effort to reform the structure of the global financial architecture by announcing specific goals and deadlines and doling out responsibilities to various international regulatory bodies.

The most important structural contribution of the Toronto Summit was the leaders' announcement of four pillars of reform, a further refinement of the agenda from the previous summits.[39] This framework appears to be the most analytically coherent and well-defined of the various G-20 frameworks discussed above, so I will use it to explore some of the specific reforms in more detail in Part I.C. Disappointingly, the G-20 leaders did not even refer to the four pillars in the Seoul Declaration but did express their dedication to the principles of reform set out in the Washington

36. Bruce Zagaris, *G20 Meeting Agree on Mechanisms and Arrangements to Increase International Financial Regulation and Enforcement*, 25 INT'L FIN. ENFORCEMENT LAW REPORTER, no. 6 (2009).

37. *G-20 Pittsburgh Leaders' Statement*, *supra* note 3, at 8-9. In addition, the leaders called on international accounting bodies to establish "a single set of high quality, global accounting standards" by June 2011; they reaffirmed their commitment to fight against non-cooperative jurisdictions, tax havens, money laundering, and terrorist financing; and tasked the IMF with reporting on "how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system." *Id.* at 9-10.

38. *Id.* at 3.

39. *See The G-20 Toronto Summit Declaration*, G-20, at 4-5 (June 27, 2010), http://www.g20.org/Documents/g20_declaration_en.pdf [hereinafter *G-20 Toronto Leaders' Statement*].

Action Plan (which are essentially the basis of the four pillars).[40] Even if the G-20 has not settled on a unified framework or has not found the best way to express its framework with clarity, it has at least moved in the direction of more clarity and refinement and has increased its attention to detail based on recommendations from the standard-setting bodies. In terms of forming policy goals and finding ways to fill in regulatory gaps, the multi-layered approach to global financial regulation appears to be working.

C. Four Pillars of Financial Reform

At Toronto, the G-20 heads of state announced a financial reform agenda that rests on four pillars: (1) a strong regulatory framework, (2) effective supervision, (3) resolution and addressing systemic institutions, and (4) transparent international assessment and peer review.[41] The pillars represent a broad framework for asserting uniform regulatory and supervisory control over financial institutions with the intent of preventing future financial crises or, if such crises occur, making financial institutions rather than taxpayers bear the primary burden of recovery.

The first and most important pillar, a strong regulatory framework, is based on the establishment of a "new global regime for bank capital and liquidity."[42] Considering that the Basel Committee spent many years trying to achieve consensus on Basel II,[43] the speed with which a new framework for capital and liquidity was created (at the G-20's urging) demonstrates the efficiency of the G-20's multi-layered model and "top-down" approach.[44] The necessity of such a framework had become apparent when the worldwide liquidity crisis culminated in government bailouts that cost taxpayers billions of dollars.[45] Before the crisis, some financial institutions had leverage ratios of 40 to 1, yet regulators were unwilling to act early and

40. *See G-20 Seoul Summit Document*, *supra* note 26, at 6-7.

41. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 4-5.

42. *Id.* at 3.

43. *See* HEIDI SCHOONER & MICHAEL TAYLOR, GLOBAL BANK REGULATION: PRINCIPLES AND POLICIES 81 (2010) (noting that in 1999, BCBS issued a proposal for a New Capital Adequacy Framework to replace the 1988 Accord. The new framework was not even introduced until 2006 and not immediately implemented by respective countries' legislatures).

44. The new framework was endorsed by the G-20 at the Seoul Summit for implementation beginning on January 1, 2013, with full phase-in to occur by January 1, 2019. *G-20 Seoul Summit Document*, *supra* note 26, at 7.

45. Jack Ewing & Sewell Chan, *Regulators Back New Bank Rules to Avert Crises*, N.Y. TIMES, Sept. 13, 2010, at A1.

forcefully.[46] (The most common leverage ratio—and the one referred to here—is a measurement of debt to equity. Generally, the more a financial institution is "leveraged," the more likely it is to go bankrupt.) If, prior to the financial crisis, institutions with high leverage ratios had been required to hold more capital to absorb potential losses resulting from their risky assets, they would have been in a less precarious position, and governments may not have been forced to rescue them. The G-20's capital and liquidity framework will be discussed later as an example of one of the G-20's most positive contributions to financial regulatory reform.[47] There are several other Pillar I regulatory agreements, including regulation of hedge funds, credit rating agencies, and over-the-counter derivatives, that unfortunately cannot be fully explored here.

The second pillar, effective supervision, involves improving standards for identifying and addressing risks.[48] "Without supervision, rules and standards lose meaning."[49] Accordingly, the G-20 at Toronto reaffirmed its commitment to the Basel Committee's Core Principles for Effective Banking Supervision,[50] a document that was originally published in 1997 and revised in 2006.[51] Countries have used the Core Principles, along with the Core Principles Methodology,[52] as a "benchmark for assessing the quality of their supervisory systems and for identifying future work to be done to achieve a baseline level of sound supervisory practices."[53] The G-20 at Seoul endorsed policy recommendations prepared by the FSB[54] to improve oversight and supervision of SIFIs.[55] These recommendations suggest ways of improving and expanding upon the Basel Core Principles.[56]

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46. Eugene Ludwig, CEO, Promontory Fin. Grp., LLC, Remarks at Duke University School of Law on Financial Regulation in a Federal System (Mar. 3, 2011), *available at* http://www.law.duke.edu/webcast/#webcasts.

47. *See* discussion *infra* Part III.A.

48. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 4-5.

49. Pan, *supra* note 7, at 266.

50. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 17.

51. *BIS Core Principles*, *supra* note 27, at 1.

52. *Id.*

53. *Id.* at 1. The Core Principles lists twenty-five principles broadly grouped into seven different categories. Some examples include licensing and structure (principles 2 to 5) and accounting and disclosure (principle 22). *Id.* at 2.

54. *Intensity and Effectiveness of SIFI Supervision: Recommendations for Enhanced Supervision*, FSB (Nov. 2, 2010), http://www.financialstabilityboard.org/publications/r_101101.pdf [hereinafter *SIFI Supervision*].

55. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 4-5.

56. *See SIFI Supervision*, *supra* note 54 (summarizing recommendations about ten categories of findings related to effective supervision).

The third pillar, resolution and addressing systemic institutions, involves implementing a plan to give countries the "powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden."[57] At Toronto, the G-20 called upon the FSB to develop concrete policy recommendations for addressing the resolution of SIFIs in advance of the Seoul Summit.[58] The G-20 said the new policy framework should reduce moral hazard risks by adopting "effective resolution tools, strengthened prudential and supervisory requirements, and core financial market infrastructures."[59] The G-20 emphasized that the financial sector would have to make a "fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution, and reduce risks from the financial system" through a financial levy or another approach.[60] The range of approaches should follow the principles of protecting taxpayers, reducing risks from the financial system, protecting the flow of credit in good times and bad times, taking into account individual countries' circumstances and options, and helping promote a level playing field.[61] The FSB responded to these G-20 requests in its report by making recommendations and timelines for the reduction of moral hazard created by SIFIs.[62] The report delegates responsibility to the FSB, BCBS, IOSCO, and other standard-setting bodies to conduct various work processes by 2011 or 2012.[63] Examples include a BCBS study on additional loss absorbency to be completed by mid-2011 and an FSB assessment on SIFI resolvability and the necessary legal and regulatory reforms to be completed by March 2011.[64] At Seoul, the G-20 endorsed these recommendations and timelines.[65]

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57. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 5.

58. *Id.*

59. *Id.* Notably, European politicians have since haggled extensively over how to structure the European Union's bailout fund and have repeatedly raised the idea of adopting a levy on banks but have faced an uphill battle. *See* Nikki Tait, *EU Plans Upfront Levy on Lenders*, FIN. TIMES, May 24, 2010, *available at* http://www.ft.com/intl/cms/s/0/79ac67c4-676f-11df-a932-00144feab49a.html#axzz1b0ei9vwB; Stephen Castle & Matthew Saltmarsh, *European Governments Consider a Bank Tax to Finance Greek Bailout*, N.Y. TIMES, July 18, 2011, at B8.

60. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 5.

61. *Id.* at 18.

62. *See Reducing the Moral Hazard Posed by Systemically Important Financial Institutions: FSB Recommendations and Time Lines*, FSB (Oct. 20, 2010), http://www.financialstabilityboard.org/publications/r_101111a.pdf.

63. *See id.* at 1-2.

64. *Id.* at 11-12.

65. *G-20 Seoul Summit Document*, *supra* note 26, at 7.

The fourth and last pillar, transparent international assessment and peer review, aims to improve assessment of risk by relying on the IMF and World Bank Financial Sector Assessment Program (FSAP) and FSB peer reviews.[66] Beginning in 2010, the FSB engaged in a series of country peer reviews and thematic peer reviews. The FSB conducted peer reviews on Mexico, Italy, and Spain in 2010 and Austria, Canada, and Switzerland in 2011.[67] The objective of FSB country peer reviews is to examine the extent to which national authorities have taken steps to address FSAP recommendations on financial regulation and supervision, as well as institutional and market infrastructure.[68] FSB member jurisdictions have agreed to undergo an FSAP assessment every five years and an FSB peer review every two to three years after an FSAP.[69] To illustrate, the country peer review that Italy voluntarily undertook noted that the country had made progress on FSAP recommendations and praised its "prudent regulatory and supervisory framework" for promoting conservative mortgage lending practices and discouraging banks from participating in complex securitization activities and sponsoring structured investment vehicles.[70] However, it also advised that Italy should make improvements, such as adopting and phasing in a 90-day past due loan classification requirement to signal the robustness of the Italian banking sector and legally empower the Bank of Italy to quickly remove bank directors and senior officers as necessary.[71] One example of an FSB thematic review is the peer review on residential mortgage underwriting and origination practices, which noted that although FSB members were making progress on improving mortgage underwriting and origination practices, most FSB member jurisdictions still needed to improve public disclosure and monitoring of mortgage markets.[72]

When considered together, the four pillars provide a solid foundation for financial reform. Each pillar involves extensive collaboration among the G-20, FSB, and other financial standard setters. Although this layered structure could result in overlapping duties and unclear roles for the different standard setters, thus far the G-20 has done an adequate job of

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66. *G-20 Toronto Leaders' Statement*, *supra* note 39, at 4.

67. Press Release, FSB Completes Peer Review of Italy, FSB (Feb. 7, 2011), at 1, *available at* http://www.financialstabilityboard.org/press/pr_110207b.pdf.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.* at 2.

72. Press release, FSB Publishes Peer Review on Residential Mortgage Underwriting and Origination Practices, FSB (Mar. 18, 2011) at 1, *available at* http://www.financialstabilityboard.org /press/pr_110318a.pdf.

publishing regular updates of its progress and "next steps."[73] The action items listed in these progress reports are explicitly linked to provisions within the G-20 declarations, and they provide clear roles and duties for the various standard setters. In addition, since the deadlines within the declarations are effectively being set by the G-20 *heads of state*, the standard-setting bodies have added pressure to perform because they are being held accountable to the leaders of the world's most powerful and economically developed countries. More research is needed on the subject of how these deadlines are set and to what extent they are followed, but there is evidence that the deadlines have thus far been taken seriously.[74]

II. THE "HARD" SOFT LAW NATURE OF G-20 RECOMMENDATIONS

Central to the regulation of international finance is the distinction between "soft" law standards and "hard" legal obligations. Scholars have proposed various conceptions of soft law, with some even denying that non-binding soft law is truly law.[75] One scholar argues that defining soft law as "agreements with imprecise obligations" (in the sense that a wide range of behavior can be considered compliant) or "agreements that are not legally binding" fails to account for the legal nature of soft law.[76] Rather, he describes soft law standards as "those international obligations that, while not legally binding themselves, are created with the expectation that they will be given some indirect legal effect through related binding

73. *See Progress Report on the Actions of the Washington Action Plan*, *supra* note 33; *see also Progress Report on the Actions of the London and Washington G20 Summits*, G-20 (Sept. 5, 2009), http://www.g20.org/Documents/20090905_G20_progress_update_London_Fin_Mins_final.pdf (detailing progress in preparation for the Pittsburgh Summit); *Progress Report on the Actions to Promote Financial Regulatory Reform*, G-20 (Sept. 25 2009), http://www.g20.org/Documents/pittsburgh_progress_report_250909.pdf (detailing progress on financial reform); *Progress Report on the Economic and Financial Action of the London, Washington and Pittsburgh G20 Summits*, G-20 (Nov. 7, 2009), http://www.g20.org/Documents/20091107_progress_report_standrews.pdf (highlighting the progress made at the first three leaders' summits); *Progress Report on the Economic and Financial Actions of the London, Washington and Pittsburgh G20 Summits*, G-20 (July 20, 2010), http://www.g20.org/Documents2010/07/July_2010_G20_Progress_Grid.pdf (detailing more progress) [hereinafter *July 2010 Progress Report*].

74. *See, e.g.*, *July 2010 Progress Report*, *supra* note 73, at 24-34 (noting the various deadlines set in the area of prudential regulation that were met).

75. *See* Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements and Antagonists in International Governance*, 94 MINN. L. REV. 706, 712-17 (2010) (outlining the debate among positivists, rational institutionalists, and constructivists).

76. *See* Timothy Meyer, *Soft Law as Delegation*, 32 FORDHAM INT'L L.J. 888, 905-06 (2009) ("[I]f soft law is to be a coherent analytical category, scholars must identify what is 'legal' about soft law, or put differently, what differentiates soft law from purely political agreements.").

obligations under either international or domestic law."[77] This makes sense in the context of international financial law because it often takes years for financial standards to gain *direct* legal effect through domestic legislative enactments, but financial institutions quickly recognize the *indirect* (or practically binding) legal effect of financial standards and start to comply with those standards soon after they are officially adopted by international regulators.[78]

One important form of soft law that has indirect legal effects is the "nonbinding" declaration,[79] a favorite tool of the G-20. "Despite their lack of formal legal status, these materials can ultimately have real effect—by working their way into customary international law or by providing the framework for informal interstate cooperation."[80] The G-20's announcement of the common principles for reform of financial markets in its Washington Action Plan and its repeated emphasis of such principles in subsequent declarations may have already had the effect of initiating the integration of those principles into customary international law.[81] Some scholars argue that the G-20, with its reliance on soft law, "provides a suboptimal regulatory framework for the international financial markets, generating a need for stronger international regulatory bodies,"[82] but the G-20's flexible structure also has advantages in terms of allowing regulators to adapt quickly to new challenges without facing unnecessary administrative obstacles.

Enforcement of soft law standards is not available through courts, so standard setters must use other tools to increase the likelihood that national regulators and market actors will comply with them.[83] The primary means of achieving such compliance is by exerting peer pressure on market actors and national regulators "to make defection from international financial agreements costly."[84] This is arguably not as difficult in international finance as in other areas where international coordination is sought because (1) financial institutions, with their considerable resources and technical

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77. *Id.* at 890.

78. *See infra* pp. 28-29.

79. *See* Jacob E. Gersen & Eric A. Posner, *Soft Law: Lessons from Congressional Practice*, 61 STAN. L. REV. 573, 575 (2008).

80. *Id.*

81. *See* discussion *supra* Part I.B.

82. Pan, *supra* note 7, at 248.

83. SCHOONER & TAYLOR, *supra* note 43, at 76.

84. Brummer, *supra* note 7, at 326; *see also* Lawrence Baxter, *Internationalisation of Law: The "Complex" Case of Bank Regulation*, *in* THE INTERNATIONALISATION OF LAW: LEGISLATING, DECISION-MAKING, PRACTICE AND EDUCATION 3, 6 (Mary Hiscock & William Van Caenegem eds., 2010).

expertise, play an influential role in the setting of financial standards and are, thus, more likely to implement them, and (2) the health of financial institutions depends largely on perceptions of how safely they operate in comparison to their peers, so once a benchmark is set by global regulators, financial institutions feel compelled to follow it.

To promote better enforcement of non-binding, soft financial law, some scholars have recommended the creation of a World Financial Organization (WFO),[85] and others have rejected the idea.[86] In international finance, the tools of regulation have been hampered by "institutional flaws that . . . limit their own coercive effect."[87] Monitoring has been ineffective because "participation in some of the most important surveillance programs is voluntary and the process depends on self-reporting by national regulators and the firms."[88] The WFO would not be a supranational regulator to which nations would cede financial regulatory power but a treaty-based organization, akin to the World Trade Organization (WTO), comprised of independent panels of experts who determine compliance with obligations.[89] Yet, the prospect of a WFO is "misconceived, doomed to failure and . . . would not be the most effective approach to global financial services for the future."[90] The WFO is misconceived because the WTO is designed "primarily to *open up* markets rather than regulate their ongoing operations," as any financial regulatory body would have to do.[91] The WFO would be doomed to failure because an agreement merely to establish a WFO would "surely take a decade or more to secure."[92] In that time, another financial crisis could emerge.[93]

Because the formation of a WFO is unlikely and undesirable, the emergence of a strong G-20-led regulatory structure is probably the next

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85. *See, e.g.*, Barry Eichengreen, *Not a New Bretton Woods but a New Bretton Woods Process*, *in* WHAT G20 LEADERS MUST DO TO STABILIZE OUR ECONOMY AND FIX THE FINANCIAL SYSTEM 25 (Barry Eichengreen & Richard Baldwin eds., 2008).

86. *Compare* Lawrence Baxter, *Exploring the WFO Option for Global Banking Regulation*, *in* GLOBALIZATION AND GOVERNANCE 113, 116-18 (Laurence Boule ed., 2011) (arguing that a WFO is not feasible), *with* Douglas W. Arner & Michael W. Taylor, *The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?* 32 U.N.S.W.L.J. 488, 490 (noting that some features of the WTO may be useful such as modeling binding arbitration for cross-border burden sharing in crisis management on WTO dispute settlement procedures).

87. Brummer, *supra* note 7, at 326.

88. *Id.*

89. *See* Barry Eichengreen, *International Financial Regulation After the Crisis*, DAEDELUS, Fall 2010, at 107, 113-14.

90. Baxter, *supra* note 86, at 116.

91. *Id.* at 117.

92. *Id.*

93. *Id.*

best alternative, though some have complained that the G-20 model is unsustainable. While most can agree that the G-20 did an adequate job of helping to mitigate the spread of financial disaster from 2008 to 2010, Eric Pan has argued that "dependence on high politics 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."[94] He argues:

> 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.[95]

Yet the major recent accomplishments stemming from the G-20's policy recommendations underscore the strength and durability of the current layered structure of international governance with strong top-down authority. The emergence of the FSB, which has so far been active in monitoring members' progress with G-20 mandates,[96] has been one critical reason for the G-20's success. The BCBS' responsiveness in coming up with new capital requirements so quickly has also helped. Since the G-20 rose to prominence in 2008, the system has seemed to work not *in spite of* the G-20's dependence on politics, but rather *because of* its dependence on politics.

There is nothing inherently vacuum-like about a diffuse system of regulators as long as the regulators are well coordinated and united in purpose under a strong agenda-setting supranational body, such as the G-20. The sturdiness of the global financial architecture depends primarily on the G-20 and FSB's coordination of the various transnational regulatory networks (TRN), or policy networks. TRNs—including the FSB, BCBS, IOSCO, and IASB—have come to dominate the field of international financial law.[97] They can address global problems that individual governments cannot tackle alone. Also, because they are "decentralized, dispersed, and involve participants that are domestically accountable [i.e., finance ministers and other political appointees], they do not pose the kinds

94. Pan, *supra* note 7, at 244.
95. *Id.* at 245.
96. *See supra* notes 33 and 73.
97. *See* Arner & Taylor, *supra* note 86, at 490.

of threats to democracy, freedom, or national sovereignty that make world government undesirable."[98] To the extent the G-20 and FSB are able to monitor TRNs' progress and collaboratively find the right policy prescriptions to solve problems of financial regulatory reform, the diffuse system works well and there is no need for a new centralized financial regulator.[99] Since most of the TRNs are led by the same financial regulators who attend G-20 and FSB meetings, the structure is quite efficient. When the TRNs enact new reforms, regulated entities can be relatively certain that such "soft" law decisions will be implemented at the national level in the form of "hard" law, so they are more likely to adopt measures to implement the reforms.

III. KEY G-20 DECISIONS AND THEIR IMPACT

The G-20 has made many important recommendations to international financial regulatory bodies on topics such as improving the OTC derivatives market, strengthening accounting standards, and reforming compensation practices.[100] However, two highlights in particular stand out. These are the reforms to the capital and liquidity framework and the improvements to regulation of SIFIs.[101] Though there is still room for improvement, G-20 progress in these two areas of reform represents strong evidence of the G-20's ability to promote and achieve effective results.

A. Capital and Liquidity Framework

At Seoul, the G-20 leaders endorsed the Basel III capital and liquidity framework agreement reached by the Basel Committee on September 12, 2010.[102] They agreed to "translate" the new framework into their national laws and regulations and implement the new framework beginning January 1, 2013.[103] The framework phases in requirements over time so that the full

98. Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113, 115 (2009).

99. *But cf.* Emilios Avgouleas, *The Global Financial Crisis, Behavioral Finance and Financial Regulation: In Search of a New Orthodoxy*, 9 J. CORP. L. STUD. 121 (2009) (U.K.) (proposing various reforms to international bank regulation and calling for a global licensing and supervisory regime for transnational investment funds with systemic importance).

100. *See Progress Since the Washington Summit in the Implementation of the G20 Recommendations for Strengthening Financial Stability: Report of the FSB to G20 Leaders*, FSB (Nov. 8, 2010), http://www.financialstabilityboard.org/publications/r_101111b.pdf.

101. *See id.* at ii (organizing the various areas of reform and putting these two at the top of the list in the table of contents).

102. *G-20 Seoul Summit Document*, *supra* note 26, at 7.

103. *Id.*

requirements will not be phased in until January 1, 2019.[104] Its primary contribution is to increase "the resilience of the global banking system by raising the quality, quantity and international consistency of bank capital and liquidity."[105] Nout Wellink, chairman of the BCBS and president of the Netherlands Bank, called the Basel III Framework "a landmark achievement that will help protect financial stability and promote sustainable economic growth."[106] It will do so by requiring financial institutions to hold higher levels of capital in relation to risk-weighted assets.[107] The capital requirements, combined with a global liquidity framework, are designed to "significantly reduce the probability and severity of banking crises in the future."[108]

Because capital comes in many different forms, the framework sets benchmark ratios for a few different categories of capital: common equity, Tier 1, and Tier 2.[109] Perhaps most important, the framework increases the minimum ratio for common equity from 2 percent to 4.5 percent and sets higher standards for what qualifies as Tier 1 capital, of which common equity should comprise a large part.[110] Common equity is important for banks to hold because it can readily absorb losses more than other types of capital. In the words of one commentator, there will be "[n]o more throwing any old garbage into the Tier 1 bucket and calling it capital: the new standards for common equity are significantly tougher than the old standards for Tier 1 capital in total."[111]

In addition, the framework imposes two "buffers" that are designed to provide extra protection during times of need. The first is a new capital "conservation buffer" requirement of 2.5 percent to "ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress."[112] Banks will likely exceed the buffer requirement because if they eat into the buffer during challenging economic times, they will be subjected to increased regulatory oversight

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104. Press release, BIS, Group of Governors and Heads of Supervision Announces Higher Global Minimum Capital Standards (Sept. 12, 2010), *available at* http://www.bis.org/press/p100912.pdf [hereinafter Basel III Announcement]; *see infra* app. Table 1.

105. *G-20 Seoul Summit Document*, *supra* note 26, at 7.

106. Press Release, BIS, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (Dec. 16, 2010), *available at* http://www.bis.org/publ/bcbs189.htm [hereinafter Basel III Rules Release].

107. Basel III Announcement, *supra* note 104, at 6.

108. Basel III Rules Release, *supra* note 106.

109. *Id.*; *see infra* app. Table 2.

110. Basel III Announcement, *supra* note 104, at 1-2.

111. Felix Salmon, *Basel III Arrives*, SEEKING ALPHA (Sept. 13, 2010), http://seekingalpha.com/article/224822.

112. Basel III Announcement, *supra* note 104, at 2.

and will be unable to issue dividends.[113] The framework also features a countercyclical capital buffer, which mandates that banks have up to 2.5 percent more common equity or other fully loss-absorbing capital in *good times* "to achieve the broader macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth."[114] The precise amount will be determined by national regulators, not the Basel Committee.[115]

To complement these capital requirements, Basel III also provides for minimum liquidity requirements through two measures, the Liquidity Coverage Ratio and the Net Stable Funding Ratio.[116] The former is designed to ensure that a bank can withstand an acute stress scenario lasting one month, while the latter is designed to ensure a bank has long-term resilience and can fund its activities with stable sources on an ongoing structural basis.[117]

B. SIFI Regulation

Financial institutions have encountered staggering growth since 2000. For example, Bank of America increased its assets from $656 billion in 2000 to $2.3 trillion in 2010, and Citibank grew its assets from $739 billion in 2000 to $2 trillion in 2010.[118] During the financial crisis, there was a wave of consolidations, with big-name banks such as Merrill Lynch, Wachovia, and Washington Mutual selling themselves at the insistence of government regulators or in response to market pressures. At the same time, some investment banks and insurance companies dramatically expanded. Investment bank Goldman Sachs had $980 billion in assets in 2010 and was the fifth largest U.S. financial institution.[119] Insurance giant MetLife had $565 billion in assets in 2010 and was the seventh largest U.S. financial institution.[120] The larger the financial institution, the more other financial institutions are exposed to it.[121] Accordingly, governments generally do not want to risk the massive financial exposure that would

113. *See id.*

114. *Id.*

115. *Id.*

116. *Id.* at 4, 7.

117. *Id.*

118. *Top 30 U.S. Banking Companies, Ranked by Assets in the First Quarter 2000*, AM. BANKER (Apr. 27, 2000), http://www.americanbanker.com/issues/165_78/-124061-1.html; Nat'l Info. Ctr., *Top 50 Bank Holding Companies* (Sept. 30, 2011), http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx [hereinafter *Top 50 Banks*].

119. *Top 50 Banks*, *supra* note 118.

120. *Id.*

121. SCHOONER & TAYLOR, *supra* note 43, at 63.

result from the failure of a big bank, and they are thus likely to extend assistance, or "bailouts," to SIFIs.

The G-20 leaders at Seoul "reaffirmed [their] view that no firm should be too big or too complicated to fail and that taxpayers should not bear the costs of resolution."[122] To reduce moral hazard risks posed by SIFIs and address the "too big to fail" (TBTF) problem, the G-20 recognized that it would have to create a "multi-pronged framework" that combines

> a resolution framework and other measures to ensure that all financial institutions can be resolved safely, quickly and without destabilizing the financial system and exposing the taxpayers to the risk of loss; a requirement that SIFIs . . . should have higher loss absorbency capacity to reflect the greater risk that the failure of these firms poses to the global financial system; more intensive supervisory oversight; robust core financial market infrastructure to reduce contagion risk from individual failures; and other supplementary prudential and other requirements as determined by the national authorities which may include, in some circumstances, liquidity surcharges, tighter large exposure restrictions, levies and structural circumstances.[123]

The leaders also urged further progress on the use of contingent capital and other instruments to encourage market discipline.[124] They encouraged the FSB, BCBS, and other relevant bodies to complete their work on these topics in 2011 and 2012.[125] They also agreed to conduct rigorous risk assessment of SIFIs through international supervisory colleges, to negotiate institution-specific crisis cooperation agreements within crisis management groups, and to grant supervisors "strong and unambiguous mandates, with sufficient independence to act, appropriate resources, and a full suite of tools and powers to proactively identify and address risks, including regular stress testing and early intervention."[126]

C. Analysis of the Key G-20 Reforms

The G-20 expects the Basel III framework to "markedly reduce banks' incentive to take excessive risks, lower the likelihood and severity of future crises and enable banks to withstand—without extraordinary government support—stresses of a magnitude associated with the recent financial

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122. *G-20 Seoul Summit Document*, *supra* note 26, at 7.
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* at 7-8.

crisis."[127] The central questions have been whether banks will be prepared to implement these requirements on schedule, whether Basel III requires the right amount of capital, and whether the transition period allows a proper amount of time. With respect to SIFI regulation, the main questions have been what kind of entities will be classified as SIFIs and what type of restrictions they will face. Despite some strident opposition from regulated entities, the G-20's policy recommendations on capital and liquidity management and SIFI regulation generally set adequate and necessary baselines for reform and leave other decisions up to national regulators.

Even assuming a rather high total capital requirement of 13 percent, analysts predict that most U.S. and European banks will not have trouble adhering to the Basel III requirements. Based on the preliminary results of a Basel Committee impact study, as of the end of 2009, "'large banks' needed to raise, in the aggregate, a 'significant amount' of additional capital to meet the new capital standards, while smaller banks for the most part already met the requirements."[128] Studies released shortly after Basel III was announced indicated that the requirements would not pose significant hurdles to large U.S. banks, though they may pose hurdles for some European banks.[129] A 2010 Goldman Sachs study found that in 2012 Bank of America, Wells Fargo, J.P. Morgan, U.S. Bancorp, Citigroup, and PNC will all have Tier 1 capital ratios between 10 percent and 13.3 percent of risk, with most hovering around 12 percent.[130] By contrast, in 2012, some European banks—among them, Austria's Erste Bank and Ireland's Allied Irish Bank—will hold 7 percent common Tier 1 capital as a percentage of risk-weighted assets.[131] To put those percentages in context, the Basel III Tier 1 level required by 2013 is 4.5 percent, and the Tier 1 level required by 2019 is 6 percent.[132] During the economic crisis, most banks improved their balance sheets and cut back on lending, making it unnecessary for them to undertake substantial capital infusions to comply with Basel III.[133] In contrast, before the crisis, almost all banks would have

127. *Id.* at 7.

128. Memorandum from DavisPolk on Agreement on Quantification and Timing of Basel III Capital Standards 5 (Sept. 13, 2010), *available at* http://www.davispolk.com/files/Publication/6a8195a6-c24d-4808-974b-b4e98d99564c/Presentation/PublicationAttachment/78121d27-39ac-4bd7-b54d-b83424ec1b70/091310_basel_iii.pdf.

129. Damian Paletta & David Wessel, *Bank Rules Win Muted Praise*, WALL ST. J., Sept. 14, 2010, at C1. It is worth noting that the projections cited in the above article from shortly after the release of Basel III might be less valid by the publication date of this note in consideration of the heavy toll of the European debt crisis and various other economic events in 2011.

130. *Id.*

131. *Id.*

132. *See infra* app. Table 1.

133. Paletta & Wessel, *supra* note 129, at C1.

needed substantial capital infusions to comply with the new requirements.[134]

Reports in the days after the framework was announced show that, despite the "dire warnings made by the industry in the run-up to the regulatory agreement," some banks were already beginning to comply with the new requirements.[135] Even though the rules gave banks a lengthy transition period before meeting the first phase of the new requirements in 2013, the day after the announcement, Deutsche Bank started a €9.8 billion (roughly $12.5 billion at the time) share sale that may have been partly aimed at positioning the lender to comply with the Basel requirements.[136] In addition, investment banks were already urging their banking clients to raise capital quickly, before investors faced more choices from other capital offerings.[137]

Some observers have noted that the capital requirements were on the low end of the spectrum and may not be enough to prevent future crises,[138] while others have expressed their strong opposition to the higher capital requirements, mainly because requiring banks to hold more capital would cause them to take more risk or charge more for their services, which would cause customers to look elsewhere.[139] Leaders of large universal banks led a vocal campaign against the new capital requirements, arguing that they would make universal banks less competitive. Jamie Dimon, CEO of JPMorgan Chase, said that the "extreme and excessive"[140] Basel III will "stifle economic growth"[141] and will be "the nail in our coffin for big

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134. *Id.*

135. David Enrich & Dana Cimilluca, *Most Banks Seem Set on Basel Rules*, WALL ST. J., Sept. 14, 2010, at C2.

136. *Id.*

137. *Id.*

138. For example, MIT economist Simon Johnson said the requirements were the "minimum." Paletta & Wessel, *supra* note 129, at C1.

139. Karen Shaw Petrou, *Basel III + Dodd-Frank = Little Leeway on Capital*, AM. BANKER, Aug. 18, 2010, at 8 (arguing that the risk-adjusted return on capital, which drives internal line-of-business capital allocation, changes a lot when capital requirements increase and that banks reallocate capital or take more risk to "make the numbers work to their satisfaction").

140. Cheyenne Hopkins, *Dimon: Basel III "Extreme and Excessive,"* AM. BANKER, Apr. 6, 2011, *available at* http://www.americanbanker.com/issues/176_66/dimon-basel-III-1035596-1.html.

141. Lawrence Baxter, *Dimon, Diamond and Demons of Financial Reform*, THE PARETO COMMONS, Apr. 6, 2011, http://www.theparetocommons.com/2011/04/dimon-diamond-and-demons-of-financial-reform/ [hereinafter Baxter, *Dimon*]. Dimon also vociferously opposed the FSB and Basel Committee regulators' recommendation—endorsed by the G-20—to impose a 1 to 2.5 percent capital surcharge on the largest banks. Dimon called the plan "anti-American" and suggested that U.S. regulators should consider pulling out of the Basel Committee. Sara Schaefer Munoz, *Capital Idea, Say Regulators*, WALL ST. J., Oct. 11, 2011, at C2; Francesca Landini & Huw Jones, *G-20 Ministers Back Big Bank Capital Surcharge*, REUTERS, Oct. 15, 2011, *available at* http://in.reuters.com/article/2011/10/15/idINIndia-59910820111015.

American banks."[142] Yet he acknowledged that the negative impact on economic growth had not been proven.[143]

Economists have asserted that claims that high capital requirements are costly and would affect credit markets adversely are "either fallacious, irrelevant, or very weak."[144] Admati and others argue that requiring banking institutions to be funded with significantly more equity "entails large social benefits and minimal, if any, social costs."[145] This argument is premised on the utility of preventing costly resolution procedures and bailouts before they occur so that taxpayers do not again have to foot the bill caused by financial institutions' excessive risk-taking. Creating better resolution procedures for banks, while important, should not be viewed as an alternative to increasing bank capital requirements because the ultimate goal of reform is eliminating the cost of financial distress, and resolution does not do that.[146] In addition, higher equity requirements are superior to bailout funds supported by bank taxes because the "self-insurance" charged to each bank "would be priced by financial markets and be more effective in reducing the need for government intervention."[147]

Despite general support for increased capital, some regulators, academics, and credit rating agencies have criticized the Basel III requirements for not going far enough. One commentator has noted that, perhaps because the United Kingdom faced "utter calamity" in the financial crisis, "it's acceptable in Britain to talk about having significantly higher standards."[148] Mervyn King, governor of the Bank of England, has said Basel III "is certainly a step in the right direction . . . . But if it is a giant leap for the regulators of the world, it is only a small step for mankind."[149] King stressed that Basel III on its own will not prevent another crisis for several reasons, including: (1) the new levels of capital are insufficient to

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142. Tom Braithwaite, *Dimon Warns of Bank "Nail in Coffin,"* FIN. TIMES (London), Mar. 30, 2011, *available at* http://www.ft.com/cms/s/0/3157bcbe-5b05-11e0-a290-00144feab49a.html#axzz1J81gFwS9.

143. Baxter, *Dimon*, *supra* note 141.

144. Anat Admati et al., *Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity Is Not Expensive*, i (Stanford Graduate Sch. of Bus. Research Paper No. 2065, 2011), *available at* https://gsbapps.stanford.edu/researchpapers/library/RP2065R1&86.pdf.

145. *Id.*

146. *Id.* at iii.

147. *Id.*

148. Jessica Eisinger, *In Debate over Bank Capital Regulation, a Transatlantic Gulf*, N.Y. TIMES DEALBOOK, Mar. 30, 2011, http://dealbook.nytimes.com/2011/03/30/in-debate-over-bank-capital-regulation-a-trans-atlantic-gulf/.

149. Mervyn King, Governor, Bank of England, The Second Bagehot Lecture, Buttonwood Gathering, New York City: Banking: From Bagehot to Basel, and Back Again 12 (Oct. 25, 2010), *available at* http://www.bankofengland.co.uk/publications/speeches/2010/speech455.pdf.

prevent another crisis; (2) Basel III's use of "risk-weighted" assets computed from past experience to calculate capital requirements will not adequately capture risk; and (3) the Basel framework's focus on the assets side of a bank's balance sheet excludes consideration of the liquidity and liability structure of the balance sheet.[150] Moody's Investors Service reported, the capital buildup required by Basel III will not make banks "as financially robust as they were before the crisis."[151] Alain Laurin, senior vice president of Moody's, noted that "Basel III does not cure the structural challenges banks continue to face from a credit perspective, such as illiquidity and high leverage, nor does it alleviate the tension between profit-maximizing equity holders and bank managers in contrast to risk-averse bondholders."[152] David Miles, a member of the Bank of England's monetary policy committee, has estimated that 16 to 20 percent would be the optimal range for capital.[153] Adair Turner, chairman of the U.K. Financial Services Authority, agrees but thinks that careful management is required to reach such levels.[154]

As for the lengthy transition period, some economists have argued that the period is too long, while others have contended it is necessary because demanding too much capital would risk a deeper lending retrenchment.[155] King has voiced his support for the lengthy transition, noting that "it is important in the present phase of de-leveraging not to exacerbate the challenge banks face in raising capital today."[156] This means "using profits to rebuild capital rather than pay out higher dividends and compensation,"[157] a strategy that most banks would be loathe to accept unless forced to do so by regulators.[158] Nonetheless, Bank of America CEO

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150. *Id.* at 12-14.

151. James Langton, *Basel III Won't Return Banks to Pre-Crisis Strength, Warns Moody's*, INVESTMENT EXECUTIVE (May 5, 2011), http://www.investmentexecutive.com/client/en/News/DetailNews.asp?Id=57982&cat=147&IdSection=147&PageMem=&nbNews=&IdPub.

152. *Id.*

153. David Miles et al., *Discussion Paper No. 31 (Revised and Expanded Version): Optimal Bank Capital*, BANK OF ENGLAND, EXTERNAL MPC UNIT 37 (Apr. 2011), http://www.bankofengland.co.uk/publications/externalmpcpapers/extmpcpaper0031.pdf.

154. John Plender, *U.K. Banking Climate Makes the U.S. Look Attractive*, FIN. TIMES, Apr. 5, 2011, *available at* http://www.ft.com/cms/s/0/f11d61cc-5f9f-11e0-a718-00144feab49a.html#axzz1IZEAKLtD.

155. For example, Anil Kashyap, a University of Chicago finance economist, and Joseph Stiglitz, the Nobel laureate at Columbia University, both said the delay was too long. Paletta & Wessel, *supra* note 129, at C1.

156. King, *supra* note 149, at 13.

157. *Id.*

158. As an illustration of why this is the case, in March 2011, Bank of America wanted to modestly increase its dividend in the second half of 2011 to win the confidence of investors, but the Federal Reserve vetoed the plan. The next day, when the market as a whole edged higher, Bank of

Moynihan has gone on the record saying that Basel III requires "a lot more capital, but it doesn't fundamentally change the business that we have. . . . We'll get through adopting new rules five years ahead of when they're effective, when they first become effective, without the phase-in. We'll adopt them."[159]

As for the response to international efforts to solve the TBTF problem, most regulators have been outspoken in favor of tougher restraints on bank size while bank executives have vehemently opposed such restrictions. Despite U.S. officials' stated commitments to the contrary, in the aftermath of Global Financial Crisis, it is doubtful that the U.S. government would again let a SIFI fail as it did with Lehman Brothers.[160] Accordingly, proponents of strong financial regulation have advanced muscular strategies for dealing with the TBTF problem before it becomes a problem. According to Kansas City Federal Reserve President Thomas Hoenig, since large banks "are now more powerful and more of a threat to our capitalistic system than before the crisis," the best possible way of avoiding future bailouts of SIFIs is to break up the big banks by "expanding the Volcker Rule and significantly narrowing the scope of [banking] institutions. . . ."[161] In the United Kingdom, King has promoted splitting up very large banks to better manage stability in the global financial system and has even supported the elimination of fractional reserve banking, the traditional practice of banks taking in short-term deposits and lending most of them

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America shares dropped by 1.66 percent. Ben Protess & Eric Dash, *Fed's Clash with Bank of America Raises Questions*, N.Y. TIMES DEALBOOK (Mar. 23, 2011), http://dealbook.nytimes.com/2011/03/23/feds-clash-with-bank-of-america-raises-questions/.

159. Sara Lepro, *Moynihan's Challenge: Make B of A "More Real" to Customers*, AM. BANKER (Mar. 11, 2011), http://www.americanbanker.com/issues/176_48/bank-of-america-moynihan-1034240-1.html. *See* Lawrence Baxter, *Cheers for Bank of America's Brian Moynihan*, THE PARETO COMMONS (Mar. 11, 2011), http://www.theparetocommons.com/2011/03/cheers-for-bank-of-americas-brian-moynihan/ (contrasting Moynihan's response with the response of "many large bank CEOs [who] continue their predictable, self-interested Jeremiads against the post-Crisis regulatory constraints that international standards such as Basel III will impose").

160. *See* Andrew Ross Sorkin, TOO BIG TO FAIL 539 (Penguin 2009) (hinting that this is the case with statements such as: "Perhaps the economy would have crumbled anyway, but Lehman's failure clearly hastened its collapse").

161. Thomas Hoenig, *Financial Reform: Post Crisis?*, FEDERAL RESERVE BANK OF KANSAS CITY, 2 (Feb. 23, 2011), http://www.kansascityfed.org/publicat/speeches/hoenig-DC-Women-Housing-Finance-2-23-11.pdf. The Volcker Rule, which prohibits banks from sponsoring hedge funds or private equity funds, was created to prevent large banks from engaging in excessively risky behavior and expecting a government bailout in the event of failure. Bank Holding Company Act, 12 U.S.C. § 1851 (1956), *amended by* Dodd Frank Wall Street Reform and Protection Act, Pub. L. No. 111-203, § 619, 124 Stat. 1376 (2010).

out in riskier and longer-term loans, but Britain's government has been "fairly clear" that it does not want to break up Britain's largest firms.[162]

Unsurprisingly, the captains at the helms of the world's biggest banks have strongly opposed efforts to break up banks or tax them more heavily. Bob Diamond, CEO of U.K.-based Barclays, has staunchly defended the universal bank structure, which combines retail, commercial, and investment banking operations:

> There is no empirical evidence that big is bad—in fact, quite the opposite. Banks dependent on a single market or product can be a greater risk, as we saw with Northern Rock. By contrast, the global universal banking model . . . is well diversified by business and geography, well diversified by clients and products. And it should carry less risk, by virtue of that diversification, if it's well run.[163]

Diamond has contended that heavy taxes and attempts to break up big banks in the United Kingdom could "hamper out [banks'] role in supporting the U.K. economy."[164] He has even suggested that Barclays may have to relocate to the United States to escape the United Kingdom's burdensome financial regulatory system.[165] Critics note that leaders of the largest universal banks are motivated primarily by self-interest in their efforts to make their banks bigger.[166] In general, bank expansion has a correlative effect on CEO compensation, so statements made by CEOs in support of continuous bank expansion must be viewed with some skepticism.

Controversy over some aspects of the new capital and liquidity framework and reforms to the regulation of SIFIs is expected and does not diminish the success of the reform effort as a whole. Once national

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162. *King Plays God*, ECONOMIST NEWSBOOK (Oct. 26, 2010), http://www.economist.com/blogs/newsbook/2010/10/fixing_finance&fsrc=nwl.

163. Hugo Duncan, *Bob Diamond: Leave Big Banks Alone*, MAIL ONLINE (Oct. 25, 2010, 10:24 PM), http://www.dailymail.co.uk/money/article-1323727/Bob-Diamond-Leave-big-banks-alone.html#ixzz1J7tQClr9.

164. Louise Armitstead, *Barclays Chief Bob Diamond Says Bank Taxes Will Hit Recovery*, TELEGRAPH (Oct. 26, 2010, 6:00 AM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8086299/Barclays-chief-Bob-Diamond-says-bank-taxes-will-hit-recovery.html.

165. *See* Editorial, *Barclays: American Dream*, FIN. TIMES, (Mar. 31, 2011, 1:51 PM), http://www.ft.com/cms/s/3/5a0bf812-5b93-11e0-b965-00144feab49a.html#axzz1IZEAKLtD.

166. *See* Lawrence Baxter, *Traction at the Fed on the Problem of Large, Complex Financial Institutions*, THE PARETO COMMONS (Apr. 1, 2011), http://www.theparetocommons.com/2011/04/traction-at-the-fed-on-the-problem-of-large-complex-financial-institutions/ (noting that "the predominant opinion of experienced regulators and non-CEOs is that these large institutions are endangering financial stability without adding economic value (beyond their executives)").

regulators settle on standards that are relatively consistent with those in other countries, detractors will start to disappear, and banks will have no choice but to comply.

CONCLUSION

The Global Financial Crisis gave financial regulators a golden opportunity to achieve far-reaching, global consensus on critical regulatory matters. The G-20 and BCBS quickly adopted a non-legally binding—but practically binding—framework for the regulation of capital and liquidity. While detractors have noted certain weaknesses with the framework, there is little doubt that it will significantly reduce (but not eliminate) the potential for future crises by forcing banks to hold more high-quality capital reserves. National authorities are already beginning to integrate these Basel III requirements into domestic law.

Likewise, the G-20 and FSB policy initiatives with regard to SIFIs have engendered positive results at both the international and domestic level. The G-20 has repeatedly emphasized the importance of regulating SIFIs, and the FSB has backed it up with studies monitoring the progress of individual countries. These efforts have motivated most of the large countries with advanced economies to implement significant legal reforms to prevent banks from becoming too large and to manage the quick and effective resolution of failing institutions.

Since consistent regulation across borders is essential for preventing regulatory arbitrage, successful reform of international financial regulation requires that countries follow the guidelines created by technical experts at the FSB, BCBS, and other international standard setters. The G-20 has played a central role in coordinating the reform effort. It has set the agenda for reform, closely monitored the progress of international regulatory experts, created and endorsed policy recommendations, and provided the necessary political authority to stimulate and achieve globally consistent financial reform. But the work of the G-20 and other financial regulatory bodies is clearly not finished, and in order to retain their current influence they must continue to exert control over the reform process in a way that fosters international cooperation.

APPENDIX

Table 1: Phase-in Arrangements In Percentage Points (all dates are as of January 1)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Minimum Common Equity Capital Ratio			3.5	4.0	4.5	4.5	4.5	4.5	4.5
Capital Conserva-tion Buffer						.625	1.25	1.875	2.5
Minimum Tier 1 Capital			4.5	5.5	6	6	6	6	6
Minimum Total Capital			8	8	8	8	8	8	8
Minimum Total Capital Plus Conserva-tion Buffer			8	8	8	8.625	9.25	9.875	10.5

Table 2: Calibration of the Capital Framework Capital Requirements and Buffers In Percentage Points

	Common Equity (after deductions)	Tier 1 Capital	Total Capital
Minimum	4.5	6.0	8.0
Conservation buffer	2.5		
Minimum plus conservation buffer	7.0	8.5	10.5
Countercyclical buffer range	0-2.5		