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THE ROLE OF THE BANK FOR INTERNATIONAL SETTLEMENTS IN SHAPING THE WORLD FINANCIAL SYSTEM

CARL FELSENFELD* AND GENCI BILALI**

The Bank for International Settlements ("BIS") was set up in Basel, Switzerland in 1923 to handle remaining financial issues from World War II largely having to do with German reparation payments. It was the first of the semi-public international banks. Over the years its functions have changed and, largely since the late 1970's, it has served as the situs for the world's central banks and financial regulators to pool ideas and deal with international financial issues. A group of committees, composed largely of representatives of central bankers, now meets at BIS and has been issuing memoranda and drafts of regulations on a number of subjects affecting international banking. Among these are the regulation of capital, the management of international conglomerates, and problems resulting from electronic banking.

Problems in world banking have sensitized observers to the absence of coordinated regulation and to the need for some form of unified control. That there is a need for one international bank regulator is increasingly acknowledged. BIS comes closer than any other organization to fulfilling this function. The International Monetary Fund ("IMF") comes close but is too politicized and has been too involved in attempting to meet a continuing series of crises to do any long range thinking. Only BIS has attracted the intellectual resources to analyze and resolve international problems in a thoughtful and deliberate manner. Only BIS output is being adopted in the world's banking centers.

BIS has been proposed as a world senior financial regulator. This article acknowledges the rationale for such a decision but argues that now is not the time for such an attempt. Banking is, of course, conducted locally even though its reach is international. To anoint any body as a senior regulator with the power to impose rules would require massive compromises among national regulators to achieve one central set of rules. It

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would also involve an abdication of measures of sovereignty by the constituent states. An effort of this kind would risk destroying the whole concept. Rather than start such a bold stroke at such an inopportune time, this Article argues that the international banking world would fare far better assisting BIS to proceed down the current track. As it continues to mature, and as its edicts are increasingly accepted throughout the world it will continue to approach its rightful place as the world's bank regulator.

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1. INTRODUCTION

Negotiations to create BIS, the oldest of the large international banks, began in Paris in 1929.¹ It was perceived then as an institution very different from today's reconstituted BIS. In 1932, when the institution was less than three years old, a book about BIS began:

In March 1929, almost to a day two hundred years after the

¹ THE BANK FOR INTERNATIONAL SETTLEMENTS AND THE BASLE MEETINGS 9 (Margaret Horne et al., trans. 1980) [hereinafter BIS AND THE BASLE MEETINGS].

death of John Law, and within a few hundred yards of the scene of his activities, the scheme of a bold experiment, worthy of the genius of that financier, was elaborated in Paris by a body of distinguished experts. It was pregnant with immense possibilities, but also with great dangers. It was as ambitious and as perilous as was John Law's scheme for a bank of issue in the less advanced conditions of eighteenth-century France.

The world was taken by surprise when it was announced that the Committee of Experts on Reparations had decided to propose the establishment of an International Bank. The novelty and boldness of the idea appeared fascinating to some people, bewildering to others.

...

The Bank for International Settlements is not designed as a superior authority over central banks No legal or political power, but the recognition of the necessity to co-operate and the development of a strong public feeling against the disturbers of harmony are the main factors which . . . [BIS depends on] for its existence.²

In 2002, as a testament to its growth and development, it was written: "The BIS is without a peer in what it has accomplished."³

As further tribute to BIS's success, some seventy years after its creation, the world financial system and BIS itself had sufficiently evolved so that the bank with, "no legal or political power"⁴ was nominated, "to perform in the domain of world financial markets what national regulators do in domestic markets."⁵ It is the goal of this article to trace that evolution and show how BIS—and, as we shall soon see, its affiliates in Basel,⁶ Switzerland—won that nomination.⁷ We will also recommend that efforts to appoint it/them

² PAUL EINZIG, *THE BANK FOR INTERNATIONAL SETTLEMENTS* 1, 4-5 (3d ed. 1932).

³ JAMES C. BAKER, *THE BANK FOR INTERNATIONAL SETTLEMENTS: EVOLUTION AND EVALUATION*, at xii (2002).

⁴ *Id.* at 5.

⁵ JOHN EATWELL & LANCE TAYLOR, *GLOBAL FINANCE AT RISK*, at x (2000).

⁶ We intend to use the American style spelling of the city where BIS is located, "Basel." Europeans and other countries commonly spell it as "Basle."

⁷ As we will soon see *infra* Section 3, it may be the Bank for International Set-

the supreme international regulator not be pursued. While we believe that there is a legitimate need for this office, we do not believe that BIS or its affiliated organizations should be supported for this role – at least not now.

BIS functioned as a significant part of the world's banking systems from its dubious creation in 1929 to its position as nominee for the world's senior financial regulator in 2000. From the start, modesty was not BIS's prime virtue. It perceived itself as a major cog in the international financial system. In 1931 it assisted in the control of an international monetary crisis that was marked by massive withdrawals of capital from the worst hit countries. The Great Depression of the 1930's saw BIS involved with such major issues as the proper place for exchange controls and the function of the gold standard in dealing with international dislocations. BIS participated in the discussion of stabilization efforts at the 1933 London Monetary and Economic Conference and had contributed to their partial inclusion in the Tripartite Agreement among the United States, England, and France in 1936.⁸

The worsening of the political situation in Europe in the late 1930's prevented further initiatives: World War II temporarily ended the role of BIS in international regulatory activities, although it achieved a unique place in a world at war in both financial dealings and reporting. Upon the end of the war, concepts for a new world financial order were largely concentrated in the Bretton Woods Conference held in New Hampshire, July 1944. It was generally assumed that international financial affairs would be centered in the newly-created IMF, which was to be based in Washington, D.C., far from BIS. The Bretton Woods final declaration consequently contained a resolution that BIS be liquidated.⁹

The resolution was never carried out because BIS almost immediately assumed a central role in the post-war international payment systems. BIS was, and is, a bank and from its creation it performed the functions of a bank. The principal reason for its

tlements ("BIS") and it may be the Committee on Banking Supervision established at BIS that is in reality the candidate for this global role. See EATWELL & TAYLOR, *supra* note 5, at x. (speaking of "the foundations of global financial surveillance and regulation that have already been laid at the Bank for International Settlements in Basle").

⁸ HENRY H. SCHLOSS, *THE BANK FOR INTERNATIONAL SETTLEMENTS: AN EXPERIMENT IN CENTRAL BANK COOPERATION* 6, 83 (1958).

⁹ See BAKER, *supra* note 3, at 7 (describing the attempts made to "abolish BIS").

creation was the German reparations issue and it assisted—in part as a direct lender to Germany—in providing the funds for those payments. It also acted as a depository bank, for countries that received reparations and suddenly had surplus reserves and also as a general depository entirely apart from reparations. Within a year after its creation, BIS had just under 1,800 million gold francs in deposits, of which 800 million were unconnected with reparation payments.¹⁰

BIS also served a regulatory/supervisory function by providing a forum for the world's central banks in their efforts to effectuate, first, the goals of Bretton Woods, and later, in their bank management functions. BIS was not created to be a central bank, but a bank for central banks.¹¹ The dominant function of central banks has always been fiscal control, oversight of the money supply. Whether central banks should simultaneously act as a regulator of the local banking system has been and continues to be a bone of contention with different countries going in different directions. A recent article surveys thirty countries and concludes that nine give their central banks regulatory responsibilities and twenty-one do not.¹² Clearly, the United States has taken a strong pro-regulatory position since its Federal Reserve System ("FRS," the U.S. central bank) regulates a major share of the American financial system including national banks and all bank holding companies. England has gone the other way. The Central Bank of England performed regulatory functions until 1977 when those responsibilities were given to the newly formed Securities and Investment Board (now the Financial Services Authority, "FSA"). Therefore, it was not unnatural that BIS should drift into regulatory activities.

BIS's Bretton Woods' work after World War II led, in turn, to the reconstruction of the European economy and ongoing attempts to remove trade and foreign exchange barriers within Western Europe. The most significant outcome of these developments was

¹⁰ See SCHLOSS, *supra* note 8, at 57, 77-78, 85 (discussing the purpose of BIS's creation).

¹¹ In 2000, BIS had forty-nine central bank members; at the June 2000 Annual Meeting in Basel, ninety-nine central banks attended with governors from seventy-six central banks. See Bank for Int'l Settlements, *Profile* (June 2000), at 9 (providing a general profile of BIS), available at <http://www.bis.org/about/profil2000.pdf>; see also BAKER, *supra* note 3, at 240 (discussing the criticisms and praise of BIS).

¹² Heidi Mandanis Schooner, *The Role of Central Banks in Bank Supervision in The United States and The United Kingdom*, 28 BROOK. J. INT'L. L. 411, 417-422, fig.1 (2003).

the creation in 1950 of the eminently successful European Payments Union ("EPU"), with BIS as a core participant in its planning. The major objective of EPU was to eliminate payment barriers within Europe and enable full transferability as an adjunct to the creation of free trade. Within the operation of the new EPU, surpluses and deficits among trading partners were largely netted and settled in terms of net credits. This meant that, compared to the earlier trading system, comparatively little had to be settled in the international media of dollars and gold. Gradually, full dollar settlement was made possible, and full convertibility became a reality not only within Europe, but the United States as well. BIS was the agency chosen as the central clearing house for this new and complex system.

The 1960's and early 1970's were periods of serious turmoil in the international financial markets. Among key events was the collapse of the Bretton Woods fixed exchange system that could not accommodate the needs of international trade. In its place there developed a system known as "managed floating," which recognized acceptable exchange rates but permitted their flexibility within certain bands. Difficulties were compounded by the creation of the Organization of Petroleum Exporting Countries ("OPEC") and the resulting worldwide rise in oil prices accompanied by new and unprecedented financial surpluses in the middle eastern oil producing countries. These had to be recycled, a process that required the cooperation of the IMF, the major international banks, and BIS. It was only the existence and efficiency of a suitable international market that made this possible and it was through BIS that the world's central banks were able to communicate.

Increasingly during its decades of growth, the banking activities of BIS meshed with its evolving function as international bank regulator. It was initially perceived as a place where central banks could conveniently meet and share their problems. As a bank, however, it also actively participated in solving those problems. For example, BIS was itself a borrower; it received money both in the form of deposits and as direct loans from institutions with surplus funds.¹³ When informed by central banks that a local bank was overly liquid, BIS would arrange to borrow from that institution, i.e., "to siphon off liquidity viewed as excessive by the central

¹³ BIS received both deposits and loans from oil-producing countries who benefited from rises in oil prices.

bank concerned."¹⁴ In its various contacts with the central banks, BIS was never far from a role as bank regulator.

At the end of 1974, BIS participated in an act that turned out to be its most consequential step in the direction of international bank regulation: it cooperated with the central bank governors of the Group of Ten countries (the "G-10" countries) and Switzerland to set up what was originally called the Committee on Banking Regulation and Supervisory Practices, and is now known as the Committee on Banking Supervision (the "CBS"). As will be discussed below,¹⁵ the CBS is not formally a unit of BIS, although it functions and is widely accepted as one. The creation of the CBS was the result of a continuing association of central banks on the international stage and, more near-term, from a series of international banking disturbances including: the fourfold increase in petroleum prices; a wide fluctuation in interest rates that reached record highs in mid-1974; an international depression that deepened in 1974; the removal in January 1974 of U.S. controls on capital outflows; and the Herstatt Bank failure that is still cited to illustrate systemic bank risks.¹⁶

BIS, the CBS, and various related committees, such as the Joint Forum, that will be dealt with together in Section 3, form a kind of amorphous international conglomerate of bank regulators. When BIS and/or the other groups are mentioned as a potential world financial authority, it is really this body that is being referenced. We will at appropriate times single out the particular committee that is at work on a particular project and, to some degree, accuracy is enhanced in this way. At the same time, we see the forest better if we do not peddle the trees and deal with the group as a whole. If a world regulator is ultimately appointed, it will be distilled from this entire group and we are in fact seeing things correctly when we consider international bank regulation as the task of this group. The group has evolved in a consistent manner.

At its formation in 1974, the CBS did not attempt to regulate international banking. Rather, it attended to "broad supervisory standards and guidelines."¹⁷ Peter Cooke, Director of Supervision

¹⁴ BIS AND THE BASLE MEETINGS, *supra* note 1, at 35.

¹⁵ See *infra* text surrounding note 115 (discussing the role of BIS as "secretariat" for other committees).

¹⁶ All of these events are mentioned in Board of Governors of the Federal Reserve System, *Developments in International Financial Markets*, 61 FED. RES. BULL. 605, 605-15 (1975).

¹⁷ Bank for International Settlements, *The Basel Committee on Banking Supervi-*

of the Bank of England, and in 1984 the chairman of the CBS, described its role at that time as follows:

The committee does not undertake a formal supernatural supervisory role [I]t formulates and recommends broad supervisory principles and guidelines of best practices in the hope and 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.¹⁸

A marked change occurred in 1988 when CBS issued the Basel Accord on Capital Adequacy (the "Basel Capital Accord").¹⁹

[T]he capital agreement marked a quantum jump for the Committee's role as a joint decisionmaking body. Previously, the Committee's role had been largely a forum for the exchange of information, and a place where supervisors could learn from each other and develop codes of best practice.

. . . [T]he capital agreement went much further. . . . Although not legally enforceable as a treaty, and although the Committee is not a formally constituted international organization, nonetheless the agreement is considered to be binding on the members and the agreement itself states that the Committee will continually monitor its application.²⁰

The CBS's stature as an international bank regulator was enhanced in 1991, three years after it issued the Basel Capital Accord, by the appointment of Gerald Corrigan, President of the Federal Reserve Bank of New York, as its chairman. The Financial Times described Mr. Corrigan as, "the leading US spokesman on supervision issues" and confirmed that his appointment "will add consid-

sion, at <http://www.bis.org/bcbs/aboutbcbs.htm> (last visited Oct. 15, 2004).

¹⁸ Joseph J. Norton, *Capital Adequacy Standards: A Legitimate Regulatory Concern for Prudential Supervision of Banking Activities?*, 49 OHIO ST. L.J. 1299, 1337 (1989).

¹⁹ See *infra* Section 3 (discussing the goal of the Basel Capital Accord and the subsequent amendments to the document).

²⁰ Peter C. Hayward, *Prospects for International Cooperation by Bank Supervisors*, 24 INT'L LAW. 787, 790-91 (1990).

erable stature to [the CBS]."²¹ The selection not only added generally to the stature of the CBS but highlighted its role as a nascent international bank regulator.²²

The life of BIS and its related companies can be divided into four phases:

1. From its creation to 1988, it undertook banking functions and opined generally on the international banking system.
2. Starting in 1988, it began to assume the role of an unofficial international bank regulator. Although it had no official international status, its members—central banks of the major banking countries—were obligated by the nature of their membership to abide by its edicts and the rest of the world took them seriously.
3. Starting in the late 1990's, it began to consider itself the equivalent of an international bank regulator. Every subject of significance was within its jurisdiction and, although its legal powers were no greater, it assumed that it had a right to make rules for local banks to observe in the conduct of their businesses.
4. There is widespread anticipation that at sometime in the future a treaty mechanism will give it the power to enforce its rules internationally.

Section 2 of this article gives a larger picture of BIS and its place in the international banking system. Section 3 describes the place of BIS, largely through the CBS, in bank regulation, the operation that led to the consideration of BIS/CBS as the international bank regulator. In Section 4 it is shown that the role of bank regulator is being assumed by BIS/the CBS through the major banking systems

²¹ David Lascelles, *NY Fed Chief to Head International Banking Watchdog*, FIN. TIMES, July 9, 1991, at 18.

²² See generally CARTER H. GOLEMBE, *The Basle Committee and the Regulation of U.S. Banks*, in THE GOLEMBE REPORTS 162 (1992) (discussing the Basle Committee's emerging role as a regulatory body). Mr. Golembe writes:

We can only guess at who all of the players were and what motivated them. My guess is that when that story is finally written it will turn out that the U.S. regulators played a major role in boot-strapping the Basle Committee to its present position of eminence, probably with a great deal of assistance from the Bank of England. And among the U.S. agencies, the Federal Reserve Board probably deserves the most credit or blame, depending upon one's assessment of what has been accomplished.

Id. at 172-73.

of the world adopting its proposals. Section 5 describes the international banking system and the needs for a senior regulator, and Section 6 presents the arguments that make BIS/the CBS a logical candidate for that position. Section 7 gives the authors' position that BIS/the CBS should not now be formally nominated for the senior regulator position. A summary of this article and its conclusions are in Section 8.

2. PROFILE OF BIS

Today, BIS stands as the world's oldest international financial institution, remaining as the principal center for maintaining stability in the international central banking cooperation among central banks.²³

BIS was formally created on January 20, 1930, at the Hague Conference ("Hague Convention of 1930") with the main purpose of implementing Germany's reparation (settlement) payments to victorious Allied nations.²⁴ The newly established bank was to take over the functions previously performed by the Agent General for Reparations in Berlin, Germany, which included collection, administration and distribution of the annuities payable as reparations. This is also why the bank was named as a bank "for international settlements."²⁵

The reparation payments were to be paid into BIS in German currency and would serve as collateral for a hard-currency bond issue to be provided by the French government. Nothing came of the bond issue because the 1929 Great Depression in the United States had such an impact on the world economy before BIS commenced its activity.

In addition to its role in Germany's reparation payments, BIS was also created to act as a trustee for international loans issued to finance reparations (often called "Young Plan" or "Dawes Plan"), to promote central bank cooperation and to facilitate operations of international financial activities.²⁶ Exactly how BIS founders were

²³ For more information about BIS, see Bank for International Settlements, *About BIS*, at <http://www.bis.org/about/index.htm> (last visited Sept. 2, 2004).

²⁴ Convention respecting the Bank for International Settlements, Jan. 20, 1930, 104 L.N.T.S. 441 [hereinafter *Hague Convention of 1930*], available at http://www.bis.org/about/convention.htm#P21_2653 (last visited Oct. 4, 2004).

²⁵ See BAKER, *supra* note 3, at 2 (detailing the formation of BIS after World War II).

²⁶ See *id.* at xi-xii (describing how BIS has formulated rules and proposals in the area of international banking).

to promote central bank cooperation was unclear at the time. Nevertheless, the financial crises of the late 1920's and early 1930's may have led central bankers to believe that a central financial institution was required to coordinate efforts of central bankers and financial regulatory authorities in preventing future financial crises.

Basel, a city located in Switzerland, was chosen as the bank's headquarters.²⁷ In addition, the bank had two representative offices, one located in the Hong Kong Special Administrative Region of the People's Republic of China,²⁸ and the other in Mexico City,²⁹ which facilitate the bank's operational activities for Asia and the Pacific, as well as for the Americas, respectively.³⁰ The bank was initially funded by the central banks of its founding countries: France, Germany, Belgium, Italy, Japan,³¹ and the United Kingdom.

BIS was created as a commercial bank and adopted the legal structure of a Swiss limited company with publicly held shares. BIS is subject to neither Swiss banking nor corporate laws. The bank's immunity from Swiss government interference and taxes in both peace and war was guaranteed by the Hague Convention of 1930, which established BIS as an international organization governed by international law with the privileges and immunities necessary for the performance of its role.³²

²⁷ Switzerland may have been chosen because of its tradition as a neutral country.

²⁸ See Host Country Agreement Between the Bank for International Settlements and the Government of the People's Republic of China Relating to the Establishment and Status of a Representative Office of the Bank for International Settlements in the Hong Kong Special Administrative Region of the People's Republic of China, May 11, 1998, BIS-P.R.C., BIS Basic Texts 2003, art. 1 (establishing a BIS branch in Hong Kong), available at <http://www.bis.org/about/hostcryhk.pdf>.

²⁹ See Host Country Agreement Between the Bank for International Settlements and the United Mexican States Relating to the Establishment and Status of a Representative Office of the Bank for International Settlements in Mexico, Nov. 5, 2001, BIS-Mex., art. 2, BIS Basic Texts 2003 (establishing a BIS branch in Mexico), available at <http://www.bis.org/about/hostcrymx.htm>.

³⁰ The bank has not yet established any representative office for Africa or the Middle East. Regardless of the bank's failure to establish its presence in these regions, some central banks there have already started to implement the bank's directives.

³¹ See Hague Convention of 1930, *supra* note 24, n.2 ("Based on an announcement made by the Swiss government on December 26, 1952, Japan renounced all rights, titles and interests under the Convention.").

³² See *id.* art. 1 ("Switzerland undertakes to grant to the Bank for International Settlements . . . the following Constituent Charter having force of law . . .").

The international legal personality of BIS and the privileges and immunities which it has enjoyed in Switzerland since its founding were also "reconfirmed" in other documents such as the Brussels Protocol of July 30, 1936³³ and the Headquarters Agreement entered between BIS and the Swiss government on February 10, 1987.³⁴ It is apparent from these documents that BIS has a legal status in Switzerland similar to that accorded to the many other international organizations which have been established there since 1930.

BIS's first annual report disclosed its total assets as of March 31, 1931 to be 1,901,148,912.91 in Swiss gold francs.³⁵ Today the gold franc of BIS weights just over 0.29 grams, identical with the gold parity of the Swiss franc at the time of BIS's founding in 1930. In September 1936, by which time a number of leading countries had left the gold standard, the gold parity of the Swiss franc was suspended. BIS employs the gold franc solely for balance sheet purposes in order to convert assets and liabilities expressed in U.S. dollars ("USD") into gold francs at the fixed rate of USD208 per ounce of fine gold (equivalent to 1 gold franc = USD1.94). All other currencies are converted into gold francs based on their market rates against the USD.³⁶

When BIS's initial capital was raised, the subscribing institutions were given the option of taking up the whole of their allocated shares or arranging for those shares to be subscribed to by the public. As a result, part of the Belgian and French issues and the whole of the American issue are not held by the institutions to which they were originally allocated. In all, some eighty-six percent of BIS issued share capital is registered in the names of central banks; the remaining fourteen percent is held by private shareholders. While all shares carry equal rights with respect to the annual dividend, private shareholders have no right to attend or vote at the annual BIS General Meetings. All rights of voting and repre-

³³ Protocol Regarding the Immunities of the Bank for International Settlements, July 30, 1936, art. 1, 197 L.N.T.S. 31, 33-34, available at <http://www.bis.org/about/protoc.pdf>.

³⁴ See Agreement between the Swiss Federal Council and the Bank for International Settlements to determine the Bank's legal status in Switzerland, Feb 10, 1987, BIS-Switz., art. 1, BIS Basic Texts 2003, (acknowledging the international legal status of BIS), available at <http://www.bis.org/about/headquart-en.pdf>.

³⁵ See BAKER, *supra* note 3, at 15 (summarizing the changes in the conversion of assets held by BIS in gold francs from a variable to a fixed rate).

³⁶ *Id.*

sentation are reserved for the central bank of the country in which the relevant national issue of shares was initially subscribed.³⁷

As of March 31, 2003, BIS balance sheet showed total assets of 92.8 billion gold francs, with capital and reserves of 5.5 billion gold francs.³⁸ These assets are held in gold, cash, treasury bills, time deposits and advances in currencies, securities purchased under resale agreements, government and other securities at term, land or buildings and equipment, and other miscellaneous assets.³⁹ In terms of the market price of gold at that time, BIS total assets were USD180 billion and its capital and reserves amounted to USD10.6 billion.⁴⁰ Regardless of these numbers, the true value of the bank is uncertain. There could be other assets, such as tracts of valuable land around Basel, which do not appear on BIS's balance sheet.⁴¹

A majority of BIS shareholders and members are still the central banks (comprising almost eighty-six percent of the bank's issued shares capital) that originally purchased its shares, and the remains of the original U.S. bank syndicate. Several central banks, including those of France, Belgium and Denmark, along with the U.S. syndicate of private banks, have sold substantial portions of their holdings to the public. However, only central banks can vote.⁴² The private shareholders do not have a right to attend, or to vote at BIS General Meetings.

Although all its depositors are central banks, BIS has consistently operated at a profit and therefore has not required a subsidy or aid from any government. Moreover, since BIS provided a safe and convenient depository for the gold holdings of the European central banks, it swiftly became the bank used by central banks.

³⁷ See generally Kristin K. Howell, *Regional and International Cooperation and Monetary Stability: The Roles of the International Monetary Fund and the Bank for International Settlements*, 39 RIVISTA INTERNAZIONALE DI SCIENZE ECONOMICHE E COMMERCIALI, No. 10-11, at 833-48 (1992) (describing the different roles of the IMF and BIS in promoting international trade).

³⁸ BANK OF INT'L SETTLEMENTS, *Balance Sheet at 31 March 2003*, in 2003 ANNUAL REPORT 73, 181, 182-85 (2003), available at <http://www.bis.org/banking/e-balancesheet.pdf>.

³⁹ *Id.* at 182.

⁴⁰ "The exchange rate used at that date was 1 gold franc = US \$ 1.94 and the price of gold used for these calculations was a fixed rate of US \$208 per ounce of fine gold." BAKER, *supra* note 3, at 15.

⁴¹ See BAKER, *supra* note 3, at ch. 1.

⁴² Federal Reserve Bank of New York, *Bank for International Settlements*, FEDPOINTS, at <http://www.ny.frb.org/aboutthefed/fedpoint/fed22.html> (last visited Oct. 8, 2004).

The 1930's had increasing number of financial panics in Europe, and a worsening depression in the United States. As a result the governors in charge of major central banks were concerned that the international financial system would not survive the increased economic pressures unless they closely coordinated their rescue efforts: "[t]he obvious meeting spot for this desperately needed coordination was BIS, where they regularly went . . . to arrange gold swap settlements."⁴³

BIS's central mission of reparations payments concluded sometime around 1932.

During World War II, when nations battled, their central banks maintained business activities. BIS was thus able to continue operating in Basel, though monthly meetings were temporarily suspended. At the Bretton Woods Conference in 1944, the U.S. government supported calling for the liquidation of BIS. This resolution followed Czech accusations that BIS had laundered money stolen by the Nazis during World War II. The notion, naïve as it was, was that the new international financial institution, the IMF, could replace BIS in its settlement and money-clearing functions. Although the Bretton Woods Conference considered liquidation of BIS, it did not make any decision on its fate.⁴⁴

The IMF could not replace BIS because BIS was more than an international clearing house. BIS was, "a supranational organization for setting and implementing global monetary strategy."⁴⁵ These leadership positions simply could not be accomplished by a democratic international agency similar to the United Nations ("UN"). The central bankers, not about to let their club be snatched away from them, quietly let the U.S. resolution die. Instead of "going out of business," BIS gained more authority, particularly in arranging financial transactions to preserve the stability of international financial markets.⁴⁶

⁴³ Edward J. Epstein, *Ruling the World of Money*, 267 HARPER'S MAGAZINE 43, 44 (1983).

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ The BIS, besides ensuring its survival, also maintained its original name, the Bank for International Settlements, although the mission of the German settlement payments process had ended. Perhaps this was a tactical strategy designed to give the international community an impression that the bank was still facilitating its settlement payments function, and therefore avoiding any protest from the international community, already sensitive to the bank's murky transactions during the Nazi period.

So, BIS re-emerged as the main clearing house for European currencies and, behind the scenes, as the favored meeting place of central bankers. When the USD came under attack in the 1960's, massive swaps of money and gold were arranged at BIS to bolster the USD. It was ironic that, as the then president of BIS observed, "[t]he United States, which had wanted to kill BIS, suddenly finds it indispensable."⁴⁷

"Since 1930, central bank cooperation at BIS has taken place through regular meetings in Basel of central bank Governors and experts from central banks and other [national financial regulatory] agencies."⁴⁸ In support, BIS develops its own research in financial and monetary economics, and makes important contributions to the collection, compilation, and dissemination of economic and financial statistics.⁴⁹

When necessary, BIS has also provided or organized emergency financing to support the international monetary system: "[d]uring the 1931-33 financial crisis, BIS organised support credits for both the Austrian and German central banks. In the 1960's, BIS arranged special support credits for the Italian lira (1964) and the French franc (1968), and two so-called Group Arrangements (1966 and 1968) to support [the British] sterling."⁵⁰

Following World War II until the early 1970's, BIS monetary policy focused on implementing and defending the Bretton Woods system. The focus shifted over following two decades to managing cross-border capital flow transactions. This shift followed the oil crisis and then the international debt crisis of that time. More recently, BIS provided finance to the stabilization programs the IMF led for the default loans of Mexico in 1982 and Brazil in 1998, and in the Asian crisis in 1997, and more.⁵¹

All the above crises, as well as the issue of financial stability in the wake of economic integration and globalization, have received considerable attention in the international banking community. This has brought the issue of regulatory supervision of internationally active banks to the attention of BIS, which resulted in the

⁴⁷ See Epstein, *supra* note 43, at 44 (describing how BIS controls the monetary activities of the free world).

⁴⁸ Bank for International Settlements, *BIS History* (June 2003) [hereinafter *BIS History*], available at <http://www.bis.org/about/history.htm#para9> (last visited Sept. 16, 2004).

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

Basel Capital Accord⁵² and its revision in 2004, Basel II.⁵³

Apart from fostering monetary policy cooperation, BIS has always performed "traditional" banking functions for the central bank community (for example, gold and foreign exchange transactions), as well as serving trustee and agency functions. BIS was the agent for the EPU between 1950 and 1958, providing assistance in restoring the convertibility of European currencies after World War II. Similarly, BIS acted as the agent for various European exchange rate arrangements, including the European Monetary System between 1979 and 1994, which preceded the move to a single currency, the euro.⁵⁴

Even though an isolationist U.S. Congress officially refused to allow the U.S. Federal Reserve Board (the "FRB") to participate in BIS or to accept shares in it (which were instead held in trust by the First National City Bank), the chairman of the FRB quietly and frequently attended important meetings at BIS's headquarters.⁵⁵ Evidently, world monetary policy was too important for the chairman to leave to national politicians.

The fact that the first president appointed to BIS (1930-1935) was an American banker, Gates W. McGarrah (formerly of Chase National Bank & the U.S. Federal Reserve Bank), shows that by 1930, the United States was a financial force on the international scene.⁵⁶

In the 1940-1946 period, the BIS Board of Directors (the

⁵² See Basel Comm. On Banking Supervision, *International Convergence of Capital Measurements and Capital Standards* (July 1988) [hereinafter *Basel Capital Accord*] (presenting, "the outcome of the [BIS] Committee's work . . . to secure international convergence of supervisory regulations governing the capital adequacy of international banks"), available at <http://www.bis.org/publ/bcbs04A.pdf> (last visited Sept. 16, 2004).

⁵³ See Basel Comm. On Banking Supervision, *Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework* (June 2004) [hereinafter *Basel II*] (setting "out the details of the agreed Framework for measuring capital adequacy and the minimum standard to be achieved" as agreed by the national supervisory authorities represented on the Committee), available at <http://www.bis.org/publ/bcbs107.htm> (last visited Sept. 16, 2004).

⁵⁴ *BIS History*, *supra* note 48.

⁵⁵ The Federal Reserve Board ("FRB") has become a leading member of BIS, before and after its formal representation in BIS Board of Directors in 1994. Either then Chairman Paul Volcker or Governor Henry Wallich attended almost every "Basel weekend" meeting.

⁵⁶ See ANTHONY SAMPSON, *THE MONEY LENDERS: BANKERS AND A WORLD IN TURMOIL* 45 (1981) (detailing the history of banking with emphasis on post-World War II international banking development).

"Board") elected another American banker, Thomas H. McKittrick, as president of BIS, and at its General Meetings it has consistently appointed a New York bank to exercise the voting rights carried by the shares of the American issue. In addition, close personal contact is regularly maintained between BIS principal officials and the FRB officers. The Federal Reserve Bank of New York is the BIS correspondent to the U.S. market.⁵⁷

No American official served as a director or alternate director of BIS until 1994.⁵⁸ Then, at its General Meeting on July 12, 1994, the Board took note of, and welcomed, the intention of the FRB to occupy the two seats on the Board, which the FRB had been entitled to since 1930. An Extraordinary General Meeting of BIS was convened on September 13, 1994 to approve a minor change in the bank's statutes, taking account of the evolution of the FRB. Subsequently, on September 13, 1994, Alan Greenspan, Chairman of the FRB, became an ex-officio member of the Board. The Board also appointed William J. McDonough, then President of the Federal Reserve Bank of New York, as a member of the Board for a period of three years beginning September 13, 1994.⁵⁹

The fact that the FRB formally joined BIS went almost unnoticed in the U.S. banking and financial community, with the exception of a few dozen U.S. banking experts. There were no U.S. Congressional hearings, nor was there a public statement by the U.S. President or Secretary of State. Not until 1995, almost a year later, did the *New York Times* report that the FRB had "joined" BIS, which was, interestingly enough, characterized as an "obscure global bank [that] move[d] into the light."⁶⁰

Since its inception, the relationships between BIS and European central bankers have gradually developed to the extent that sometimes the bank is regarded as a "European" bank. Until 1994, BIS did function as the principal organization for cooperation among

⁵⁷ See generally Charles J. Siegan, *The Bank for International Settlements and the Federal Reserve*, 80 FED. RES. BULL. 900 (1994) (describing the Federal Reserve's relationship with BIS).

⁵⁸ See BANK FOR INT'L SETTLEMENTS, 65TH ANNUAL REPORT 205-06 (65th ed. 1995) (listing changes in the Board of Directors (the "Board") and Management in the fiscal year ending March 31, 1995).

⁵⁹ See Reginald H. Howe, *The BIS and Greenspan: Freezing-Out the U.S. Constitution* (Oct. 27, 2000) (discussing BIS's planned freeze-out of private shareholders), available at <http://www.golensextant.com/BIS.html> (last visited Sept. 1, 2004).

⁶⁰ See Keith Bradsher, *Obscure Global Bank Moves Into the Light*, N.Y. TIMES, Aug. 5, 1995, Business, at 1 (reporting on the emergency of BIS into the public's consciousness).

Europe's major central banks, of which several were and continue to remain friendly toward gold. But, with the signing of the Treaty establishing a European Union in 1992,⁶¹ and the creation of the European Monetary Institute ("EMI") in 1994, a predecessor organization to the European Central Bank, BIS has faced the prospect of playing a rapidly reducing role in European monetary affairs.⁶²

Observers feared that the creation of a unified European financial institution would jeopardize the future role of BIS. However, BIS was quick to assure bankers otherwise. For example, in 1994, when Baron Alexandre Lamfalussy resigned from his post as General Manager of BIS in order to become head of the EMI, his replacement, Andrew Crockett, said that he, "did not foresee the EMI . . . impinging on the work of the Basel-based BIS, which is widely regarded as the central bankers' central bank . . ."⁶³ Mr. Crockett further added that, "the EMI would enable BIS to refocus on global issues and develop its role as a forum for collaboration between central banks in the monetary and regulatory fields."⁶⁴

It may have been a coincidence, perhaps a well-coordinated step, that at the same time BIS's role in European monetary affairs was diminishing because European central bankers were focusing on the creation of a European Central Bank, the FRB decided to join BIS. The FRB may have felt that it was the right time to fill the vacuum.

Since its inception, BIS established a remarkable pattern of secrecy. Central bankers sought complete anonymity in their activities. They comprised BIS membership and met monthly to discuss matters of relevance to economic and banking policy. The success of the organization depended on the secrecy of its meetings and the trust created among central bankers through their discussions at their frequent meetings.

Central bankers paid particular attention in finding a discreet location for the head-offices of BIS. Upon careful review of various

⁶¹ Treaty on European Union, Feb. 7, 1992, O.J. (C 191) 1, 31 I.L.M. 253 (treaty establishing a European Union).

⁶² See generally *Economic and Monetary Union* ("EMU") (describing the three stages to the Economic and Monetary Union), available at <http://www.ecb.int/ecb/history/emu/html/index.en.html> (last visited Sept. 16, 2004).

⁶³ See Colin Narbrough, *France Demands Action to Stabilise Currencies*, THE TIMES (LONDON), Nov. 10, 1993, at 24 (mentioning Crockett's ascension to General Manager of BIS).

⁶⁴ *Id.*

locations, the central bankers chose an abandoned building (formerly a hotel named "Grand Hotel et Savoy Hotel Univers"),⁶⁵ as well as premises above the adjacent candy store (known as Frey's Chocolate Shop).⁶⁶ The central bankers decided not to put a sign on the premises in order to disguise the activity of BIS inside such premises. Even central bankers and guests visiting BIS were led through the entrance to Frey's shop, which was conveniently located near the railroad station of Basel. If the walls within BIS's premises could talk, they would reveal discussions and decisions made by the central bankers on issues of devaluation or defending of currencies, fixing the price of gold, regulation of off-shore banking, raising or lowering interest rates, etc. The central bankers also purposely left the public-at-large unaware of BIS's role and activities in shaping of international banking and financial system.⁶⁷

With time, central bankers saw a need to relax their sense of closeness and anonymity in conducting the business of BIS. The first sign of openness was seen in May 1997, when the central bankers decided to relocate BIS. The new headquarters was located in an eighteen story circular skyscraper in center of Basel. This building, which is called the Tower of Basel, has become a well-known historic landmark in Basel, attracting numerous visitors and tourists from all over the world. However, some central bankers grew uncomfortable and concerned with the increase of tourism to BIS's premises. Some of the central bankers openly expressed their feelings. For example, Dr. Fritz Leutwiler, former president of BIS, said "[t]hat [attention] was the last thing we wanted." In expressing his discontent with moving to the "Basel Tower," Dr. Leutwiler added that, "[i]f it had been up to me, it never would have been built [here]."⁶⁸

Inside the walls of Basel Tower, BIS's central bank members and staff are surrounded by deluxe accommodations and efficient

⁶⁵ The building, which was formerly the *Grand Hotel et Savoy Hotel Univers* at Centralbahnstrasse 7, Basel, and a series of adjacent buildings taken over either wholly or partially, was where the Bank had its seat from 1930 until 1977.

⁶⁶ Epstein, *supra* note 43. The BIS purchased a new office building constructed at Centralbahnplatz 2, Basel, and moved in 1977. Additionally, the Bank built a sports center in Kreuzackerweg, Bottmingen, (Canton of Baselland) which was inaugurated in 1972.

⁶⁷ See BIS AND THE BASLE MEETINGS, *supra* note 1, at 59 (describing how the exchange of views among central-bank economists "tend to be extremely frank" because of the confidential nature of these meetings).

⁶⁸ Epstein, *supra* note 43, at 45.

services. Those who work in the Basel Tower live in their own "world" with central heating, air-conditioning, and fire-extinguishing systems; its own nuclear bomb shelter; indoor health care and dental services; etc. An impressive part of BIS's archives, where books, materials and database are preserved in a great order and privacy. Even today BIS's archive is heavily secured, allowing only limited access to outsiders.

The Basel Tower has a functional lay out. For example, the central bankers have access to a restaurant on the top floor of the tower that provides a great view while they enjoy a quality dining experience. Underneath the restaurant, the central bankers' offices and pertinent services (conference room, secretarial working stations, etc.), are located on three separate floors of the Basel Tower. The offices of the staff (traders, gold traders, etc.) who carry out financial transactions and other services on behalf of BIS, are located on the lower floors of the Basel Tower. The electronic database system of BIS is connected directly to the central banks that are BIS members. Through this system, the staff of BIS provides central banks with access to updated financial data related to international monetary situations and related information. Describing the type of work environment inside the Basel Tower, the former BIS general manager, Gunther Schleiminger said, "[BIS] tries to provide a complete clubhouse for central bankers... a home away from home."⁶⁹

BIS earned an unenviable reputation for its readiness to serve the Nazi regime. In 1938, when Hitler marched into Prague, BIS nearly collapsed in its rush to surrender the gold that the Czechoslovakian government had left with the bank for safekeeping.⁷⁰ Two other examples of BIS's bias can be noted.

First, BIS arranged the transfer of USD378 million of what was in effect, gold looted from the coffers of invaded Austria, Czechoslovakia, Holland and Belgium into the account of the German Reichbank.

Second, in 1942, plans for the projected U.S. invasion of Algeria were leaked to the governor of the French National Bank, who immediately contacted his German colleague in BIS (SS Gruppen-

⁶⁹ *Id.*

⁷⁰ See William Clarke, *Nazi Gold: The Role of the Central Banks - Where Does the Blame Lie?*, 8 CENTRAL BANKING (Summer 1997) (discussing the accusations against the behavior of Swiss banks after World War II), available at <http://www.bigeye.com/nazigold.htm> (last visited Oct. 21, 2004).

fuehrer Baron Kurt von Schroder of the Stein Bank of Cologne), and transferred nine billion gold francs – via BIS – to Algiers. The Germans and their French correspondents made a profit of some USD175 million in this U.S. dollar exchange scam.⁷¹

BIS has always tried to keep a low profile with respect to its activity during the Nazi regime. As the former general manager of BIS, Andrew Crockett said on the subject, “[i]t is fair to say [the bank’s] original focus has been to establish facts rather than to try to guess the motivations and opinions’ of the wartime management.”⁷²

In the face of its accomplishments, BIS continues to stand in the shadow of its past controversial role in laundering Nazi gold in the late 1930’s and early 1940’s. However, while it has been asserted that BIS entered into unlawful transactions in gold during the Nazi period, at least one commentator has said that, “there is very little historical documentation presented to support the argument.”⁷³ It remains the duty of historians to uncover the historical truth of this dark period in the activity of the bank.

Central banks regularly transfer deposits to BIS. By commingling part of their reserves in what amounts to large blocks of mutual funds of short-term investments, the central banks create a convenient screen behind which they can conceal their own deposits and withdrawals in financial centers around the world. For example, if BIS places funds in France, central banks do not have to answer to their respective governments for investing in France. Central banks are perceived to pay high fees to use such transactional services from BIS. It becomes apparent that, regardless of its name, BIS is far more than – or perhaps different from – a bank.

⁷¹ See CHARLES HIGHAM, *TRADING WITH THE ENEMY: AN EXPOSÉ OF THE NAZI-AMERICAN MONEY PLOT 1933-1949*, 10-11 (1983) (arguing the existence of a monetary plot between the financial establishment in the United States and the Nazi regime).

⁷² See Alan Cowell, *Global Central Bank Says It Held Gold Looted by Nazis*, N.Y. TIMES, May 13, 1997, at A8 (reporting that BIS gold transactions with the Nazis included looted gold).

⁷³ One of the major factors limiting the historical documentation has been that BIS did not open its archives until the 1990’s. Under BIS open archive rules, all records relating to the Bank’s business and operational activities which are over thirty years old are available for consultation, with the exception of a very limited number of records that remain private or confidential even after thirty years have elapsed. A.M. Endres, *The Bank for International Settlements: Evolution and Evaluation*, EH.NET (July 2003) (reviewing James C. Baker’s book on the history of BIS from a generalized vantage point), at <http://www.eh.net/bookreviews/library/0645.shtml> (last visited Sept. 1, 2004).

From the outside, BIS seems to be a small, technical organization. Just eighty-six of its 298 employees are ranked as professional staff. But BIS is not a monolithic institution. Artfully concealed within the shell of an international bank, like a series of Chinese boxes one inside another, are the real groups and services the central bankers need – and pay to support.⁷⁴

BIS emerged over time as a major international organization charged with the task of increasing the efficiency of regulatory and supervisory activities for improvement of the international banking system. BIS ultimately claimed a major place in world financial affairs. It became part of the international cooperative effort post-1945, ensuring the stability of the international financial system.

During the 1960's, BIS started to analyze international financial markets, including the new euro currency markets, and developed new databases on international capital and currency stocks and flows. During the 1970's, BIS started to study potential risk in developing economies. It was among the first financial institutions to warn of the possibility of a sovereign debt crisis in loan default matters. The independence of central banks from their respective governments, a goal sought by most central banks reflects the image of BIS, which has a most ambiguous background from the other international financial institutions.

BIS confirms the belief of most of its members that central banks should act independently of their home governments. The bank holds extensive discussions with central bankers, encouraging them to remain as independent in their activities as possible. This independence is visible in the Bundesbank (Central Bank of Germany), whose president, "is not required to consult with government officials or answer the questions of [the German] Parliament—even about such critical issues as raising interest rates."⁷⁵ The Bundesbank President has even refused, "to fly to Basel in a government plane, preferring instead to drive in his Mercedes limousine."⁷⁶

In order to safeguard BIS's independence, a director of BIS cannot be an official of a government or a member of a legislative body, unless he is the governor of the central bank. It is precisely this provision which gives BIS its characteristic as a central bankers' club, and its resistance against the intrusion of government of-

⁷⁴ Epstein, *supra* note 43, at 46.

⁷⁵ *Id.* at 47.

⁷⁶ *Id.*

ficials.⁷⁷ For example, when Dr. Leutwiler became president of BIS in 1982, he insisted that no government official be allowed to visit during a "Basel weekend." He recalled that in 1968, U.S. Treasury Undersecretary, Fred Deming had been in Basel and stopped in at the bank. "When word got around that an American Treasury official was at BIS," Leutwiler said, "bullion traders, speculating that the U.S. was about to sell its gold, began a panic in the market."⁷⁸

Further, BIS shares a strong preference for pragmatism and flexibility over any economic ideology. Rather than resorting to rhetoric and invoking principles, BIS searches for any remedy that will relieve a potential financial crisis. For example, in the external debt rescheduling of Brazil in 1993, Peru in 1997, and Cote d'Ivoire in 1998, BIS stepped up its efforts, acting as an agent for these debt reschedulings. In the late 1980's, when Brazil defaulted on its loan payments, BIS loaned monies, guaranteed by the central bank members. In this case, the bank quietly decided to extend the deadline instead of collecting the money from guarantors. As one former high official of BIS summed it up, BIS is, "constantly engaged in a balancing act—without a safety net."⁷⁹

Fundamentally, "the most important belief of [the BIS] inner club is its conviction that when the bell tolls for any central bank, it tolls for them all."⁸⁰ For instance, in the Mexican default crisis of 1982, the issue for BIS was not the welfare of Mexico but rather, the stability of the entire banking system and its central banks. Mexico had been constantly borrowing overnight funds from the interbank market in New York to pay the interest on its USD80 billion external debt. Each time, Mexico had to borrow more money to repay the interest on the previous transactions, and within a few months, it had borrowed nearly one quarter of all the "Fed Funds" (a banker's term for loans between banks). The FRB found this an emergency situation requiring its intervention and asked BIS to take a leading role in the escalating situation. BIS realized that Mexico's entire financial system was a time bomb, and in less than forty-eight hours, BIS responded to the Mexican central bank's desperate need to get out of the interbank market by arranging a

⁷⁷ See STATUTES OF THE BANK FOR INTERNATIONAL SETTLEMENTS, Jan. 20, 1930 (amended Mar. 10, 2003) [hereinafter THE BIS STATUTES] (establishing the BIS), available at <http://www.bis.org/about/statutes-en.pdf> (last visited Sept. 16, 2004).

⁷⁸ Epstein, *supra* note 43, at 47.

⁷⁹ *Id.* at 48 (quoting Dr. Leutwiler).

⁸⁰ *Id.* at 47.

temporary bridging loan of USD1.85 billion. While in the press, money for this loan appeared to have come from BIS, almost all the funds came from the central bank members, including the FRB, Bundesbank, Swiss National Bank, Bank of England, Bank of Italy, and Bank of Japan. BIS undertook virtually no risk in this rescue operation but rather coordinated assistance among central banks.⁸¹ The central banks' efforts, led by the FRB, rescued one of their own, the Mexican central bank, and avoided the potential spread of the financial crises.⁸²

However, the bailout of Mexico was only a temporary victory for BIS. Other countries, including Argentina, Chile, Venezuela, Brazil, the Philippines, and Russia have faced similar default situations and BIS has repeated its role as a crises manager.⁸³

Financial interventions from BIS have created considerable concern among critics who do not share BIS's philosophy. Some of these critics prefer that the FRB, instead of BIS, worry about financial crises such as Brazil and the rest of Latin America. Others have argued that the bank does not have the experience or facilities to become a sort of IMF, extinguishing financial crises around the world.⁸⁴

On one hand, the central bank members publicly pay lip service to the ideal of maintaining the character of BIS, and not turning it into a lender of last resort for the world. On the other hand, they are in constant discussions among each others for finding ways to minimize or prevent occurrence of financial crises in weak markets. In the end, this approach makes sense because in cases of financial crises BIS uses the capital invested by central bank members. The quicker central bankers extinguish the "fires" created from financial crisis in the world, the safer their monies are with BIS. Presently, central banker members seem determined to con-

⁸¹ *Id.*

⁸² See Mark Matthews & Carl M. Cannon, *Clinton Bypasses Congress, Moves to Rescue the Peso*, BALT. SUN, Feb. 1, 1995, at 1A (discussing President Clinton's efforts to alleviate the financial crisis in Mexico).

⁸³ Robert E. Norton, *Argentina Hails Latin Cooperation*, AM. BANKER, Apr. 3, 1984, at 2; see also Guillermo Ortiz, *Recent Emerging Market Crisis - What have we learned?*, Speech at the Per Jacobsson Lecture (Jul. 7, 2002), available at <http://www.bis.org/events/agm2002/sp020707.pdf> (discussing the aftermath of the financial crisis in Mexico) (last visited Oct. 14, 2004).

⁸⁴ See Catherine L. Mann, *Market Mechanisms to Reduce the Need for IMF Bailouts*, INST. FOR INT'L ECON. (1999) (evaluating the role of the IMF as the, "international lender of last resort"), at <http://www.iie.com/publications/pb/pb99-4.htm> (last visited Oct. 20, 2003).

tinue maintaining their double standard (for the public and among themselves) when it comes to protecting the safety net of their investment with BIS.⁸⁵ Through financial crises, and its success and failures, BIS has cultivated a low profile as the banker from which the international banking system can scheme its way out of the restrictions placed on the insolvent banks during financial crises.

The governance of BIS is determined by its statutes.⁸⁶ These governing statutes restrict BIS to granting only short-term loans (typically less than thirty days). Moreover, all loans must be government-guaranteed, or backed with gold deposited at BIS.

The main duties of BIS⁸⁷ include:

- To purchase, sell, open accounts and maintain custody in gold, on its own behalf and/or the central banks' behalf;
- To loan to or borrow from the central banks;
- To enter into short-term obligation transactions, such as bills of exchange, promissory notes, or checks, on its own behalf and/or the central banks' behalf;
- To purchase or sell negotiable securities;
- To discount and re-discount bills from its own portfolio or the central banks' portfolios;
- To create and maintain bank accounts with the central banks;
- To accept deposits from the central banks and other parties;⁸⁸
- To act as agent or correspondent of the central banks; and,
- To act as trustee or agent in international settlement transactions.⁸⁹

⁸⁵ See generally Epstein, *supra* note 43, at 47-48 (describing the "inner club" of powerful central bankers and their business principles and practices).

⁸⁶ See The BIS Statutes, *supra* note 77, art. 24 (listing prohibited activities of BIS).

⁸⁷ *Id.* at arts. 21 and 22.

⁸⁸ Other deposits may pertain to trustee agreements for international settlements, as well as other deposits within BIS's scope of activity.

⁸⁹ From 1986 through 1999, BIS served as an agent for the private clearing and settlement system of the European Currency Unit at the creation of the EMU. Since the early 1980's, acting as "agent" of the World Bank, BIS has arranged bridge loans for member states and emerging market countries. As a result, these loans sped countries' access to IMF or World Bank credits. Of recent note, at the end of 1998, BIS arranged a \$13.28 billion dollars credit facility for Brazil as part of a financial support program.

However, BIS, unlike a central bank, is prohibited from printing currency; loaning or opening accounts to governments; acquiring a significant interest in any business transaction; or engaging in real estate transactions.⁹⁰

BIS's purchase and sale transactions on behalf of central banks are kept highly confidential. Presently, approximately 130 central banks and international financial institutions use BIS's operations.⁹¹ As of March 2002, the total currency deposits kept with BIS reached USD154 billion, which represents almost 7.6% of world foreign exchange reserves. Upon request from a central bank, BIS provides them with the available funds that are part of the reserve assets of the central bank with BIS. Therefore, an important role in the activity of BIS is its level of asset liquidity. BIS acts very shrewdly and carefully in investing its funds. Large portions of these funds are put principally as direct investments in large international banks and financial institutions. The remaining funds are used to purchase short-term government securities, buying and selling gold, entering into foreign exchange transactions, etc.

BIS is actively looking to develop its investment services, responding particularly to the concern of central banks to increase the return on their foreign assets. Therefore, to assist central banks with longer-term reserve management, BIS offers investment instruments of up to five years.⁹²

BIS also offers a variety of asset management services for central banks, including enhancement of individual customer services, knowledge exchange, dedicated portfolio mandates, an open-end fund structure, and allowing blocks of customers to invest in common pools of assets.⁹³ BIS makes short-term loans to central banks in the form of secured credits against gold, other collateral or currency deposits held with BIS. BIS also provides loans on an unsecured basis, for example in the form of a standby credit which

⁹⁰ See The BIS Statutes, *supra* note 77, art. 24 (listing prohibited activities of BIS).

⁹¹ See REFORMING BANK CAPITAL REGULATION, U.S. SHADOW FINANCIAL REGULATORY COMMITTEE MEETING (2000) (describing the history of BIS).

⁹² See generally Siegman, *supra* note 57, at 900-06 (surveying BIS and its functions); Bank for International Settlements, *Profile of BIS – Bank for Central Banks* (2002) (describing BIS's role in relationship to central banks), available at <http://www.bis.org/about/profcbank.htm#pgtop> (last visited Sept. 16, 2004).

⁹³ See *Profile of BIS – Bank for Central Banks*, *supra* note 92 (offering asset management services for central bankers); see also Kristin K. Howell, *The Role of the Bank for International Settlements in Central Bank Cooperation*, 22 J. EUR. ECON. HIST. 367-80 (1993) (addressing the success of BIS in central bank cooperation).

a central bank can draw on at short notice. In recent decades, BIS has provided financial support to central banks with the backing, by way of guarantees, of a group of leading central banks. "Multi-lateral assistance of this kind has usually prefinanced disbursements of credits granted by international institutions such the IMF or the World Bank."⁹⁴

An important part of BIS's financial activities is its risk control functions consisting of Internal Audit, Credit Risk Control, and Treasury Risk Control. "Market and credit risk are measured and managed under an integrated economic capital framework employing state of the art methodology. [In particular] asset quality is rigorously and constantly monitored."⁹⁵

But how does BIS put everything together in order to, "promote the cooperation of central banks and to provide additional facilities for international financial operations and to act as a trustee or agent for international settlements?"⁹⁶ It is BIS's organizational structure and management that makes it efficient and disciplined. The three most important decisionmaking bodies within BIS are: the General Meeting⁹⁷ of member central banks; the Board;⁹⁸ and the Management.⁹⁹

In 2003, BIS had fifty "shareholders" (central banks or financial monetary authorities¹⁰⁰) as members,¹⁰¹ exercising the rights of rep-

⁹⁴ *Profile of BIS – Bank for Central Banks*, *supra* note 92.

⁹⁵ *Id.*

⁹⁶ See The BIS Statutes, *supra* note 77, art. 3 (stating the objectives of BIS).

⁹⁷ See *id.* ch. V (containing provisions regarding the General Meetings such as each country voting in proportion to the number of shares it owns in BIS).

⁹⁸ See *id.* ch. IV (containing provisions regarding the Board).

⁹⁹ See *id.* (containing provisions regarding management of BIS).

¹⁰⁰ A financial monetary authority from a member country may be a nominee to participate in the General Meeting with voting rights. If such a nomination is not offered by the central bank, the central bank and the Board may approve the appointment of a financial institution of widely recognized standing. If there is no central bank, then the Board has the power to appoint a financial authority in that member country. See *id.* art. 14 (delineating voting rights at the General Meeting).

¹⁰¹ Members are the central banks or monetary authorities of Argentina, Australia, Austria, Belgium, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, China, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong SAR, Hungary, Iceland, India, Ireland, Italy, Japan, Korea, Latvia, Lithuania, the Republic of Macedonia, Malaysia, Mexico, the Netherlands, Norway, Poland, Portugal, Romania, Russia, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, the United Kingdom, the United States, and the European Central Bank.

resentation and voting at General Meetings¹⁰² in proportion to the number of BIS shares issued to their respective countries. The General Meeting is held annually, usually on the second Monday of June.¹⁰³ At the General Meeting, the shareholders approve the Annual Report, including the annual financial statements of BIS (the Balance Sheet, and the Profit and Loss Account); approve changes in the remuneration, fees, and allowances of the Board members; elect Auditors; and discharge the Board from any responsibilities.¹⁰⁴ The General Meeting may also be called in extraordinary sessions where the shareholders have the right to amend the statutes, change the capital of the bank, as well as call to liquidate BIS.¹⁰⁵

The Board is composed of the governors of the central banks of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States. The current statutes allow the governors (appointed members) of the central banks of Belgium, France, Germany, Italy, the United Kingdom, and the United States to appoint another individual of the same country to the Board. These are known as *ex-officio* members.¹⁰⁶ The statutes also provide for the election to the Board of no more than nine governors of other member central banks than the appointed member countries.¹⁰⁷ The governors of the central banks of Canada, Japan, the Netherlands, Sweden, and Switzerland are currently elected members of the Board, which totals seventeen members. The Board elects a Chairman from among its members and appoints the President of BIS. Since 1948 the two offices have been vested in one person. The Board's main role is to represent BIS in its dealings with third parties and to enter into undertakings on its behalf.¹⁰⁸

¹⁰² See The BIS Statutes, *supra* note 77, ch. V (articulating the structure and functions of the General Meeting).

¹⁰³ See *id.* art. 45 (describing in further detail the guidelines for a General Meeting).

¹⁰⁴ See *id.* art. 46 (listing the powers of the General Meeting).

¹⁰⁵ See *id.* art. 47 (stating when extraordinary General Meetings may be called).

¹⁰⁶ See *id.* art. 27(1) (noting that the directors representing the six *ex officio* members may appoint an alternate, "to attend and exercise the powers of a Director at meetings of the Board if the Governor himself is unable to be present." [emphasis added]).

¹⁰⁷ *Id.* art. 27(3).

¹⁰⁸ See *id.* arts. 36, 37 (defining the Board's interaction with third parties).

The Management consists of: the President,¹⁰⁹ who can also be the Chairman or a member of the Board; General Manager or a Deputy General Manager;¹¹⁰ heads of a department; or other officer or staff.¹¹¹ In 2003, the staff of BIS, including temporary staff, numbered over five hundred employees from over forty countries.¹¹² The President implements policies approved by the Board as well as supervises administration of the bank's activities.¹¹³ The General Manager, as the head of BIS's operating staff, reports and coordinates its daily activities, and reports this information directly to the President.¹¹⁴

BIS acts as secretariat for committees which include the Markets Committee,¹¹⁵ the Committee on the Global Financial Systems,¹¹⁶ the CBS,¹¹⁷ and the Committee on Payment and Settlement Systems.¹¹⁸ These committees participate in the Financial Stability Forum, which BIS created in April 1999 to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance.¹¹⁹ In addition to the Financial Stability Forum, BIS has created the so-called Financial Stability Institute, which provides a venue for international discussions among high level officials in the banking and financial sectors in order to promote better and more independent banking, capital markets, and insurance supervision.¹²⁰ As to in-

¹⁰⁹ See *id.* art. 38 (explaining the election of the President by the Board).

¹¹⁰ See *id.* art. 40 (giving the Board the power to appoint a General Manager and a Deputy Manager).

¹¹¹ See *id.* arts. 40, 41 (giving the Board the power to appoint Heads of Departments and other officers, and giving the General Manager the power to appoint staff).

¹¹² See Bank for International Settlements, *Organization and Governance* (providing basic information about BIS governance), at <http://www.bis.org/about/orggov.htm> (last visited Sept. 14, 2004).

¹¹³ See The BIS Statutes, *supra* note 77, art. 38 (outlining the powers and duties of the President).

¹¹⁴ See *id.* art. 40 (outlining the powers and duties of the General Manager).

¹¹⁵ The Markets Committee was established in 1962.

¹¹⁶ The Committee on the Global Financial System was established in 1971.

¹¹⁷ The Basel Committee on Banking Supervision ("CBS") was established in 1974.

¹¹⁸ The Committee on Payment and Settlement Systems was established in 1990.

¹¹⁹ To learn more about the Financial Stability Forum from its official website, see *The Financial Stability Forum*, at <http://www.fsforum.org/home/home.html> (last visited Sept. 14, 2004).

¹²⁰ To learn more about the Financial Stability Institute ("FSI") from BIS offi-

insurance supervision, BIS organizes the secretariats of the International Association of Insurance Supervisors and the International Association of Deposit Insurers, who do not have any direct relationships with BIS or its member central banks. Respectively, these insurance agencies focus on the business of insurance and deposit insurance for financial institutions.

With some exceptions, BIS officials are not members of the Markets Committee, the Committee on the Global Financial Systems, the CBS, or the Committee on Payment and Settlement Systems. Membership in these committees normally consists of national technical experts in the fields of banking and finance. However, BIS helps to organize meetings of such committees and performs secretarial functions for them.¹²¹

BIS is a paramount institution in the preparation of research and analysis of monetary and financial issues. Its Monetary and Economic Department maintains a macroeconomic database accessible by member central banks and international financial institutions.¹²² Specialists, experts and research analysts of various economic and financial fields who work for the Monetary and Economic Department author publications and articles of interest to central banks. Mainly, these publications and articles appear in the BIS Working Papers, financial related journals, symposiums, seminars organized by central banks, etc. Macroeconomic data and research provided by the staff of the Monetary and Economic Department with respect to global monetary statistics is presented in the BIS Annual Report and Quarterly Review. The department's publications remain models for central banks and major financial institutions.¹²³

During its more than seventy year history, BIS has adapted to major changes in the financial industry and central banking practices. This ability to adapt is primarily due to its limited, nearly homogeneous membership. An example of this ability is demonstrated in BIS's quick response to the challenge of meeting regula-

cial website, see Bank of International Settlement, *Financial Stability Institute*, at <http://www.bis.org/fsi/> (last visited Sept 3, 2004).

¹²¹ See *infra* Section 3 for a discussion of these committees.

¹²² See Bank for International Settlements, *Functions and Organization* (June 2004) (discussing the responsibilities and functions performed by the Monetary and Economic Department), at <http://www.bis.org/about/functions.htm> (last visited October 8, 2004).

¹²³ See *Profile of BIS – Bank for Central Banks*, *supra* note 93 (describing the activities of the Monetary and Economic Department).

tory deficiencies at the international level. Furthermore, it has persuaded even many of the less developed countries, to implement BIS standards to maintain and improve the soundness and safety in their banking systems.¹²⁴

In order for BIS to continue as a significant player in the international banking arena, it must continuously adapt its activities. Changes in business practices among banks, as well as changes in the technology that accomplishes those practices, pressure BIS to change. Changes might be beneficial not only to the inner structure, but also to BIS's relationships with customers, including the central banks, particularly in undeveloped countries. The escalating globalization of the economy is forcing banking to become increasingly international. Central banking cannot run nationally, while commercial banking is going international. The role of BIS in riding with this evolution is indispensable.

BIS currently consists of a wide array of committees that report to various bodies, with different memberships and different sponsors. This structure often creates confusion about the allocation of responsibilities and the particular missions of each committee or group within BIS. It also contributes to the lack of transparency in BIS's role. BIS's success as a meeting ground for central bankers has been facilitated by its small, homogeneous, and cohesive membership. For that reason, membership expansion through other means, such as the Financial Stability Forum, might be a disruptive development for BIS, and should be undertaken cautiously. There is a risk that inclusion may be at the expense of efficiency.¹²⁵ In the words of the Meltzer Commission Report, "any expansion of membership in BIS or its committees or groups [should] be undertaken gradually and deliberately to avoid disruption of the information exchange that central bankers find valuable."¹²⁶

While it is quite difficult to make specific recommendations on how to restructure BIS, it is clear that some streamlining of the or-

¹²⁴ See Stephany Griffith-Jones, *Developing Countries and the New Financial Architecture* (Nov. 30, 2000) (unpublished paper) (remarking on recent reforms in the international financial community), available at <http://www.globalpolicy.org/socecon/ffd/2001/1130idsreport.pdf> (last visited Oct. 14, 2004).

¹²⁵ See Michele Fratianni & John Pattison, *The Bank for International Settlements: An Assessment of Its Role in International Monetary and Financial Policy Coordination*, 12 OPEN ECON. REV. 197, 212 (2001) (reviewing BIS's history and praising its performance).

¹²⁶ Int'l Financial Inst. Advisory Comm'n, *Commission Report 99*, Mar. 2000 [hereinafter *Meltzer Report*] (Commission chaired by Allan H. Meltzer), available at <http://www.house.gov/jec/imf/meltzer.pdf>.

ganizational structure is necessary.

Through its ever increasing role, BIS has helped create international financial order. BIS continues to remain a relevant financial institution. It has expanded from a regionally oriented agency to a financial institution with global outreach. While it has not been particularly successful in acting with other international organizations to solve regional economic and currency crises, BIS has been a focal point for cooperative efforts among central banks that supplement the actions of IMF and the World Bank.

BIS's reputation as a pre-eminent economic forecaster and disseminator of financial data, is based on its efforts to reduce Y2K problems, cope with technical innovations in international banking, securities and insurance activities, encouraging transparency in financial transactions across national borders, dealing with international money laundering, and much more. Yet, it is not clear why most of these achievements could not be brought within the functions of private, international commercial banks. Most regulations on banking, securities and insurance activities have been harmonized within the EMU and, even earlier, within the United States, without the need for organizations such as BIS. However, BIS is increasingly found to be a "closed club for central bankers. . . without clear lines of accountability to national governments."¹²⁷

How far BIS will go is anybody's guess. Regardless of what policies it chooses, BIS's impact is felt not only by central bankers and their governments, but also by those who do not closely follow the developments. As one journalist remarked:

Behind closed doors one now hears open discussions of the printing of money.

That sure as hell scares me. I visualize the Bank for International Settlements in Basel, opposite the railroad station, a heavy iron grille across the door. Inside, they are drinking cups of coffee that cost \$3 in American currency. The Swiss inflation rate has been so low that the dollar has ballooned, as tourists know. It's not Swiss money they're talking about printing. A trillion dollars in dollars.¹²⁸

Since its inception, BIS has established itself as an *avant-garde* institution improving and strengthening relationships among cen-

¹²⁷ Endres, *supra* note 73.

¹²⁸ Adam Smith, *Maybe I Am Easily Scared: Energy and Superinflation*, 1978 ATLANTIC MONTHLY, Dec. 1978, at 35, 36.

tral banks, national financial regulatory agencies, and international financial institutions for the coordination and improvement of their activities. Obviously, this remains a difficult and ongoing task which BIS appears to be handling successfully, so far. In the end, as domestic financial markets become more global, the success of BIS lies not only in its ability to issue financial guidelines, but also in the willingness of international and national financial banks and institutions to implement them.¹²⁹

3. START OF INTERNATIONAL BANK SUPERVISORY AUTHORITY

3.1. *BIS-Related Activities*

BIS's work on the regulation of international banking has been accomplished through a series of committees both within and without. On its website, BIS states that it facilitates, "cooperation among central banks . . . [and] assists central banks and other financial authorities in their efforts to promote greater monetary and financial stability."¹³⁰ The committees which concern us here are not formally affiliated with BIS or with each other.¹³¹ Of the committees, three are so-called permanent committees. They are the CBS, the Committee on Payment, and Settlement Systems and the Committee on the Global Financial System. The committees and their work are detailed below.

3.1.1. *The CBS*

The oldest and most active of the committees, the CBS, is the most likely of the existing BIS bodies to metamorphose into a supreme international bank regulator, or as it is sometimes called, a World Financial Authority ("WFA"). Created in 1974 by the cen-

¹²⁹ See Matthew Bishop, *The Regulator Who Isn't There*, *ECONOMIST*, May 16, 2002 (noting regulators have to "rely on the private sector to assist them in their regulatory task"), available at http://www.economist.com/surveys/display_story.cfm?story_id=1119911 (last visited Oct. 14, 2002).

¹³⁰ Bank for International Settlements, *Functions and Organisation* (June 2004), at <http://www.bis.org/about/functions.htm> (last visited Oct. 21, 2004).

¹³¹ The committees, however, meet at BIS, are identified by the international banks with BIS and are described in the BIS website as if they are BIS subsidiaries or affiliates. See BAKER, *supra* note 3, at 73 (referring to the CBS and its original name of the Committee on Banking Regulations and Supervisory Practices); see also EATWELL, *supra* note 5, at x, (noting that as part of BIS, "the foundations of global financial surveillance and regulation that have already been laid at the Bank for International Settlements in Basel").

tral bank governors of the so-called G-10 it was principally a reaction to the systemic risk that resulted from the international payment failure of the Herstatt Bank.¹³² The Herstatt failure contributed to a period of instability in international banking markets¹³³ in the early 1970's and a general recognition that bank regulators in different countries had many of the same problems.¹³⁴ As a result, the CBS was aimed at the strengthening of collaboration among national authorities in their supervision of international banking.¹³⁵ The CBS has about thirty technical working groups and task forces which meet regularly. Its members now come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States.¹³⁶

As BIS notes, the CBS lacks formal authority:

[The CBS] does not possess any formal supranational su-

¹³² The Herstatt Bank, based in Cologne, Germany received a funds transfer of U.S. dollars in purchase of deutsche marks. Before BIS could wire back the currency, it was closed by the German authorities. Thus, it received, but could not disburse funds. The send failure had international repercussions and took years to remedy. This type of problem is still called "Herstatt risk." See EATWELL, *supra* note 5, at 200 (defining the "Herstatt risk"). The Herstatt failure was closely followed by the closing of the British-Israel Bank of London, "for insolvency problems. The closure of the Herstatt and British-Israel Bank of London starkly revealed the vulnerability of the international banking system." Lawrence L.C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 2, 16 (1998).

¹³³ Adding to the Herstatt and British-Israel failures were severe problems in the United States, at the Franklin National Bank, and the National Bank of San Diego. Lee, *supra* note 132.

¹³⁴ While Herstatt was the key event in the creation of the CBS, other world events followed that contributed to the legitimacy and solidity of the CBS. Principal among these events were: (1) the collapse of the fixed international exchange system established by the Bretton Woods agreement in 1945—causing much more speculative investment and a general movement of funds in the currency markets, and (2) "the oil shocks of 1973-74 and 1978-79" that resulted in enormous cash holdings by the Middle-Eastern oil states and the need for international banks to absorb and invest these funds. ETHAN B. KAPSTEIN, GOVERNING THE GLOBAL ECONOMY: INTERNATIONAL FINANCE AND THE STATE 30, 58 (1994) (stating explicitly that the CBS was created in response to the two events described above).

¹³⁵ C.J. Thompson, *The Basle Concordat: International Collaboration in Banking Supervision*, in 1 CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS 331, 333 (Robert C. Effrose ed., 1992).

¹³⁶ Bank for International Settlement, *The Basel Committee on Banking Supervision*, at <http://www.bis.org/bcb/aboutbcb.htm> (describing the structure of the Basel Committee on Banking Supervision) (last visited Sept. 3, 2004).

pervisory authority, and its conclusions do not, and were never intended to, have legal force. Rather, it formulates 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. In this way, the Committee encourages convergence towards common approaches and common standards without attempting detailed harmonisation of member countries' supervisory techniques.¹³⁷

From its inception, as a natural result of its membership, the CBS began inexorably to assume the role of an international financial services regulator. This does not appear in its publications nor, as far as one can tell, even in its deliberations. The CBS has regularly reported to the central bank Governors of the G-10 countries, and sought the endorsement of the G-10 for its major initiatives. The CBS has also attracted representatives from institutions, which are not central banks and through them the decisions made carry the commitment of many national authorities outside the central banking fraternity. The CBS has worked to extend its influence by stimulating contacts and cooperation between its members and the banking supervisory authorities of other countries. In many cases, non-G-10 have seen fit to publicly associate themselves with the CBS's initiatives. Contacts have been further strengthened by an International Conference of Banking Supervisors which takes place every two years, most recently in Basel.

The CBS has operated consistently with two basic principles. First, no international banking establishment should escape regulation. Second, supervision should be adequate. To accomplish these goals, the CBS has issued a number of documents.¹³⁸

First to consider is the Basel Concordat. Almost immediately upon its creation, the CBS issued a blockbuster report¹³⁹ that in its

¹³⁷ *Id.*

¹³⁸ Much of the material in the following paragraphs is taken from a research paper by the Authors. Carl Felsenfeld & Genci Bilali, *The Role of the Bank for International Settlements In Shaping the World Financial System* (Jan. 2004) (unpublished paper, on file with Fordham University School of Law).

¹³⁹ The Basel Concordat began in 1974, the year of BIS's creation, and was released in 1975. It was supplemented in 1990 and 1992.

revised form is the backbone of international bank regulation. The Basel Concordat, "sets out certain principles, which the Committee believes should govern the supervision of banks' foreign establishments by parent and host authorities."¹⁴⁰ Known as "consolidated bank supervision," and clarified over the years, the principles have come to dictate that the home state, the state where the bank was chartered, would be principally responsible for the financial well-being of the institution. The host state, the state where an international bank did business, would have principal responsibility for the banks' powers and functions. The host state was not to accept a bank unless it is subject to acceptable home state supervision. The two states were encouraged to be in regular contact with each other.¹⁴¹

Second, is the Basel Capital Accord. This document, currently receiving the most attention from banks and regulators, is the set of guidelines officially titled, *International Convergence of Capital Measurement and Capital Standards*.

The Basel Capital Accord was originally released in July 1988¹⁴² and represented the CBS's effort to secure international convergence of supervisory regulations governing the capital adequacy of international banks. Following the Mexican financial crisis of the 1980's, the U.S. regulators' efforts to force national and state banks to hold more capital, led to immediate industry resistance on competition grounds, and strengthened efforts within the Basel committee to issue the accord.¹⁴³ The Basel Capital Accord reflects the effort of the CBS to ensure a maximum degree of consistency between the framework agreed upon in Basel and the separate rules of the constituent countries. At the same time, the accord pays due

¹⁴⁰ See Basel Comm. Report on Banking Supervision, *Principles for the Supervision of Banks' Foreign Establishments* (1983), available at <http://www.bis.org/publ/bcbasc312.pdf> (last visited Oct. 21, 2004).

¹⁴¹ Application of the Basel Concordat has been enhanced by the issue on July 6, 1992 of a CBS report that requires all supervisory authorities enforcing the Concordat to follow its dictates. Basel Comm. on Banking Supervision, *Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments* (1992) [hereinafter *Banking Supervision Standards*], available at <http://www.bis.org/publ/bcbasc314.pdf> (last visited Oct. 21, 2004).

¹⁴² See *Basel Capital Accord*, *supra* note 52 (reporting on the work of the CBS over a period of several years).

¹⁴³ William R. White, *International Agreements In the Area of Banking and Finance: Accomplishments and Outstanding Issues*, BANK FOR INT'L SETTLEMENTS, at 23 (discussing major accomplishments of the international financial market), available at <http://www.bis.org/work38.pdf> (last visited Oct. 14, 2004).

regard to particular features of the existing supervisory and accounting systems in individual member countries. "It [the CBS] believes that this objective has been achieved."¹⁴⁴ The accord sets a minimum capital standard at eight percent, a figure that is still generally in effect.¹⁴⁵

The Basel Capital Accord has been modified twice and one major modification is now on the drawing board.

The 1996 Amendment¹⁴⁶ principally dealt with the ways banks should adjust their capital based upon market risk—the risk arising from broad factors as contrasted with risk of loss from specific loans and investments. Of particular importance was the addition to the accord of qualitative standards for banks basing their capital requirements on the results of internal models, a relatively new approach to the measurement of capital proposed to the banking community in 1995. Tentatively accepted in the 1996 Amendment was use of a bank's own internal model as an evaluation of specific risk. The CBS expressed its desire that this approach be developed and improved by the banking system.¹⁴⁷

The 1998 Amendment is the second modification.¹⁴⁸ In a document titled, *Amendment to the Capital Accord to Incorporate Market Risks*, the CBS resolved certain speculations contained in the 1996 Amendment. Its principal goal in the 1998 Amendment was to confirm that a bank could use its own internal model to estimate both market risk and specific risk. Although the 1998 Amendment does not specifically state this, it is clear that a bank's internally created model is the device of the future in the establishment of bank capital. Use of the model was conditioned upon a bank's establishing supervisory approval of the model from both home and

¹⁴⁴ *Banking Supervision Standards*, *supra* note 141, at 981.

¹⁴⁵ Banking regulations in the United States, depending upon the particular definition of capital, set minimum percentages at three percent, four percent and the generally accepted eight percent. Treas. Reg. § 3.6, app. A (as amended in 2004).

¹⁴⁶ Basel Comm. on Banking Supervision, *Overview of the Amendment to the Capital Accord to Incorporate Market Risks* (1996) [hereinafter *Overview of the Amendment*], available at <http://www.bis.org/publ/bcbs23.pdf> (last visited Oct. 14, 2004).

¹⁴⁷ See *id.* at 2 (noting that the main feature of the April 1995 proposal was the bank's use of in-house models to evaluate risk).

¹⁴⁸ *Amendment to the Capital Accord to Incorporate Market Risks* (1996, updated 1998), available at <http://www.bis.org/publ/bcbsc222.pdf> (last visited Oct. 14, 2004).

host countries.¹⁴⁹ Approval is based upon four principles: (1) a bank's risk management system must be conceptually sound and implemented with integrity; (2) a bank has a sufficient number of trained staff; (3) the model must have a record of reasonable accuracy; and (4) a bank conducts stress tests of its model.

The 1998 Amendment elaborates at some length on these underlying principles. For example, to demonstrate reasonable accuracy, the model must be shown to reflect both the bank's activities and the geographic areas in which the activities are conducted. Stress testing is defined to mean the identification of "events or influences that could greatly impact banks."¹⁵⁰ It is made clear that no particular type of model is required for use in the estimation of capital. The 1998 Amendment also authorizes banks to base specific, as well as market capital, upon modeled estimates if the models meet a set of qualified and quantitative estimates.¹⁵¹

The Basel II, is a proposed modification under consideration. In 2001, the CBS issued a proposed amendment to the Basel Capital Accord that has been extensively studied, revised and was reissued in May 2003. The CBS anticipated that it would issue a final rule based upon the amendment by the end of 2003; that due date has been deferred. Plans are for U.S. regulators to consider and probably revise the CBS product and issue a rule designed to become effective in local banking communities in 2006 or 2007.¹⁵² Whether any of these "final" dates will materialize is, at best, questionable.¹⁵³

The proposed amendment essentially leaves intact the capital guidelines in place under the original accord, including the 8% capital floor. It introduces, however, an alternative method of computation, through five years of discussion, that has left much of the banking community bewildered. It is not the place of this

¹⁴⁹ See *id.* at 38 (noting that the application of the scenario's analysis by a bank will be subject to supervising consent).

¹⁵⁰ *Id.* at 47.

¹⁵¹ See *id.* at 51 (outlining specific treatment of risk).

¹⁵² See Barbara A. Rehmy, *Fed's Ferguson: Why it's Okay for U.S. to Ease Basel Load*, AM. BANKER, Apr. 10, 2003, at 1 (stating that the U.S. FRB anticipates that revisions to Basel II will take effect in 2006 or 2007).

¹⁵³ Hearings are being held in both the House and the Senate about Basel II and key lawmakers are telling bank regulators that they are skeptical about the proposed accord. The House Financial Services Committee is to consider a bill that would create a new regulatory committee under the Treasury Department to coordinate the U.S. position on Basel II. Rob Garver, *Final? Not Quite, as Hill Finally Gets Started on Basel II Debate*, AM. BANKER, June 23, 2003, at 1.

article either to detail Basel II or to evaluate it. It is based upon further use of the banks' internal risk ratings systems as the definer of their required capital. As the most recent of the CBS prescriptions to the banking community, it reflects the CBS's perception of itself as the international regulatory leader.

The world's banks and bank regulators' major objection to Basel II is its complexity, not its substance. Comprising some five hundred pages, the proposal is filled with highly technical language and arcane mathematical formulations. The U.S. Comptroller of the Currency, regulator of national banks, has testified to Congress:

This (the level of detail and specificity in the proposal) has led to a proposal of immense complexity - greater complexity, in my view, than is reasonably needed to implement sensible capital regulation. I believe we have to avoid the tendency to develop encyclopedic standards for banks, which *minimize* the role of judgment or discretion by banks applying the new rules or supervisors overseeing them. . . . If we determine through our rulemaking process that changes in the Basel proposal are necessary, we will press the Basel Committee to make changes.¹⁵⁴

Third to consider are the Core Principles. In 1995, the CBS issued the *Core Principles of Effective Banking Supervision*, which came to be known as the "Core Principles."¹⁵⁵ Basically comprising twenty-five key areas of banking supervision, these principles were designed to present the essential ingredients of a regulatory banking structure that will stimulate confidence in the international banking market. The principles cover the significant "pre-conditions for effective banking supervision, licensing of banking institutions, capital standards and other prudential guidelines for risk management and internal control, methods of ongoing banking supervision, information requirements, formal powers of su-

¹⁵⁴ *The New Basel Accord: Sound Regulation or Crashing Complexity?: Hearings Before the House Comm. on Fin. Servs.*, 108th Cong. 12, 14 (2003) (statement of Hon. John D. Hawke, Jr.) (emphasis added).

¹⁵⁵ Basel Comm. on Banking Supervision, *Core Principles for Effective Banking Supervision* (Sept. 1997) [hereinafter *Core Principles*], available at <http://www.bis.org/publ/bcbs30a.pdf> (last visited Oct. 14, 2004).

pervisors and cross-border banking."¹⁵⁶

The CBS, "intended the Core Principles to be applied in all countries" ¹⁵⁷ It issued them in its conviction that they represent the essential ingredients to make an international bank regulatory system work. Writing about its own work in 1999, the CBS said, "[t]he Core Principles for Effective Banking Supervision have become the most important global standard for prudential regulation and supervision."¹⁵⁸ They represent another example of the CBS granting to itself the authority to prescribe regulations for the international banking system.

In October 2001, the CBS issued a paper titled *Customer Due Diligence for Banks*. This represents the CBS's views on the generally acknowledged duty of banks to both know their customers, and generally know the source of the assets that their customers bring.¹⁵⁹ The CBS anticipates that the "principles [of the paper] will be incorporated into the Committee's *Core Principles for Effective Banking Supervision* in due course."¹⁶⁰

Fourth, are the three papers of September 1998.¹⁶¹ In September 1998, the CBS issued three papers dealing with bank regulation:

1. The Bank Transparency Paper. This paper advocates the use of greater contributions from market discipline and resulting public disclosure to complement the efforts already being made by the supervisory sector in controlling banks.¹⁶²

¹⁵⁶ Christine M. Cumming, *Financial Services Regulation*, 33 BUS. ECON. 20, No. 4, 23 (1998).

¹⁵⁷ *Id.*

¹⁵⁸ Basel Comm. on Banking Supervision, *Core Principles Methodology* (Oct. 1999), available at <http://www.bis.org/publ/bcbs61.pdf> (last visited Oct. 14, 2004).

¹⁵⁹ The International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, Pub. L. 107-56, 115 Stat. 296 (2001) in Title III of the massive United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA Patriot Act) of 2001, Pub. L. 107-56, 115 Stat. 272 (2001), is, at bottom, a detailed application of the know-your-customer principle applicable to terrorist activities. The USA Patriot Act was enacted as a result of the attack of September 11, 2001.

¹⁶⁰ *Bank Regulation/Thrift Regulation*, 22 BANKING & FIN. SERV. POL'Y REP. 14, No. 8 (2003).

¹⁶¹ The three papers are discussed in, Connie M Friesen et al, *The 1998 Basle Committee Supervisory Initiatives and their Potential Consequences on International Banking Activities*, 14 J. Int'l Banking L. 55 (Feb. 1999).

¹⁶² See *id.* at 56 (remarking on trends in banking disclosure).

2. The Internal Control Paper. This paper emphasizes the use of banks' internal control procedures and measurement of the effectiveness of those procedures in affecting bank performance.¹⁶³
3. The Operational Risk Paper. The last paper is based upon the CBS's survey of the operational risk management techniques in use in banks. It relates those techniques to communication breakdowns and resulting financial losses in those institutions.¹⁶⁴

Fifth to consider is the paper titled, *Banks' Interaction with Highly Leveraged Institutions*. In January 1999, influenced by the near collapse of Long Term Capital Management, the CBS issued a report dealing with the relationship of banks and highly leveraged institutions. The thirty-two page document stressed aspects of bank regulation together with greater public disclosure and an improvement of bank internal practices. It noted: "[b]anks generally did not appear to possess effective policies and guidelines for managing exposures to some . . . [highly-leveraged institutions] in a manner consistent with their overall credit standards."¹⁶⁵ The report is written in the form of a set of directions to bank supervisors. It reads, "supervisors should ensure that the proper incentives, procedures and standards are in place" and should, "consider these issues carefully."¹⁶⁶

Sixth, *Sound Practices for the Management and Supervision of Operational Risk* (hereinafter *Sound Practices Paper*) was issued in February 2003 by the CBS Risk Management Group.¹⁶⁷ This paper expands a prior paper published in 1998, titled, *A Framework for Internal Control Systems in Banking Organizations*.¹⁶⁸ The *Sound Prac-*

¹⁶³ See *id.* at 57 (discussing trends in risk control).

¹⁶⁴ See *id.* (noting operation risk management techniques).

¹⁶⁵ Basel Comm. on Banking Supervision, *Sound Practices for Banks Interactions with Highly Leveraged Institutions* (Jan. 1999), available at <http://www.bis.org/publ/bcbs46.pdf> (last visited Oct. 14, 2004).

¹⁶⁶ *Id.*

¹⁶⁷ Chaired by Roger Cole of the Federal Reserve Board and consisting of thirty-one individuals from central banks, major international banks, regulatory groups and the CBS itself. Basel Comm. on Banking Supervision, *Sound Practices for the Management and Supervision of Operational Risks* (Feb. 2003) [hereinafter *Sound Practices*], available at <http://www.bis.org/publ/bcbs96.pdf> (last visited Oct. 14, 2004).

¹⁶⁸ Basel Comm. on Banking Supervision, *Framework for Internal Control Systems in Banking Organisations* (Sept. 1998), available at <http://www.bis.org/publ/bcbs40.pdf> (last visited Oct. 14, 2004).

tices Paper describes the growth of several ingredients that make the update appropriate. Among these are greater use of highly automated technologies, large scale acquisitions and mergers that test the viability of newly integrated systems, and the emergence of banks as large-volume service providers, including participation in settlement and clearing systems. Basically, this paper provides a framework for the effective management and supervision of operational risk.¹⁶⁹

The CBS has drawn on its work in the management of other significant banking assets, "such as credit risk, interest rate risk and liquidity risk, and the [c]ommittee believes that similar rigour should be applied to the management of operational risk."¹⁷⁰ The paper identifies a five pronged approach to the control of operational risk: "developing an appropriate risk management environment; risk management: identification, assessment, monitoring and control/mitigation; the role of supervisors; and the role of disclosure."¹⁷¹

The *Sound Practices Paper* assumes the role of a financial regulator and assigns to banks a series of elements that should be universally undertaken in the control of operational risk. These include: the appropriate roles of the board of directors and senior management; the use of risk identification, assessment, monitoring, control and mitigation procedures; implementation of clearly designated supervisory roles; and the role of public disclosure in the control of risk.¹⁷² The sweep of these proposals assumes the CBS's function as an international regulator without portfolio.

Seventh, *Risk Management Principles for Electronic Banking* was published in June 2003 by the Electronic Banking Group of the CBS.¹⁷³ It has two main areas of focus. The first builds on a similar paper published in May 2001, also titled, *Risk Management Principles for Electronic Banking*.¹⁷⁴ The earlier paper presented fourteen

¹⁶⁹ The definition of operational risk, coming from the CBS studies of bank capital, is "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events." *Sound Practices*, *supra* note 167, at 2.

¹⁷⁰ *Id.* at 4.

¹⁷¹ *Id.*

¹⁷² See *id.* at 4-5 (setting out principles to be used by banks and supervisory authorities when evaluating risk management policies and practices).

¹⁷³ Basel Comm. on Banking Supervisions, *Risk Management Principles for Electronic Banking* (July 2003) [hereinafter *Risk Management Principles 2003*], available at <http://www.bis.org/publ/bcb98.pdf> (last visited Oct. 14, 2004).

¹⁷⁴ Basel Comm. on Banking Supervisions, *Risk Management Principles for Elec-*

risk management principles, "to help banking institutions expand their existing risk oversight policies and processes to cover their e-banking activities."¹⁷⁵ The 2003 paper stresses the banks' need to integrate cross border electronic banking risks into the banks' overall risk management framework. The second objective is to identify more clearly the home country and host country responsibilities for electronic activity, and to focus attention on the need for effective home country supervision of cross-border electronic activity, as well as international cooperation between banking supervisors.¹⁷⁶

3.1.2. *The Joint Forum*

In early 1996, the CBS joined forces with two other international financial committees—the International Organization of Securities Commissions ("IOSCO") and the International Association of Insurance Supervisors ("IOIS")—to create the Joint Forum. Strictly speaking the Joint Forum is not a committee, although it essentially serves a committee function within its area.¹⁷⁷ The Joint Forum's mandate was brought up to date in 1999, but its focus remains on international conglomerates. As the activities of conglomerates both expand and refine, the area of activity is generally referred to, not as banking, or securities, or insurance, but rather, as financial services. The major founding organizations were no longer in these fields separately, but were organized around a con-

tronic Banking (May 2001) [hereinafter *Risk Management Principles 2001*], available at <http://www.bis.org/publ/bcbs82.pdf> (last visited Oct. 14, 2004).

¹⁷⁵ *Id.*

¹⁷⁶ See *Risk Management Principles 2003*, *supra* note 173.

¹⁷⁷ The Joint Forum of Financial Conglomerates was successor to an essentially identical prior group titled the Tripartite Group and composed of the same three types of regulatory agencies. The Tripartite Group issued a report on conglomerate regulation in 1995. See The Tripartite Group of Banks, Securities and Insurance Regulations, *The Supervision of Financial Conglomerates* (July 1995), available at <http://www.iosco.org/pubdocs/pdf/IOSCOPD47.pdf> (last visited Oct. 14, 2004). The United States Comptroller of the Currency issued a statement on the report on July 24, 1995, and briefly described its approach to international conglomerate regulation. Basically, it recommended continued regulation by the three types of regulatory agencies; each in its own area and a high degree of access to general information by all of them, as well as coordination among them. Statement by Eugene A. Ludwig, Comptroller of the Currency, Comptroller Ludwig Welcomes International Report on the Supervision of Financial Conglomerates (July 24, 1995), at <http://www.ocs.treas.gov/ftp/release/95-75.txt> (last visited Sept. 16, 2004). The Tripartite Group, as well as the successor Joint Forum, saw itself as an advisor to regulators.

geries of financial activities which drew upon the various areas of traditional banking, securities activities and insurance.

In 1996, and even before, the financial services movement represented the direction of the major international financial organizations. However, it gained major impetus from the United States with the enactment on November 12, 1999, of the Gramm-Leach-Bliley Act,¹⁷⁸ a statute that brought banking, securities operations, and insurance closer to one another.¹⁷⁹ At first the attention of the Joint Forum was upon the larger international conglomerates; more recently it is increasingly interested in smaller firms too.

The Joint Forum issued its first major report, titled, *The Supervision of Financial Conglomerates*, in February 1999.¹⁸⁰ The Joint Forum identified itself in the report as representing the CBS, IOSCO, IAIS, thirteen countries¹⁸¹ and the European Union ("EU") Commission in an observer capacity.¹⁸² The Joint Forum addressed international conglomerates from the vantage point of a regulator and prepared a number of papers in this capacity.¹⁸³ Dealing as it does with different financial businesses, the Joint Forum stresses what it terms the "cross-sectoral issues" related to the business on which it concentrates. The papers were released by the three parent regulator bodies in 1998 and have stimulated a new, more broadly based kind of regulation.

3.1.3. *The CGFS*

One of the three permanent committees, the CGFS¹⁸⁴ was estab-

¹⁷⁸ 113 Stat. 1338 (2000).

¹⁷⁹ Banks had always been involved in both securities activities and insurance. Even after the Gramm-Leach-Bliley Act, there were technical divisions among the three fields, but the new statute made convergence much more available.

¹⁸⁰ Joint Forum on Financial Conglomerates, *Supervision of Financial Conglomerates* (Feb. 1999) [hereinafter *Supervision of Financial Conglomerates*], available at <http://www.bis.org/publ/bcbs47.pdf> (last visited Oct. 14, 2004).

¹⁸¹ Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom and the United States.

¹⁸² *Supervision of Financial Conglomerates*, *supra* note 180, at 1.

¹⁸³ The papers were titled: Capital Adequacy Principles; Supplement to the Capital Adequacy Principles Paper; Fit and Proper Principles; Framework for Supervisory Information Sharing; Principles for Supervisory Information Sharing; and Supervisory Questionnaire. *Id.* at 2.

¹⁸⁴ See Bank for International Settlements, *Committee on the Global Financing System* ("CGFS") (providing general information on the CGFS), at <http://www.bis.org/cgfs> (last visited Oct. 14, 2004).

lished in 1971 as successor to the Euro-Currency Standing Committee. The committee has three major tasks, all dealing—as the committee’s name indicates—with the global financial system: systematic short-term monitoring of global financial system conditions; longer-term analysis of the functioning of financial markets; and the articulation of policy recommendations aimed at improving market functioning and promoting stability.¹⁸⁵ The CGFS website lists twenty-one published CGFS reports through March 2003.¹⁸⁶ The focus of the CGFS is the functioning of the global market, and its publications and reports are focused more on that market, as is the work of the CBS, than upon the operations and solvency of the financial institutions which it reviews. From this vantage point, however, it also acts as a central bank forum and submits reports and recommendations to central banks designed to enhance their responsibilities for monetary and financial stability.

A recent report that illustrates the niche occupied by the CGFS is the January 2003 paper titled, *Credit Risk Transfers*.¹⁸⁷ While devices such as financial guarantees and credit insurance are long-standing features of the international marketplace, the last few years have seen a considerable expansion of the range of credit risk reduction transactions and the circumstances when they are used. At the same time, new credit risk transfer instruments are relatively few compared to the underlying risk-related instruments that create the credit risk itself. This paper identifies and analyzes the implications to the financial market of the growth of financial institutions in new risk reduction instruments.

3.1.4. The CPSS

This committee, also a permanent committee, was formally established in 1990 to continue work on both domestic and cross-border payment, and clearing systems undertaken since 1980 by a series of different groups and committees organized by the G-10 countries. These relatively short-lived groups had examined such issues as the development of electronic funds transfer systems and the question of cooperation versus competition in payment systems. The result of an early study by a so-called group of com-

¹⁸⁵ *Id.*

¹⁸⁶ Bank for International Settlements, *CGFS Publications*, at <http://www.bis.org/cgfspubl.htm> (last visited Oct. 16, 2004).

¹⁸⁷ Comm. on the Global Financial Systems, *Credit Risk Transfer* (Jan. 2003), available at <http://www.bis.org/publ/cgfs20.pdf> (last visited Oct. 14, 2004).

puter experts in 1985 was the first of a series that has become known as "Red Books."

3.1.5. *The Committee on Interbank Netting Schemes*

Through the years, BIS, the CBS and the other loose affiliates created still other committees that studied and reported upon bank and related financial activities. For example, the Committee on Interbank Netting Schemes was created by the G-10 central banks in 1990. The committee issued a report, actually published and released by BIS, that contained a set of minimum standards for the operation of bilateral and multilateral netting systems and set an agreed approach for the joint oversight of such systems. Committee reports in the years since then advise central banks on such topics as the development of electronic payment issues, retail payments—largely devoted to consumer payments—the nature of payments in various selected countries and securities settlements. In connection with their work in the securities field, the committee has done several reports with the OSLO, and covered both domestic and international settlements. The committee has also reported on clearing arrangements for derivative products. All together, there are over fifty reports issued by this committee on payment and settlement topics.¹⁸⁸

This committee reflects the position of bank regulators in the continuing belief that confidence in the banking system cannot survive without public confidence in the currency and the ability to sustain economic development. In the many ways illustrated above, the committee, as a virtual public regulator, seeks to enhance that goal.

3.2. *Other Entities*

Entities outside BIS and its immediate colleagues have moved in various ways to approach the international regulation of banking and bank-related activities. We can name a few.

1. In the imposition of conditionality standards as part of its offers of financial assistance, the IMF has positioned itself as a quasi-regulator of international banking ac-

¹⁸⁸ A description of the Committee and a list of its publications may be found on the BIS website. Bank for International Settlements, *Report of the Committee on Interbank Netting Schemes of the central banks of the Group of Ten countries* (Lamfalussy Report), CPSS Publication No. 4 (Nov. 1990), at <http://www.bis.org/publ/cpss04.htm> (last visited Oct. 14, 2004).

tivities. It has been mentioned as a possible senior international bank regulator.¹⁸⁹

2. IOSCO has actually joined with BIS in the regulation of financial conglomerates.¹⁹⁰
3. The Ad Hoc Group on Securities Markets was set up by the Organization for Economic Co-operation and Development in the late 1980's.¹⁹¹

Moving farther afield from banking, international groups with uncertain authority work in such international fields as climate control, energy, water, fisheries, the environment and, of course, nuclear energy.¹⁹²

4. RELATIONSHIP BETWEEN BIS AND NATIONAL FINANCIAL AUTHORITIES

The BIS issues supervisory guidance to central and local banks, and other financial institutions on various banking matters, including core banking and such related problems as banknote counterfeiting,¹⁹³ international payment systems establishment of a uniform foreign exchange, derivatives systems, and financial risks in commercial lending. Ultimately BIS must be measured by the effect it has upon the financial institutions actually in the market place. This is an evolving relationship, but BIS can be accurately seen as becoming closer to local banks.

The BIS's recommendations do not have any legal force (so-called "soft law") with national financial authorities and banks around the world. However, local authorities and banks cannot

¹⁸⁹ See ANNE L.M. SALDA, 4 THE INTERNATIONAL MONETARY FUND 45 (International Organization Series 1992) (summarizing William McChesney Martin, Toward a world central bank? Lecture and Commentaries, Lecture before the Per Jacobsson Foundation and BIS (1970)) (considering the possibility of the IMF incorporating all aspects of the Organization for Economic Co-operation and BIS)).

¹⁹⁰ See discussion *supra* Section 3.1.2 (describing the formation of the joint forum).

¹⁹¹ Cynthia C. Lichtenstein, *International Standards for Consolidated Supervision of Financial Conglomerates: Controlling Systemic Risk*, 19 BROOK. J. INT'L L. 137, 139 (1993).

¹⁹² See *infra* text accompanying note 359 (stating that the CBS represents the major central banks).

¹⁹³ See Press Release, The Chairman of the Governors of the Group of Ten (May 10, 2000) ("In response to the threat of increasing use of personal computers and digital imaging tools, the Governors [of the G-10 central banks] authorized work by a group of central banks (SSG 2) to develop a system to deter PC-based counterfeiting."), available at <http://www.bis.org/press/p000510b.htm> (last visited Oct. 14, 2004).

simply ignore BIS's recommendations. In such cases, they know they risk being regarded by major international banks and their financial authorities, including BIS itself, as "unattractive" business partners. And they know that in this global economy, they cannot afford to develop activities in isolation. Therefore, in addition to the central bank members, recommendations and suggested guidelines issued from BIS are also constantly adopted by central banks that are not members of BIS.¹⁹⁴

All of BIS's activities aim at promotion of an international financial stability—which was, in its originally limited scope, the main purpose of BIS's creation. International financial stability is of even more interest to the financial authorities today than in 1929.¹⁹⁵ As for banks, financial stability starts with stable profits

¹⁹⁴ See Andrew Crockett, International Standard Setting in Financial Supervision, Lecture Before the Cass Business School, City University, (Feb. 5, 2003) (discussing the importance and the difficulty in achieving financial stability as opposed to monetary stability), available at <http://www.bis.org/speeches/sp030205.htm> (last visited Oct. 14, 2004).

¹⁹⁵ Roger W. Ferguson, Jr., Should Financial Stability Be an Explicit Central Bank Objective?, Remarks Before an International Monetary Fund Conference on Challenges to Central Banking from Globalized Financial Markets (Sept. 17, 2002) (presenting a paper on how the Federal Reserve is focusing on financial stability objectives through the fostering of price stability and sustainable output growth), available at <http://www.federalreserve.gov/BOARDDOCS/SPEECHES/2002/20021016/default.htm> (last visited Oct. 14, 2004).

Financial stability, is an explicit central bank objective among other countries, and is adapted in central banks' charters.

For example, in 1977, the statement, "[t]he Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" was added to the law governing the Federal Reserve. 12 U.S.C. § 225a (2002).

The Bank of Canada charter states its purpose is to, "regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada." Bank of Canada Act, R.S.C., ch. B-2, § 1 (1985) (Can.).

The Bank of England charter states, "objectives of the Bank of England shall be - (a) to maintain price stability, and (b) subject to that, to support the economic policy of Her Majesty's Government, including its goals for economic growth and employment." Bank of England Act, 1998, c. 4, § 11 (Eng.).

The Bank of Japan charter, notes, "[c]urrency and monetary control shall be aimed at, through the pursuit of price stability, contributing to the sound development of the national economy." The Bank of Japan Law, art. 2 (2001) (preliminary translation by the Bank of Japan), available at <http://www.boj.or.jp/en/>

and fewer risk-taking activities. Financial stability for all financial authorities means a developed economy, a low unemployment percentage, and appropriate interest rates in lending. BIS has undertaken these goals as its mission, and has assumed a constantly increasing influence over the day-to-day affairs of local banks and other financial institutions.

After the economic crisis of the 1970's, most industrialized countries became concerned with their banks taking increased risks. Low capital levels and off balance sheet activities made it highly difficult for banks to be monitored by national financial authorities. This first led in 1986 to a joint undertaking between the United States and the United Kingdom, aimed at achieving a common risk-weighted capital measuring system. In December 1987, the joint undertaking was followed with the creation of the Basel Capital Accord. In 1989, the EU adopted its own capital guidelines based on the Basel structure. The Basel Capital Accord was thereafter adopted by many non-EU countries. Adoption of the accord was perceived as enhancing a country's international reputation and enabling it to operate throughout the developed financial world (such as the United States), which increasingly required conformity with BIS standards as a condition to carry out activities in their respective markets.¹⁹⁶ Today, there are over 120 countries, which have adopted¹⁹⁷ the revised Basel Capital Ac-

about/basic/law/bojlaw1.htm (last visited Oct. 14, 2004).

The European Central Bank resolution states that, "[t]he primary objective of the European System of Central Banks shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support general economic policies in the Union with a view to contributing to the achievement of the Union's objectives." Draft Treaty Establishing a Constitution for Europe, June 20, 2003, art. I-29, para. 2, at <http://european-convention.eu.int/docs/Treaty/cv00850.en03.pdf> (last visited Oct. 14, 2004).

¹⁹⁶ See Enrico Colombatto & Jonathan R. Macey, *A Public Choice Model of International Economic Cooperation and The Decline of The Nation State*, 18 CARDOZO L. REV. 925 (1996) (applying the theory that changes in the world, including technological changes and changes to market process, create strong incentives for countries to create international agreements and institutions like the Basel Accords); see also Hal S. Scott, *The Competitive Implications of the Basle Capital Accord*, 39 ST. LOUIS U. L.J. 885, 888 (1995) (indicating that BIS Committee includes "the G-10 countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, United Kingdom, and United States) plus Switzerland and Luxembourg" and an extension of the Accord in 1989 brought in Denmark, Greece, Ireland, Portugal, and Spain).

¹⁹⁷ See William J. McDonough, *Global Finance Reform: A Regulator's Perspective*, Remarks Made Before the Foreign Policy Association (Nov. 17, 1999), available at <http://www.ny.frb.org/newsevents/speeches/1999/mcd991117.html>

cord.¹⁹⁸

The revised accord is a statement of the CBS as agreed to by all its members. It provides details of the agreed framework for measuring capital adequacy and minimum reserve standards to be carried out, which the national supervisory authorities represented on the committee intend to implement in their respective countries.¹⁹⁹ Implementation of BIS's rules continues to be a top priority for national financial authorities of the individual countries, which do not underestimate the wide-ranging legal, infrastructural and educational changes resulting from such implementation. National financial authorities do not hesitate to establish ambitious programs with clear time frames for the rules implementation.

International financial institutions, particularly the IMF and the World Bank, should have an important role in monitoring the implementation of BIS's rules. Those in support of this argument say that these international financial institutions already send teams of experts to almost all countries across the world whose implementation of BIS rules are connected to monetary policies and lending practice reforms orchestrated by the IMF and the World Bank. In this "cohabitation," BIS is increasingly earning a role of primary responsibility for creating a sound and safe environment for banking activities. This role, in turn, is dependent on the national financial policies sponsored by the World Bank and the IMF.²⁰⁰

The major international banks and even those of lesser scope are eagerly adapting the Basel Capital Accord in their lending businesses. The BIS's role is particularly felt in assisting emerging financial markets. The world's less sophisticated banks are adopting the BIS capital approach, as they embrace capital requirements

(last visited Oct. 14, 2004). The Basel II Accord is adopted by countries under bilateral "Memoranda of Understanding" between respective countries and BIS.

¹⁹⁸ See Patricia Jackson, International Financial Regulation and Stability, Speech at the Finance and Regulation Seminar Series at the Judge Institute of Management (Mar. 8, 2002) (stating that over one hundred countries have adopted Basel II), available at <http://www.bankofengland.co.uk/speeches/speech177.pdf> (last visited Oct. 14, 2004).

¹⁹⁹ *Basel Capital Accord*, *supra* note 52, at 980 (detailing the agreed framework for measuring capital adequacy and the implementation of this framework in each respective country).

²⁰⁰ See Tom de Swaan, Address at the 14th Annual Meeting of the Latin American and Caribbean Banking Supervisory Organizations (Sept. 1, 1997) (discussing, "the background, advantages and implementation of the core principles for effective banking supervision"), available at <http://www.bis.org/review/r970912a.pdf> (last visited Oct. 14, 2004).

in the lending system.²⁰¹

National financial authorities still have the dominant role in developing and utilizing prudent regulations and requirements to control risks, including those covering capital adequacy,²⁰² loan loss reserves,²⁰³ asset concentrations,²⁰⁴ liquidity, risk management²⁰⁵ and internal controls.²⁰⁶ These requirements may be of a qualitative and/or quantitative nature, and their purpose is to limit banks' imprudent risk-taking. These requirements guide but are not a substitute for management decisions. Rather, they establish minimum calculated standards that ensure banks conduct their activities in a suitable manner. The evolving nature of banking requires national supervisory authorities to constantly assess sound

²⁰¹ Basel Comm. on Banking Supervision, *Overview Paper for the Impact Study* (Oct. 2002) (focusing on a comprehensive field test of BIS' proposals for revising the Basel Capital Accord), at <http://www.bis.org/bcbs/qis/qis3ovrv.pdf> (last visited Oct. 14, 2004).

²⁰² Bank regulators must issue minimum capital requirements for banks that reflect the risks that the banks undertake, and define the components of capital, considering its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord. See *Core Principles*, *supra* note 155, at 5 (detailing Principle 6, which implements greater use of assessments of risk provided by bank's internal systems as measurements for capital calculations), available at <http://www.bis.org/publ/bcbs107.pdf> (last visited Oct. 14, 2004).

²⁰³ See *id.* (detailing Principle 8, "Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating . . . loan loss reserves.").

²⁰⁴ See *id.* (detailing Principle 9, "Bank regulators must be satisfied that banks have management information systems that enables management to identify concentrations within the portfolio and supervisors must place prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.").

²⁰⁵ See *id.* (detailing Principle 7, "An essential part of any supervisory system is the evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.").

²⁰⁶ See *id.* at 6 (detailing Principle 14, "Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal and external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations."); see also *id.* (detailing Principle 15, "Bank supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.").

requirements, evaluate the continued applicability of existing requirements and also assess the need for new requirements.²⁰⁷

Implementation of the Basel Capital Accord requires a substantial commitment of resources by banks and their national financial supervisory authorities, and raises practical implications.²⁰⁸ Implementation of the Basel Capital Accord by a bank is not a simple process. It depends on various factors, including the bank's size, structure, and the nature and complexity of activities. Clear strategies by the banks' management, a strong operational risk culture and internal control culture, clearly assigned responsibilities and segregation of duties, effective internal reporting and contingency planning, are all crucial elements of an effective operational risk management framework for banks of any size and scope.²⁰⁹

There are certain specific areas to which banks direct their efforts in implementation of the accord. The areas mainly include design of an internal rating system, supervision of the rating system, data requirements and validation, and corporate governance.²¹⁰

Banks' internal rating system policies and degrees of risk should differentiate between each other. Credit risk rating systems are more useful to the extent they distinguish differing degrees of borrower risk. Thus, banks normally expand the number of ratings categories in which they keep their risk exposures. Nevertheless, it is not enough for banks to establish more ratings categories. The most difficult part for banks is to determine fairly and clearly the criteria for ratings categories, providing more meaningful assessments to both individual credit exposures and overall risk profiles. Transparency of the ratings criteria is of critical importance in or-

²⁰⁷ See generally *id.* at 5-7 (laying out core principles of banking supervision from the theory that financial instability not only threatens the stability but also the stability of international markets).

²⁰⁸ Roger W. Ferguson, Jr., *Basel II: A Realist's Perspective*, Remarks Made at the Risk Management Association's Conference on Capital Management (Apr. 9, 2003) (addressing concerns that the approach of the United States to Basel II is too limited in scope), available at <http://www.federalreserve.gov/boarddocs/speeches/2003/20030409/default.htm> (last visited Oct. 14, 2004).

²⁰⁹ See *Core Principles*, *supra* note 155, at 4 (listing key elements of newly proposed minimum capital requirements).

²¹⁰ See William L. Rutledge, *Implementing the New Basel Accord*, Remarks Before the British Bankers Association Basle 2/CAD 3 Half-Day Conference (Mar. 13, 2003) (addressing various challenges to implementing Basel II and describing preparations underway for implementation), available at <http://www.newyorkfed.org/newsevents/speeches/2003/rut031303.html> (last visited Oct. 14, 2004).

der to ensure that ratings are assigned in a rigorous and reliable way.²¹¹ Without a system of checks and balances, or control balance, any ratings system becomes useless. For any good ratings system control structure, the necessary structural elements are independence from the ratings process,²¹² internal review of such ratings,²¹³ and overall transparency.²¹⁴ They all contribute in consolidation of controls over ratings mechanism, which should be complemented by the collection of accurate data upon which the ratings are based.

Obviously, a credit system is only as satisfactory as the data upon which it is based. From a broad risk management point of view, access to a bank's data history and external data enables such a bank to evaluate the performance of its internal rating and risk valuation systems in a consistent and significant way.²¹⁵ As a result, banks are creating data "warehouses,"²¹⁶ enabling them, over time, to collect, store and draw upon loss statistics in an effective fashion. Designs, controls, or data that are added to a risk rating system should be evaluated based upon a strict corporate governance structure. Here, the active role of the banks' management body is crucial to the successful implementation of the accord. Banks will apply the accord productively only with full knowledge of the operational mechanisms, including the banks' internal ratings systems and the measure of risk derived from ratings.²¹⁷

²¹¹ Letter from Ed Duncan, Risk Management, International Swaps and Derivatives Association, Inc., to Nicholas Le Pan, Accord Implementation Group, Basel Committee on Banking Supervision (Dec. 20, 2002) (addressing views on issues discussed in the Technical Guidance accompanying a Quantitative Impact Study), at <http://www.bis.org/bcbs/qis/resp3isda.pdf> (last visited Oct. 14, 2004).

²¹² Those in charge of assigning ratings and approving loans should be independent of the marketing department and revenue producers.

²¹³ This includes having a subsequent review of ratings by an independent review group, which reviews ratings for accuracy, timeliness and consistency. Both the ratings system and individual ratings should be subject to review by the internal audit department.

²¹⁴ Ratings criteria are intended to be objective. A bank has policies and procedures in place, which clearly document the rationale for each ratings category. The more transparent the process is, the easier it is to audit ratings.

²¹⁵ See William J. McDonough, Risk Management, Supervision and the New Basel Accord, Remarks at the Bond Market Association: 2003 Legal and Compliance Conference (Feb 4, 2003) (discussing improvements to banks' risk management processes and business imperative), available at <http://www.bis.org/review/r030207a.pdf> (last visited Oct. 14, 2004).

²¹⁶ See Rutledge, *supra* note 210 (addressing various challenges ahead in implementing Basel II).

²¹⁷ See William J. McDonough, Implementing the New Basel Accord, Re-

It is revealing that, according to a 2001 survey from the CBS, on the annual reports of fifty-four internationally active banks, which included questions related to quantitative and qualitative disclosures in various pertinent categories (i.e., capital structure, capital adequacy, market risk internal modeling, internal and external ratings, credit risk modeling, securitization activities, asset quality, credit derivatives and other credit enhancements, other derivatives, geographic and business lines diversification, accounting and presentation policies, and other risks),²¹⁸ a majority of these banks were expanding their disclosure of lending information.²¹⁹ The main disclosures from the banks consisted of accounting policies, risks and capital structure. Credit risk modeling, credit derivatives, and other credit enhancements were the least widespread of the disclosures.

From 1999 to 2001, banks sought to increase the disclosure of information on securitization activities, internal and external ratings, credit derivatives, credit enhancements, operational and legal risks, liquidity risk, and interest rate risk in the banking books.²²⁰ The most common individual disclosure items concerned the structure of capital, accounting and presentation policies, market risk internal modeling, and the risk-based capital ratio calculated in accordance with the Basel Capital Accord parameters. In examining the banks' reporting, the CBS encouraged them to expand the transparency of their use of lending credit risk mitigation methods, asset securitization, and internal ratings, given that disclosure in these areas will support use of these methods under the accord.

The CBS also encourages those banks that do not disclose their information to act according to the existing CBS disclosure guidelines issued in order to improve disclosure procedures.²²¹ And

marks Before the Global Association of Risk Professionals (Feb. 11, 2003) (discussing the need for clarity and transparency in risk rating systems as they apply to the 1988 Accord), available at <http://www.bis.org/review/r030217a.pdf> (last visited Oct. 14, 2004).

²¹⁸ This publication of the results of the 2001 disclosure survey is part of the sustained effort by the Basel Committee on Banking Supervision to promote transparency and effective market discipline in the banking and capital markets.

²¹⁹ Overall, in 2001, banks disclosed sixty-three percent of the items included in the survey, up from fifty-nine percent in 2000 and fifty-seven percent in 1999.

²²⁰ See Basel Comm. on Banking Supervision, *Public Disclosures by Banks: Results of the 2001 Disclosure Survey* (May 2003) at 14 (describing the results of internal and external ratings of banks), available at <http://www.bis.org/publ/bcb97.pdf> (last visited Oct. 14, 2004).

²²¹ See generally Michele Fratianni & John Pattison, *International Financial Ar-*

when this committee raises the red flag, banks take notice.

The CBS is paying particular attention to the rapid, and often difficult to supervise, expansion of e-banking activities worldwide. The committee expects the risks of e-banking to be acknowledged and managed by banking institutions in a prudent manner, accounting for the fundamental characteristics and challenges that e-banking services offer, including the unprecedented speed of change related to technological and customer service innovation, the universal nature of open electronic networks, and the integration of e-banking applications in computer systems. "[T]hese characteristics [have] increase[d] and modified some of the traditional risks associated with banking activities, particularly strategic, operational, legal, and reputational risks, thereby influencing the overall risk profile of banking."²²²

While existing risk management principles remain applicable to e-banking activities, such principles must be tailored, adapted, and expanded to address new challenges created by e-banking. It is incumbent upon bank management and boards of directors to ensure that their institutions have reviewed and modified existing risk management policies and processes to cover e-banking activities. Integration of e-banking applications demands an integrated risk management approach for all banking activities.²²³

Banks in developed economies have significantly increased their risk based capital ratios, particularly with the introduction of the Basel Capital Accord in 1988. A survey from BIS found that the industry average capital ratio rose from 9.3% in 1988 to 11.2% in 1996. Those banks which were close to (or under) the accord's minimum capital adequacy ratio of eight percent in 1988, showed a much higher overall increase than those which had historically high capital ratios.²²⁴ Although the data is not completely compa-

chitecture and International Financial Standards, 57 ANNALS AM. ACAD. POL. & SOC. SCI. 183 (2002) (proposing a portal solution to international financial standards with the United States and the United Kingdom as examples).

²²² Basel Comm. on Banking Supervision, *Risk Management Principals for Electronic Banking* (May 2001), available at <http://www.bis.org/publ/bcb82.pdf> (last visited Oct. 14, 2004).

²²³ See Basel Comm. on Banking Supervision, *Management and Supervision of Cross-border Electronic Banking Activities* (July 2003) ("[s]tressing the need for banks to integrate cross-border e-banking risks into the banks overall risk management framework."), available at <http://www.bis.org/publ/bcb99.pdf> (last visited Oct. 14, 2004).

²²⁴ See PATRICIA JACKSON ET AL., CAPITAL REQUIREMENTS AND BANK BEHAVIOUR: THE IMPACT OF THE BASLE ACCORD (Basle Comm. on Banking Supervision, Working

rable across countries, it is clear that the introduction of the Basel capital adequacy ratios was followed by a significant increase in the average capital ratios in most industrialized countries. Bank regulators regularly set ratios higher than the accord's minimum, bank by bank.²²⁵ From 1988 through 1996, seventy-three percent of banks in the most industrialized countries increased both capital and risk-weighted assets while three percent of banks decreased capital (and also increased risk-weighted assets). The BIS study concluded that in total ninety-two percent of banks increased their capital levels while seventy-six percent raised their risk-weighted assets.²²⁶

These statistics show clear differences between the capital and lending decisions of banks and the effects of those decisions in different countries.²²⁷ Studies indicate that banks with relatively low capital ratios have subsequently tended to improve these ratios—in the process outperforming the better capitalized banks.²²⁸ However, in the United States the combination of increased capital levels and reduced risk-weighted assets by banks, may have contributed to the sharp decrease in economic growth experienced from 1988 to 1991. Some critics say that the introduction of minimum regulatory capital requirements harms the competitiveness of the banking industry. They argue that if capital standards dictate that a bank maintain an equity position in excess of what the bank would hold independently or in response to market pressure, then these standards constitute an artificial constraint on the bank's operations.

Paper No. 1, Apr. 1999) (noting studies which show that post-Accord, weakly capitalized banks rebuilt their capital ratios), available at http://www.bis.org/publ/bcbs_wp1.pdf (last visited Oct. 14, 2004).

²²⁵ See George Sheldon, *Capital Adequacy Rules and the Risk-Seeking Behavior of Banks: A Firm-Level Analysis*, SWISS J. OF ECON. & STATISTICS 709 (1996) (discussing how Bank Regulators utilize the Basel Capital adequacy ratios).

²²⁶ See S. Pilcer & M. D. Dierdorff, *Understanding Structured Liquidity Facilities in Asset-Backed Commercial Paper Programs*, ASSET-BACKED COM. PAPER MARKET REV. (First Quarter 1997) (discussing the implications of credit risk shifting), available at <http://www.securitization.net/pdf/abcp3.pdf> (last visited Oct. 14, 2004).

²²⁷ See John Boyd & Mark Gertler, *U.S. Commercial Banking: Trends, Cycles and Policy*, in NBER MACROECONOMICS ANNUAL (1993) (proposing key policy options and examining trends in U.S. commercial banking).

²²⁸ See generally Adrian Blundell-Wignall et al., *Monetary Policy in the Wake of Financial Liberalization* (Org. for Econ. Co-operation and Dev., Working Paper No. 77, April 1990) (examining evidence concerning the impact of financial liberal trends, and innovation on monetary policy), at <http://www.oecd.org/dataoecd/16/40/2002723.pdf> (last visited Oct. 14, 2004).

Evidence supports the view that the Basel Capital Accord, which was implemented in the United States in the beginning of 1990, played a role in the U.S. "credit crunch" when the portfolios of U.S. banks shifted from commercial lending into government securities. For example, shortly after the passing of the accord, the share of total bank credit invested in commercial and industrial loans in the United States fell from 22.5 percent in 1989 to below sixteen percent in 1994. Yet, the share of total bank credit invested in U.S. government securities rose from fifteen percent to twenty-five percent over the same period of time.²²⁹ The development of risk management policies by BIS and the consideration of those policies by local bank regulatory authorities has a salutary effect in several ways: bank regulators are evaluating the relationship between capital and bank activity,²³⁰ and bank regulators and bank management are more deeply evaluating the effects of bank activity on general economic activity.²³¹

The work on bank capital and risk measurement being conducted in Basel does not ignore that many, perhaps most, banks are safe, sound and well managed. The CBS found similarities and differences in the structure, methodology and application of internal rating systems among banks.²³² According to a BIS study,²³³ almost thirty banks and financial institutions in the most developed countries had well-developed internal rating systems.

Although there is no unique standard for the design and opera-

²²⁹ See Craig Furfine, Evidence on the Response of US Banks to Changes in Capital Requirements (Bank for Int'l Settlement, Working Paper No. 88, June 2000) (presenting a structural model of a banking firm in order to test how banks typically adjust loan portfolios over a given period of time), at <http://www.bis.org/publ/work88.htm> (last visited Oct. 14, 2004).

²³⁰ See generally Ronald E. Shrieves & Drew Dahl, *The Relationship Between Risk and Capital in Commercial Banks*, 16 J. BANKING AND FIN. 439 (1992) (supporting regulation for banks with low capital levels).

²³¹ See, e.g., William J. McDonough, Speech before the Monetary Authority of Singapore (Mar. 24, 2001) (discussing the broad economic effects of bank policies), at <http://www.bis.org/review/r000328a.pdf> (last visited Oct. 14, 2004).

²³² See Press Release, Bank for International Settlements, A New Capital Adequacy Framework, Supplementary Documents (Jan. 18, 2000) (quoting Pierre-Yves Thoraval, Chairman of the Working Group that produced the paper that is the subject of the press release), at <http://www.bis.org/press/p000118.htm> (last visited Oct. 14, 2004).

²³³ See *id.* In spring 1999, BIS Committee's Models Task Force received a mandate from the Committee to embark on a study of banks' internal rating systems and processes, and to evaluate the options for relating internal ratings to a regulatory scheme.

tion of an internal rating system, the CBS concluded that banks are establishing similar strategies, including, among others: using the same types of risk factors when assigning an internal rating, accompanied by different supervision approaches in doing so; assignment of these ratings based on an assessment of the borrower; use of information gleaned from ratings for management reporting, pricing, limit setting; and ways of collection and analysis of internal data to quantify risks.²³⁴

Since the birth of the Basel Capital Accord, the CBS has produced numerous policy statements dealing with sound risk management practices for banks related to derivative activities and most recently involving the management of interest rate risk.²³⁵ One of the most recent notable accomplishments of the committee was the creation of new capital standards for market risk in trading activities, reflecting a new approach for building international banking standards. Banks and other financial institutions apply the new capital standards to their existing risk management practices, resulting in increased efficiency.²³⁶

²³⁴ There is much for local bank regulators to do in applying the Basel Capital Accord standards. In determining whether a bank may rely on its market risk model for capital purposes, national financial supervisory authorities need to evaluate the technical fundamentals of the model, as well as to establish risk control and management procedures for implementation of such a model. Particular attention should be paid to (1) whether the model is based on reasonable risk assumptions; (2) whether a bank is appropriately using back-testing procedures; (3) performance of the model under normal and stressed market conditions; and (4) the overall use of models, including the model evaluation process and the new product approval process. See William J. McDonough, *Completing the Journey to the New Basel Accord*, Remarks before the Twelfth International Conference of Banking Supervisors (Sept. 18, 2002) (commenting on the promotion of risk management via the regulation of capital), at <http://www.bis.org/review/r020920b.pdf> (last visited Oct. 14, 2004). Other important tasks for the bank regulators are (1) to audit how banks are managing operational risk management and control structures from a corporate governance point of view, (2) to analyze banks' assessments of their economic capital requirements for operational risk, and (3) to examine how this capital is allocated to business lines to strengthen efforts for improving internal controls. The regulators' ultimate goal is to ensure that the internal processes in place are in fact working and are effective in mitigating the relevant risks of banks' activities. See Rutledge, *supra* note 210.

²³⁵ See Masaru Hayami, *Financial system stability and future agenda—need to strengthen the capital base*, Speech at the Fiftieth Anniversary Symposium of the Institute for Financial Affairs (July 14, 2000) (discussing the incorporation of "market and operational risks" and the improvement of credit risk measures in the reformed Capital Accord), available at <http://www.bis.org/review/r000718a.pdf> (last visited Oct. 14, 2004).

²³⁶ See Robert T. Parry, *Monetary policy in a new environment—the US experience*, Speech at the Joint Bundesbank/BIS conference on "Recent develop-

Promoting sound risk management in banks is a goal which bank regulators need to pursue aggressively when they consider implementing new banking policies and regulations. This should be compatible with underlying economics and market demands in their respective countries to the extent of building on "best" or sound banking practices in designing rules and regulations, leading toward a common end. Identifying those practices and deciding how to apply them as supervisory or regulatory standards will also strengthen relations among national financial authorities, proving invaluable in times of market stress.

Among banks and related financial institutions, there are significant differences in operations, structures, and historical development. No single or specific technique is the best for every institution in its risk measurement, modeling processes or, of course, regulatory capital standards. The current proposals to the Basel Capital Accord encourage banks to adapt their own risk measurement and management processes to their needs, determining the proper incentives and techniques for managing their affairs. However, it is also necessary for bank regulators to limit the level of flexibility embodied in the accord's recommendations.²³⁷ Bank regulators must develop flexible, market-compatible regulations and also cautiously rely on market discipline and on banks' internal incentives. The modern approach also demands that the public be provided information on the risk exposures of banks and their procedures to manage those risks.²³⁸ Public disclosure of information on financial institutions varies throughout the world; not infrequently, such disclosure practices are minimal at best. In add-

ments in financial systems and the challenges for economic policy" (Sept. 28-29, 2000) (noting that technological developments have improved efficiency), *available at* <http://www.bis.org/review/r001005c.pdf> (last visited Oct. 14, 2004).

²³⁷ See Laurence H. Meyer, Capital Standards and Community Banks, Remarks at the Ohio Bankers' Day Conference (Mar. 15, 2001) (questioning whether it would be wise for U.S. regulators to adopt the flexible approach in the accord), *available at* <http://www.federalreserve.gov/boarddocs/speeches/2001/20010315/default.htm> (last visited Oct. 14, 2004).

²³⁸ See Laurence H. Meyer, The New Basel Capital Proposal, Remarks at the Annual Washington Conference of the Institute of International Bankers (Mar. 5, 2001) (discussing the benefits of the disclosure requirements in the U.S. market and advocating for more disclosure to decrease risk), *available at* <http://www.federalreserve.gov/boarddocs/speeches/2001/20010305/default.htm> (last visited Oct. 14, 2004). The extent to which public perception is a vital cog in controlling banks is a major issue in the Congressional and regulatory review of the deposit insurance system. Many believe that deposit insurance should be reduced in order to increase the public's supervisory function.

ing transparency to the providing of market information, bank regulators may attract an increased number of investors interested in banks and other financial institutions, leading to the growth of local capital markets.

Additionally, the role of banks in increasing disclosure may lead to expansion into other financial and non-financial sectors. Of course, the more information shared and disclosed by banks about their condition and future prospects, the less uncertainty will be felt by investors.²³⁹

Bank regulators should exercise caution when implementing the CBS's recommendations. Often regulators create new or different techniques, based on the committee's recommendations, which might impair their oversight efforts or which do not relax them beyond prudent limits. In globalized markets, weak or ineffective supervision in countries of any economic size might have far reaching consequences. These are precisely the concerns of the CBS, which systematically tries to identify the respective roles and responsibilities of home and host bank regulatory authorities. It remains the imperative duty of bank regulators to coordinate with sister regulatory authorities in other countries in order to administer agreed-upon standards of financial institution safety and soundness.²⁴⁰

Implementation of the CBS's recommendations often has become too costly and burdensome for banks. Sometimes, these recommendations put a crimp in a particular banking activity. However, such barriers are overcome by banks, whose fundamental objective is to create a risk-based capital system and to promote better risk management, which leads to a safer banking system. Banks, principally large banks with exposure to international activities, are extensively participating in discussions for the production of a better risk prevention systems addressed to both the

²³⁹ See Roger W. Ferguson, Jr., *Community and Regional Banks—Increasing Complexity and Risk-Management Needs*, Remarks at the 106th Annual Convention of the North Carolina Bankers Association (May 21, 2002) (discussing the importance of risk management procedures and oversight in community and regional banks), available at <http://www.federalreserve.gov/boarddocs/speeches/2002/200205212/default.htm> (last visited Oct. 14, 2004).

²⁴⁰ See Alan Greenspan, *Testimony before the Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises of the Committee on Banking and Financial Services of the U.S. House of Representatives* (Mar. 19, 1997) (stating the importance of risk management procedure and oversight in community and regional banks), available at <http://www.federalreserve.gov/boarddocs/testimony/1997/19970319.htm> (last visited Oct. 14, 2004).

needs of private and public financial institutions. The CBS and national bank authorities take banks' comments and suggestions seriously, and respond to them accordingly.²⁴¹ The relationship between bank regulators and banks is ongoing and operates best when it includes the industry's understanding that the regulator's wider objective is to develop a safer and sounder banking system by strengthening risk management in banking institutions.²⁴²

The United States adopts the Basel proposals under the statutory authority of the International Lending Supervision Act.²⁴³ On an interagency basis, the FRB, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation are all represented on the CBS. The Federal Reserve is also represented on the Committee on Payment and Settlement Systems. The Federal Reserve and the other bank regulatory agencies have increasingly recognized the significant role of the Basel Capital Accord, particularly its introduction of risk-based capital requirement recommendations.²⁴⁴ U.S. bank regulators work systematically with banks in order to supervise their implementation of the Basel Capital Accord's minimum capital requirements.²⁴⁵ Shortly after the introduction of the accord, a new trend occurred in U.S. commercial bank portfolios consistent with the new economic incentives given

²⁴¹ See Edward W. Kelley, Jr., Remarks at the Seminar on Banking Soundness and Monetary Policy in a World of Global Capital Markets Sponsored by the International Monetary Fund (Jan. 29, 1997) (recognizing the significance of the liquidity transformation function of banks and its interaction with national economies), *available at* <http://www.federalreserve.gov/boarddocs/speeches/1997/19970129.htm> (last visited October 14, 2004).

²⁴² See Alice M. Rivlin, Remarks at The Brookings Institution National Issues Forum (Dec. 19, 1996) (addressing how bank regulators should supervise bank risk-taking), *at* <http://www.federalreserve.gov/boarddocs/speeches/1996/19961219.htm> (last visited Oct. 14, 2004).

²⁴³ See 12 U.S.C. §§ 3901-12 (2000) (declaring the congressional policy fortifying the economic health of the nation through strengthening of bank regulatory frameworks).

²⁴⁴ Under the 1998 Agreement, banks should hold a higher percentage of equity capital for loan than for government security. Considering that loans are presumably more risky than securities, these new capital regulations seem to improve the link between bank risk and bank capital. Considering also the common view that equity capital is more costly than alternative funding sources, these requirements made lending more expansive than purchasing securities, which in turn provided an incentive for banks to shift their portfolios away from loans and into securities.

²⁴⁵ See 12 U.S.C. § 3907(a)(1) (2000) ("Each appropriate Federal banking agency shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions . . .").

to bank managers. Banks²⁴⁶ started to reduce their investments in commercial lending and began instead to invest in government securities. By way of example, the total share of bank credit invested in commercial loans dropped from 22.5 percent to sixteen percent during the period 1989 to 1994, while credit invested in U.S. government securities increased from fifteen percent to twenty-five percent.²⁴⁷

In the United States, some long time critics believe that BIS's proposed rules are too complex and unnecessary to be implemented by U.S. banks and their regulators.²⁴⁸ One of those critics was John D. Hawke, Jr., head of the Office of the Comptroller of the Currency, who said, "U.S. banks—led by credit card lenders—were united in opposition to a provision requiring them to hold capital for expected losses on problem loans," arguing that banks today set aside reserves or charge high prices for products like credits cards in order to cover their expected losses.²⁴⁹ The CBS acceded to Comptroller Hawke's objection and reduced its capital design to where capital would have to be held only against unexpected, and not expected, losses.²⁵⁰ Concern was also expressed concerning a decision by U.S. bank regulators that the Basel rules would apply only to some ten leading banks that account for about ninety-nine percent of the foreign exposure in the U.S. banking system.²⁵¹

In general, the U.S. regulatory agencies see BIS as an entity that helps in developing compatible regulations to maintain a healthy international banking system which meets the growing needs of the U.S. economy. The effect of BIS's work is to enable U.S. institutions to compete safely on a nondiscriminatory basis.²⁵² If there

²⁴⁶ Banks that are bound by the capital requirements are commercial and savings banks, credit unions, foreign bank branches and agencies, and Edge Act corporations.

²⁴⁷ See FURFINE, *supra* note 229, at 1-2.

²⁴⁸ The CBS has dropped its wish that U.S. regulators adopt the Basel Accord II rules by the end of 2003.

²⁴⁹ Gary Silverman, *U.S. Regulator Voices Basel Concerns*, FIN. TIMES, Sept. 13, 2003, at 8.

²⁵⁰ See Barbara Rehn, *Basel Rewrite – Suddenly, Simple is In*, AM. BANKER, Oct. 21, 2003, at 1 (listening to the concerns of industry, the CBS "is shifting back to a . . . less prescriptive approach").

²⁵¹ See generally *id.* at 3 (discussing difficulties in rewriting international capital requirements).

²⁵² See William J. McDonough, *Bank Supervision and Credit Standards under Basle II—perspectives for SMEs*, Remarks at the Gürzenich Köln (Apr. 25, 2002)

were regulatory competition between BIS and the U.S. bank regulators, the U.S. Congress at some point might oppose the work in Basel. It is also, however, conceivable that such regulatory competition could demonstrate advantages from accommodating different risk reduction recommendations and permitting financial institutions to have alternative ways to protect their business.²⁵³ Surveys over the years have tended to show that despite a natural inclination in banks to keep their internal information confidential, demands by law and by regulatory authorities to disclose their affairs to the public have had relatively good effects. Pressures from Basel and from local regulators continue in this direction, including such proposals as that the banks' so-called "call reports," be made available to the public.²⁵⁴

The Federal Reserve and other U.S. bank supervisory agencies believe that the CBS approach on internal credit risk ratings of banks will be a major step for bank supervision and regulation and will also have major implications for banks, not only in the United States, but also around the world. It seems to be a step in the right direction, keeping pace with market practices and addressing developments that undermine current standards.²⁵⁵ In sum, the Federal Reserve and other U.S. bank supervisory agencies are committed to the efforts of the CBS and the direction they are taking.²⁵⁶

(addressing needs of small and midsize businesses vis á vis banking regulations).

²⁵³ See Susan S. Bies, Corporate Governance and Risk Management, Speech at the Annual International Symposium on Derivatives and Risk Management, Fordham University School of Law (Oct. 8, 2002) (discussing the role of risk management in strengthening corporate governance from the viewpoint of management, boards, and internal control functions), available at <http://www.federalreserve.gov/boarddocs/speeches/2002/20021008/default.htm> (last visited Oct. 14, 2004).

²⁵⁴ See William J. McDonough, The Foundation of Financial Stability, Speech before the 50th Anniversary Symposium of the Bank of Korea, (Jul. 8, 2000) (noting financial sector reform in relation to the rehabilitation of Asian financial systems), available at <http://www.bis.org/review/r000713b.pdf> (last visited Oct. 21, 2004).

²⁵⁵ See Roger W. Ferguson, Jr., Financial Market Lessons for Bankers and Bank Supervisors, Remarks before the Bond Market Association, New York (Oct. 28, 1999) (stating the effects business practice and financial innovation have upon the supervision and regulation of banks), available at <http://www.federalreserve.gov/boarddocs/SPEECHES/1999/19991028.htm> (last visited Oct. 21, 2004).

²⁵⁶ See also Alan Greenspan, The Condition of the Financial Markets, Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, (Sept. 20, 2001) (discussing the U.S. economy's resilience to disruption as a result of deregulated financial markets and advances in information technology), avail-

Standards set by the CBS are finding their way into the bank examination process.²⁵⁷ Large U.S. banks have already commenced implementation of the Basel II rules. The Federal Reserve is working in combination with banks to provide improved training techniques. Encouraged by the CBS, local banks and regulators are increasingly setting their sights on global as well as domestic issues. Worldwide consolidated supervision is becoming an accepted part of banking.²⁵⁸

The Federal Reserve is actively involved in the ten meetings each year among G-10 central bank governors, under the auspices of BIS, where they exchange information on global economic issues, including the risk profiles of internationally active financial conglomerates and holding companies.²⁵⁹ Alan Greenspan, Chairman of the Federal Reserve Board, in his testimony to the Congressional Sub-Committee on Financial Institutions and Consumer Credit, said "[r]isks managed on a consolidated basis cannot be reviewed on an individual legal entity basis by different supervisors."²⁶⁰ The BIS and its constituent committees are increasingly

able at <http://www.federalreserve.gov/boarddocs/testimony/2001/20010920/default.htm> (last visited Oct. 14, 2004).

²⁵⁷ See Susan M. Phillips, *International Competition: Should We Harmonize Our National Regulatory Systems?*, Remarks at the IMF Seminar on Banking Soundness and Monetary Policy in a World of Global Capital Markets, (Jan. 28, 1997) (discussing efforts of the United States in concert with other countries to develop more consistent supervisory and regulatory systems), available at <http://www.federalreserve.gov/BOARDDOCS/SPEECHES/1997/19970128.htm> (last visited Oct. 14, 2004), see also Laurence H. Meyer, *Basel II: Moving from Concept Toward Implementation*, Remarks at the Bank Administration Institute's Conference on Treasury, Investment, ALM, and Risk Management (Oct. 15, 2001) (discussing the Basel proposal for developing processes for improving internal rating based systems and the impact such processes might have on the U.S. banking system), available at <http://www.federalreserve.gov/BOARDDOCS/SPEECHES/2001/20011015/default.htm> (last visited Oct. 14, 2004).

²⁵⁸ See Susan M. Phillips, *The Changing Financial Landscape and Umbrella Supervision*, Speech at The Exchequer Club (June 18, 1997) (discussing the need for industry-wide supervisory roles as a response to the changing nature of financial services in the twenty-first century), available at <http://www.federalreserve.gov/BOARDDOCS/SPEECHES/1997/19970618.htm> (last visited Oct. 14, 2004).

²⁵⁹ See Laurence H. Meyer, *Globalization and U.S. Monetary Policy*, Speech before the Institute for Global Management and Research, School of Business and Public Management, The George Washington University (Oct. 14, 1997) (discussing the effects of globalization on the U.S. economy), available at <http://www.federalreserve.gov/BOARDDOCS/SPEECHES/1997/199710143.htm> (last visited Oct. 14, 2004).

²⁶⁰ See Howard Davies, *Market and Regulatory Structures in a Global Envi-*

emphasizing that for a bank operating in a large financial group, it is necessary to look not only at the soundness of the bank itself but also at the group as a whole.

In the EU, Basel recommendations serve as the basis to issue EU banking directives, which are legally binding in all EU member countries.²⁶¹ Among the most relevant EU directives with respect to compliance with BIS's recommendation are: the EU Directive on Investment Services (hereinafter "Investment Services Directive");²⁶² the EU Directive on Capital Adequacy (hereinafter Capital Adequacy Directive);²⁶³ the EU Directive on Solvency Ratio (hereinafter Solvency Ratio Directive);²⁶⁴ the EU Directive on Own Funds (hereinafter Own Funds Directive);²⁶⁵ and the EU Directive on Deposit Guarantee Scheme (hereinafter Deposit Guarantee Scheme Directive).²⁶⁶

The Investment Services Directive provides the European "passport" to investment firms to offer investment services cross-border or by branches in other European member countries without the need to undergo additional authorization requirements in these countries.

The Capital Adequacy Directive lays down the initial capital requirements for investment firms. The directive also establishes the amount of capital which must be set aside by both banks and

ronment, Speech at the Federal Reserve Bank of Atlanta's Financial Markets Conference (Feb. 22, 1997) (discussing UK regulatory structures and proposals for change), available at <http://www.bis.org/review/r970305e.pdf> (last visited Oct. 14, 2004).

²⁶¹ See JACKSON, *supra* note 224 (reviewing the empirical evidence on the impact of the Basel Capital Accord).

²⁶² Council Directive 93/22, 1993 O.J. (L 191) 27 [hereinafter Investment Services Directive] (establishing an approach to secure mutual recognition of authorization and supervision systems throughout investment service providers in the EU).

²⁶³ Council Directive 93/6, 1993 O.J. (L 141) 1 [hereinafter Capital Adequacy Directive] (establishing guidelines, though not common standards, for initial capital amounts of EU investment firms).

²⁶⁴ Council Directive 89/647, 1989 O.J. (L 386) 14 [hereinafter Solvency Ratio Directive] (detailing a common solvency standard in the form of a minimum ratio to reinforce the capital of credit institutions in the EU).

²⁶⁵ Council Directive 89/299, 1989 O.J. (L 124) 16 [hereinafter Own Funds Directive] (setting basic standards for the EU with respect to the own funds of credit institutions).

²⁶⁶ Council Directive 94/19, 1994 O.J. (L 135) 5 [hereinafter Deposit Guarantee Directive] (providing for a system for the single authorization of each credit institution by means of a single guarantee scheme).

investment firms to cover their market risk exposure.²⁶⁷ Unlike the Basel Capital Accord rules, the Capital Adequacy Directive is intended to apply not only to institutions with international operations, but also those that are purely domestic. Currently, Basel rules and the Capital Adequacy Directive are under revision. There is a good likelihood that the final drafts of the Basel and EU capital rules will be substantially and significantly more consistent than they are currently.²⁶⁸

The Solvency Ratio Directive was the vehicle by which the EU implemented the Basel Capital Accord into an EU law.

The Own Funds Directive determines the composition and the basic standards for the funds of credit institutions and specifies the qualifying criteria for certain own funds items, although EU member countries are free to apply more stringent provisions if they wish.

Under the Deposit Guarantee Scheme Directive, the home country deposit protection scheme of a bank also covers deposits of the bank's branches in other EU jurisdictions.

Under the First Banking Directive of 1978, banks within the EU had the authority to implement the recommendations proposed by BIS and other international banking institutions.²⁶⁹ By way of example, institutions subject to reserve requirements in various European member countries are:

- Austria, all domestic credit institutions;
- France, all credit institutions except the Caisse Francaise de Developpement;
- Germany, with few exceptions, all institutions doing the business of banking;
- Italy, all credit institutions except very small ones; and,
- the United Kingdom, all authorized banks except very small ones.²⁷⁰

²⁶⁷ See Jackson, *supra* note 198, at 20 (discussing the reasons behind international agreements on financial regulation).

²⁶⁸ See David Clementi, Speech at an [sic] Financial Services Authority Conference (Dec. 2, 1999) (describing the Bank of England's efforts to work with the FSA on the Basel Committee proposals), available at <http://www.bankofengland.co.uk/speeches/speech63.htm> (last visited Oct. 21, 2004).

²⁶⁹ See Council Directive 77/780/EEC (Dec. 12, 1977) (discussing the implications of the First Banking Directive of 1978), available at <http://europa.eu.int/smartapi!celexapi!prod!CELEXnumdoc&lg=E> (last visited Oct. 21, 2004).

²⁷⁰ See CLAUDIO E.V. BORIO, THE IMPLEMENTATION OF MONETARY POLICY IN INDUSTRIAL COUNTRIES: A SURVEY (BIS Econ. Papers No. 47, 1997) (reviewing monetary policy implementation procedures to demonstrate similarities and differences

Many EU member states implemented general banking risk reserves before BIS commenced work to introduce the concept of loan-loss reserves in capital, including disclosure requirements.²⁷¹

Within the EU, the supervisory authority on banking and securities is shared among the national financial supervisory authorities, European Central Bank²⁷² and other international institutions, such as BIS. This overlapping power, among supervisory institutions, potentially represents a conflict of interest.²⁷³

The Bank of England and its successor, FSA, have a close relationship with BIS's various committees and institutions. The Bank of England and the FSA always believed that effective supervision of financial groups must involve consolidated supervision. The cases of English bank failures, e.g., Barings and Daiwa, have highlighted the difficulty that the U.K. financial authorities face in supervising bank operations which are far from their head offices. Along with strengthening their international regulatory cooperation, the U.K. financial institutions have been devoting considerable thought to the development of internal credit ratings based on an approach to setting capital, utilizing the experience BIS has built up in the course of its work on credit risk modeling.²⁷⁴

In reference to the Basel capital minimum, many of the largest international bank operations in the United Kingdom are in branches rather than in independent subsidiaries. This probably

remaining among EU countries), *available at* <http://www.bis.org/publ/econ47.pdf> (last visited Oct. 14, 2004).

²⁷¹ See BASLE COMM. ON BANKING SUPERVISION, AMENDMENT TO THE BASLE CAPITAL ACCORD (1998) (reducing the risk weight for claims on regulated securities firms), *available at* <http://www.bis.org/publ/bcb09.pdf> (last visited Oct. 14, 2004).

²⁷² The CBS resides at the ECB. This body consists of senior representatives of the central banks and regulatory authorities of all EU countries and is thus well suited to covering the various aspects of supervision. In the event of an impending systemic crisis with potential contagion effects, the CBS could also play an important role in crisis management bringing together the countries involved.

²⁷³ See Edgar Meister, *How Should Regulatory and Supervisory Responsibilities Be Shared among the National Functional Regulators?*, Lecture at the Multinational Banking Seminar (June 9, 2001) (discussing the potential for conflict of interest between member countries of the EU in the arena of the converging European financial market), *available at* <http://www.bis.org/review/r010613d.pdf> (last visited Oct. 14, 2004).

²⁷⁴ See David Clementi, *Speech at a Financial Services Authority Conference* (Dec. 2, 1999) (discussing the development of internal credit ratings at the Bank of England in accordance with the Basel Committee's proposals), *available at* <http://www.bankofengland.co.uk/speeches/speech63.htm> (last visited Oct. 14, 2004).

relates to the fact that the U.K. financial authorities have generally required more capital for operations of an independent bank than the Basel minimum capital requirement.²⁷⁵ A branch of a bank in the United Kingdom can operate on the Basel minimum.

The greatest positive impacts of implementation of BIS's rules are undoubtedly felt in the Japanese financial sector, which has been made more open and competitive.²⁷⁶ BIS has responded positively to the Japanese Central Bank's implementation of its recommendations. Japan still has a number of issues to tackle in order to strengthen its financial stability.²⁷⁷ Most important is the need to strengthen Japanese banks' capital base as it applies to credit, market, and operational activities.²⁷⁸ Risk-based capital of Japanese banks, which are internationally active, was 11.8 percent at the end of March 2000, out of which Tier 1 capital was 6.6 percent.²⁷⁹

In accordance with BIS's recommendations, Japanese banks are working toward the redemption of high-cost capital and an increase in internal reserves through higher profits in order to achieve reduction of capital cost and an increase of return on equity.²⁸⁰ Japanese banks²⁸¹ are increasingly facing more complex and sophisticated types of risks. In order to satisfactorily manage such risks, as well as to face severe competition ahead, the Central Bank of Japan has realized that risks and related capital charges must be measured with greater sophistication. A related problem for Japanese regulators is to deal with intensified competition triggered by the entry of foreign capital and non-financial firms into the banking industry.

²⁷⁵ See Jackson, *supra* note 198, at 2-3 (setting out the "Three Pillars," including Pillar 1, minimum capital requirements).

²⁷⁶ See WILLIAM R. WHITE, INTERNATIONAL AGREEMENTS IN THE AREA OF BANKING AND FINANCE: ACCOMPLISHMENTS AND OUTSTANDING ISSUES (BIS, Monetary and Econ. Dept., Working Paper No. 38, Oct. 1996) (discussing the relaxation of restrictions on domestic financial markets and international capital flows through international agreements in banking and finance).

²⁷⁷ *Id.*

²⁷⁸ *Id.*

²⁷⁹ According to the U.S. standard, if we calculate the Tier 1 capital of internationally active Japanese banks, it would decline from 6.6% to the 4% level.

²⁸⁰ The New Capital Accord incorporates market and operational risks which are not taken into account in the current Capital Accord. See *Basel II*, *supra* note 53. It also measures credit risk more precisely and imposes capital charges more appropriately. *Id.*

²⁸¹ In Japan, banks bound by the Accord's capital requirements are city banks, regional banks, regional banks II, trust banks, long-term credit banks, branches of foreign banks, shinkin banks and Norinchukin Bank.

Even the China Banking Regulatory Commission (China's national financial regulatory authority) is planning to draft regulatory rules and operational guidelines in line with the requirements of the Basel Capital Accord. A high ranking official of the commission daringly said, "we [Chinese bank regulators] have long been studying ways to improve the existing capital supervision system."²⁸² Since Chinese financial markets still remain essentially closed to foreign capital investors, the extent of the implementation of BIS's recommendations to Chinese bank regulators is unclear.

South Korean bank regulators have already put into place the risk-adjusted capital standards recommended by BIS. These requirements came into force at the end of 1995, and now all South Korean banks are required to maintain an equity capital position equivalent to at least eight percent. Since the late 1990's involvement of international lending agencies in the restructuring of the South Korean financial sector, the influence of BIS's recommendations has become increasingly noticeable. The BIS recommendations are used as an important policy tool in restructuring the troubled South Korean financial industry. The South Korean financial authorities apply disciplinary measures to commercial banks, including the revocation of merchant banking licenses, freezing management payrolls, prevention of dividends and even liquidation contingent upon rehabilitation plans meeting BIS's standards. South Korean commercial banks have become so sensitive to BIS's standards that they initiated a recall of outstanding loans which resulted in a sudden chain of bankruptcies among the affected firms.²⁸³

The BIS is the principal forum for developing international supervisory standards for banks in both industrialized and the less developed countries throughout the world. The BIS relies on market conditions to discipline banks and protect consumers. In the end, national bank regulators have little choice but to implement the recommendations in part or in whole as "global standard"

²⁸² See *Banks Embrace New Basel Accord*, CHINA DAILY, June 2, 2003 (expressing hope that the Basel Accord proposals, focusing on improved risk management, will lead to progress in the risk management of Chinese banks), available at <http://www.china.org.cn/english/2003/Jun/65988.htm> (last visited Oct. 14, 2004).

²⁸³ See Hwa-Jin Kim, *Living With the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea*, 17 BERKELEY J. INT'L L. 61 (1999) (discussing the development of Korean corporate governance and addressing lessons Korea gleaned from comparative corporate governance studies).

rules. Implementation of BIS's recommendation should not be seen as a legal burden, but rather as a necessary requirement to reduce risks and failures in the business of banking. National financial authorities should be especially attentive in developing countries, which need to increase their cooperation in implementing the standards provided by BIS.²⁸⁴ As financial markets become more and more integrated, bank regulators around the world will be seeing more of each other than they have in the past. Banks operating imprudently and without proper supervision are the ones most likely to mis-measure their risks, mis-price their products, and disrupt the markets. Detecting and deterring such institutions does not necessarily require having uniform regulatory or supervisory systems rather than a certain level of cooperation and coordination and a material level of consistency. Even in countries that have no internationally active domestic banks, authorities need to ensure that the banks operating in their markets are sound and subject to adequate supervision, whether by home or host authorities.

In its deliberations and in the materials that it sends out, BIS and the CBS influence local regulators as well as the banks subject to their supervision. Bank regulators must understand the full implications of their practices for the financial safety of depository institutions.²⁸⁵ Flexibility in implementing CBS recommendations may well be more important for bank regulators in developing countries than in industrialized countries with large, developed financial systems. The economies of developing countries are often too weak to adapt BIS or the CBS recommendations strictly. However, different situations would normally require different solutions. Accommodating differences does not reduce the need for minimum regulatory or supervisory standards in compliance with sound banking and safety net principles. At the end of the day, it would be up to bank regulators and, as required, to legislators to pass regulations and laws consistent with internationally recognized standards, but always accommodating the local "culture" of

²⁸⁴ See Jonathan Ward, *The New Basel Accord and Developing Countries: Problems and Alternatives* (2002) (unpublished working paper) (detailing the issues and possible remedies developing countries may face in implementing Basel II).

²⁸⁵ See Andrew Crockett, *Speech at the Annual General Meeting of the Bank for International Settlements* (Jul. 8, 2002) (detailing BIS responses to the needs of its clients with respect to yield, flexibility, and security), *available at* <http://www.bis.org/speeches/sp020708.htm> (last visited Oct. 14, 2004).

doing business and economic needs.²⁸⁶

So far, BIS's recommendations are serving supervisors and the industry reasonably well as one of the primary tools for maintaining a sound and safe banking system. The nature and complexity of risk, as undertaken by banks and other financial institutions, is making the blunt traditional measures of capital adequacy less meaningful. Considering the likelihood of the continued modernization of technology, financial authorities are trying to develop ways to improve their control and supervisory role towards banks, while reinforcing incentives for sound risk management of banks activities. The BIS's recommendations help national financial authorities achieve these multiple objectives.²⁸⁷

Implementation of BIS's recommendations alone is insufficient to ensure international financial stability. Nor are these standards an end in themselves, or some kind of magic "cure-all." Instead, they should be viewed as a means of promoting sound financial systems and, in turn, to sustaining economic growth. One expects that implementation of BIS's recommendations will, at the least, reduce the likelihood of future international crises of significant proportions.²⁸⁸ The BIS will continue to monitor the activities of banks and other financial institutions closely.

5. NEED FOR INTERNATIONAL BANK GUIDELINES

The concept of an open market, available to entry and to competition and also subject to failure, is the accepted economic philosophy of today's international economy.²⁸⁹ Regulation has not,

²⁸⁶ See Roger W. Ferguson, Jr., G-10 Study of Financial Sector Consolidation, Speech at the Task Force on Financial Sector Consolidation Press Briefing (Jan. 25, 2001) (discussing the effects of consolidation of the G-10 financial sector and the need for associated policy development), available at <http://www.federalreserve.gov/boarddocs/speeches/2001/20010125/default.htm> (last visited Oct. 14, 2004); see also *Overview of the Amendment*, *supra* note 146, at 2 (summarizing amendments to the new Accord, most significantly that banks will have more flexibility in specifying parameters for internal models).

²⁸⁷ The New Basel Capital Accord is based on three pillars: (1) minimum capital requirements that are more sensitive to risk, (2) a supervisory review process, and (3) market discipline. Ward, *supra* note 284, at 26-32.

²⁸⁸ See *International Banking and Financial Market Developments*, BIS Q. REV., Mar. 2001 (detailing international market developments and international finance highlights of the fourth quarter of 2000).

²⁸⁹ The failure of the World Trade Organization meeting in Cancun, Mexico on September 14, 2003 was, ironically, the result of some of the world's wealthiest states, including the United States, refusing to subject their agricultural businesses to the international free market. See Elizabeth Becker, *Poorer Countries Pull Out of*

however, abdicated its function; the dominant economic problem of our time may be where and how much to regulate both nationally and internationally. This question lies at the heart of the process of state-building in such new governments as Afghanistan and Iraq as well as in re-creations as in Russia. Should there be a Securities Exchange Commission ("SEC") equivalent? Should there be an Environmental Protection Agency ("EPA") equivalent? Following major international bank failures over the twentieth century, it is generally agreed that it is consistent with the theory of a free market that organizations, particularly banks, be regulated. Degrees of regulation vary with the type of function involved. Whatever benefits apply, for example, to the unrestrained manufacture and sale of sneakers do not necessarily apply to banks. Not only is the general money supply inextricably bound with the solidity of the banking system, but the financial reserves of the public sector in terms of, for example, lender-of-last-resort exists in tandem with a dependable banking system.

Banks are fundamentally always at risk. It is, in fact, the nature of a bank to be at risk because its dominant business is the loan of money to individuals, companies, and governments. A bank's assets are measured by the likelihood that the obligations it holds will be repaid. Its success is measured by the soundness of its financial evaluations of others; by the degree that others honor their debts. A bank's assets are not measured in tangible goods but rather almost entirely in the degree to which other parties are true to their obligations. A bank that totally manages to avoid risk is probably not doing a banking business.²⁹⁰ However, a bank that incurs undue risk in its evaluations of others is risking failure. Its security is inherently reduced by the fact that the debts of the bank to others are mostly short term—deposits—while its assets are generally payable over considerably longer periods of time. All banks stand on banana peels. The history of banking has made this evident. A prime function of a bank regulator is to measure

Talks Over World Trade, N.Y. TIMES, Sept. 15, 2003, at A1 (discussing the collapse of world trade negotiations, which were meant to benefit developing nations, upon the failure of wealthier nations to offer compromises on agriculture and other areas at issue).

²⁹⁰ During the savings and loan crisis of the late 1970's, some S&L's reduced their lending activities because of suspect business conditions. They were roundly criticized by their regulators for this unbank-like conduct despite what proved to be a sound business philosophy.

and control risk.²⁹¹ A banking system needs this regulator to function and survive.

Today, all major banks are engaged in international financing activities. Every major bank is an international bank; yet, each bank has a strong domestic orientation. Each bank is a single business entity responsible to senior executives and usually to stockholders with a base in one home country. Contrastingly, bank regulators who affect these banks are dispersed through the countries in which the bank does its business. Each country has its own system of regulators; each system is organizationally separate from the others. The banks and its regulators do not match each other. There is no centralized control over the international operations of banks.

As we saw in the late 1990's, banking failure is serious; it is often virtually the equivalent of economic failure. This is because bank failure is often "systemic" in nature and can infect first a country, then a region of the world, and then spread to other regions. While it is generally agreed that coordinated banking regulation is in principle a good thing, the nature and quality of that regulation raises difficult and controversial issues. The meeting of the G-10 central banks and related bank regulators at Basel is regarded beneficently. The soft law that has emanated from those meetings has been well received and one expects more to come, particularly in the field of capital regulation.²⁹²

Although there has not been anything compulsory about the positions taken by the CBS, it has come tantalizingly close to requiring member central banks to abide by its positions in their home countries and to give formal effect to those decisions. The formal document adopted by the CBS in July 1988 as a standard for measuring international bank capital²⁹³ provides in the first paragraph:

²⁹¹ In the United States, a bank must achieve what the legal system calls "safety and soundness." To measure this, regulators monitor banks under what is called the CAMELS standard. The letters are an acronym derived from Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to risk.

²⁹² Lee, *supra* note 132, at 6 ("[A]lthough the Basle members are not legally bound, the Basle Accords' methodology now applies to virtually all financial institutions worldwide.").

²⁹³ *Basel Capital Accord*, *supra* note 52 (including sections on the constituents of capital, the risk weighing system, the target standard ratio, and transitional and implementing arrangements).

The present paper is now a statement of the Committee agreed by all its members. It sets out the details of the agreed Framework for measuring capital adequacy and the minimum standard to be achieved which the national supervisory authorities represented on the Committee intend to implement in their respective countries.²⁹⁴

A commentator at the time wrote: "[t]he July 1988 Report clearly envisions some form of subsequent adaptation by national authorities."²⁹⁵ In 1988, with the Basel Capital Accord, the CBS took a clear step in the direction of international bank regulation. We are groping for the next step. Indeed, should there be a next step? Should we be planning now to turn soft law into hard law and create a real, functioning international body of bank regulation?²⁹⁶

6. PROPOSALS THAT BIS BECOME THE WFA

Institutions, public and private, are created when those in power feel they are necessary. This truism applies to all levels of society, including the community of international financial institutions. The number and magnitude of banking crises in the world

²⁹⁴ *Id.* This was a considerably more aggressive posture than that taken in the prior draft of the paper dated December 1987 which stated:

[t]his paper sets out the conclusions of the Committee's discussions (reflecting as appropriate important minority views) in the form of a proposal for a common framework of capital adequacy measurement and a common minimum target capital standard to be achieved and maintained by banks operating internationally.

Basel Comm. on Banking Regulations & Supervisory Practices, *Proposals for International Convergence of Capital Measurement and Capital Standards*, 27 I.L.M. 524, 530 (1988).

²⁹⁵ Norton, *supra* note 18, at 1347. In the same article, Norton discusses "soft law" and writes, "[i]n fact, one author (albeit with minimal supporting authority) characterizes the Committee's actions as a form of 'international administrative law.'" *Id.* at 1347 n.249. The administrative law idea, however, was picked up some decades later when, in reviewing the CBS's process, another commentator noted: "[t]his process is similar to the process of administrative rulemaking in the United States." Heath P. Tarbert, Comment, *Are International Capital Adequacy Rules Adequate? The Basle Accord and Beyond*, 148 U. PA. L. REV. 1771, 1788 n.80 (2000).

²⁹⁶ It has been predicted that the widespread and basically uniform adoption of soft law will evolve into the ultimate hard law status of the CBS. Lee, *supra* note 132, at 40 ("Through the major industrial nations' acceptance of the Basle Accords as soft law, a framework for hard law may be created.").

over the last decades are impressive. A crisis, when defined as a situation in which the banking system's capital is exhausted as a result of recorded losses, occurred sixty-seven times between 1980 and 1996.²⁹⁷ This figure has since grown substantially higher as a result of the Asian, Mexican, Brazilian, Russian and other major financial crises.

The Asian crisis of 1997 in particular initiated a worldwide reappraisal of international banks' activities. The reappraisal was conducted by banking commentators, international financial institutions (including the IMF, the World Bank, and BIS), and most industrialized nations' economic policy forums (the Group of 7 ("G-7"), G-10, etc.). This ongoing debate is commonly called "reform of the international financial architecture." International financial liberalization has been costly but with benefits. Costs could have been substantially mitigated if a key lesson had been drawn from domestic financial markets that liberal markets are only efficient if they are efficiently regulated. The main task of financial regulation is management of the risks; it must take its appropriate place in the liberalization of financial markets. Without regulation, the risks and the accompanying costs can become excessive.

During the late 1990's, a debate took place on what institutional changes were needed to manage current international financial systems. Among the most striking alternatives were to "leave it to the markets," "create a super-regulator," or employ "step by step initiatives to deal with particular issues."²⁹⁸ Advocates of "leaving it to the markets" have argued that the international financial system can run based on every market's needs; let the financial market run its own course. "Creating a super-regulator" refers to the logic applied by John Eatwell and Lance Taylor on the creation of a WFA.²⁹⁹ The philosophy of this approach is that as financial institutions become more global, their regulators and supervisors should also become global. The absence of a global regulator may

²⁹⁷ See GERARD CAPRIO, JR. & DANIELA KLINGEBIEL, *BANK INSOLVENCIES: CROSS-COUNTRY EXPERIENCE* 13-20 (Fin. & Private Sector Dev. Div., World Bank, Policy Research, Working Paper No. 1620, 1996) (discussing studies and data which document the banking crises of recent years).

²⁹⁸ Philip Turner, *Development and the International Financial Architecture*, Presentation at the Overseas Development Institute Meeting Series on Financing for Development § 3 (Apr. 11, 2001) (searching for optimal responses to macro-economic crises), available at <http://www.odi.org.uk/speeches/schneider7a.html> (last visited Oct. 14, 2004).

²⁹⁹ EATWELL & TAYLOR, *supra* note 5, at 208-35.

create problems in maintaining safety and soundness in international financial markets.

In referring to the concept of "step-by-step initiatives to deal with particular issues," it is argued that countries will adopt international standard initiatives when the market needs them. An example is the international cooperation on bank supervision that occurred under the guidance of the CBS. International rules on capital adequacy originated in a joint proposal by the United States and the U.K. bank regulatory agencies in 1987. Thereafter, this approach was extended to the G-10 countries. As a result of the fact that the rules on capital adequacy gained credibility with markets and were also implemented by financial authorities in the major industrialized countries, other countries followed suit. These rules became a global standard not because they were issued by the CBS's initiative, but because an internationally accepted standard was needed.

Among those who have argued for regulation of the international financial market was former President Tietmeyer of the Deutsche Bundesbank (German Central Bank),³⁰⁰ who persuaded the G-7 to create a Financial Stability Forum that would bring together ministries of finance, central banks, and major supervisory authorities, as well as international financial institutions. The mission of the Financial Stability Forum was to build on existing institutions, which would remain fully responsible for their mandated tasks. It would also attempt to enhance synergies that could be achieved from a better pooling of information and points of view.³⁰¹

Proposals on the future of international financial institutions range from a significant enlargement of the powers of the IMF to

³⁰⁰ See Hans Tietmeyer, International Cooperation and Coordination in the Area of Financial Market Supervision and Surveillance, Report to the Financial Stability Forum 6-7 (Feb. 11, 1999) (emphasizing the role of BIS in the creation of the Financial Stability Forum), available at <http://www.fsforum.org/publications/Tietmeyerreport.pdf> (last visited Oct. 14, 2004). Mr. Tietmeyer states:

[t]he Bank for International Settlements (BIS) provides analytical, statistical and secretariat support for various official groupings [such as the Financial Stability Forum] working to strengthen the global financial system Support for the Forum would be provided by a small secretariat located at BIS in Basle. Members of the secretariat could be drawn from BIS

Id. at 2, 7.

³⁰¹ See *id.* at 4 ("[B]etter procedures are needed for systematically pooling and efficiently using the information available").

the creation of a WFA to head up all initiatives aimed at financial stability,³⁰² with intermediary variants such as the merger of the two Bretton Woods institutions and the organization of an international lender-of-last-resort function by the IMF³⁰³ or BIS.³⁰⁴ Even some world leaders, such as the British Prime Minister Tony Blair, are calling for a new international financial architecture in the direction of a "New Bretton Woods for the New Millennium."³⁰⁵ In the United States, the 1999 Economic Report of the President stated that (a remarkable statement on behalf of President Bush) financial liberalization and innovation have rendered national boundaries irrelevant.³⁰⁶ If regulation was necessary within national boundaries, then it is now (at least) equally necessary in the international market.

All these proposals have two characteristics in common. First, they focus on institutional reforms rather than on less ambitious but more pragmatic and rapid initiatives. Second, they concentrate power in one or a limited number of institutions rather than disperse responsibilities.

Regardless of the lessons learned from the history of international financial crises, they remain unpredictable. Realistically, reforms should be organized around a cautionary principle and should contain market failures when they occur. The key role of

³⁰² See JOHN EATWELL & LANCE TAYLOR, *INTERNATIONAL CAPITAL MARKETS AND THE FUTURE OF ECONOMIC POLICY* (Ctr. for Econ. Pol'y Analysis, CEPA, Working Paper Series III No. 9, 1998) (proposing the establishment of the WFA), available at <http://www.newschool.edu/cepa/papers/archive/cepa0309.pdf> (last visited Sept. 24, 2004).

³⁰³ See Charles W. Calomiris, *Blueprints for a New Global Financial Architecture*, in *INTERNATIONAL FINANCIAL MARKETS: THE CHALLENGE OF GLOBALIZATION* (Leonardo Auernheimer ed., 2000) (discussing how the IMF redesigned its lending practices to solve the problems in global finance).

³⁰⁴ See Michele Fratianni & John Pattison, *International Financial Architecture and International Financial Standards*, 579 *ANNALS AM. ACAD. POL. & SOC. SCI.* 183 (2002) (proposing promulgation of international financial standards as a "precondition for acceding to the international lender of last resort (ILOS) facilities"), available at <http://ann.sagepub.com/cgi/reprint/579/1/183> (last visited Oct. 14, 2004).

³⁰⁵ See *Democratizing Global Finance: Civil Society Perspectives on People-Centered Economics*, NGLS ROUNDUP (UN Non-Gov't Liaison Serv.), July 1999, at 5 (reviewing a conference on macroeconomic policy), available at <http://www.un-ngls.org/documents/pdf/roundup/38demfin.pdf> (last visited Oct. 14, 2004).

³⁰⁶ See President's Economic Report to Congress 5 (Feb. 1995) ("When nations around the World descend into economic disruption . . . it hurts them and it hurts us."), available at http://www.gpoaccess.gov/usbudget/fy00/pdf/1999_erp.pdf (last visited Oct. 14, 2004).

large international banks should be more carefully supervised since the banks can transmit market discipline to their debtors. Large banks with failing internal control systems would be subject to corrective measures at an early stage. In this respect, the WFA would have a key role in obtaining the necessary cooperation among national supervisors.

With respect to international crisis management, there is a need for an international lender-of-last-resort who could intervene in the market if the risk of crises becomes endemic. It seems that a structured cooperation between central banks and a WFA should be part of any plan.³⁰⁷

Eatwell and Taylor have proposed the establishment of an international financial institution, called a WFA, which would perform the functions of a world financial market regulator similar to those of national regulators in domestic markets.³⁰⁸ They further suggest that a WFA should be built upon the foundations for global financial surveillance and regulation, which are already provided by BIS.³⁰⁹ They argue that we need a fundamental restructuring of international financial institutions and propose the establishment of a WFA as an independent institution to perform activities in the world financial markets, similar to what national regulators do in the domestic financial markets.³¹⁰ An effective WFA should have the ability of any domestic regulator.

A WFA would develop analysis of markets and policies, further enhancing the efficiency of international finance.³¹¹ Resulting

³⁰⁷ See OLIVIER DAVANNE, *INSTABILITY OF THE INTERNATIONAL FINANCIAL SYSTEM* para. 10 (Conseil d'Analyse Economique, Report No. 14, 1998) (stating that "a cooperation between the main Central Banks of the world, within the Basel Club, would be the most feasible solution"), available at http://www.archives.premier-ministre.gouv.fr/jospin_version2/gb/pm/cae/report14.htm (last visited Oct. 14, 2004).

³⁰⁸ See John Eatwell, *Macroeconomics and the Regulation of International Financial Markets*, (Apr. 5-6, 2002) (unpublished paper presented at Queens' College, Cambridge) (analyzing "the relationship between micro-economic actions and the behaviour of the macro-economy" in the context of the discussion of international financial regulation), available at <http://www.cerf.cam.ac.uk/publications/files/Eatwell%20-%205-6%20April%2002.pdf> (last visited Oct. 14, 2004).

³⁰⁹ *Id.*

³¹⁰ See Epstein, *supra* note 43, at 43 (noting "the unabashed purpose . . . is to coordinate and, if possible, to control all monetary activities in the industrialized world").

³¹¹ See John Eatwell, *The Coordination of Macro-economic Policy in the European Community*, in *UNEMPLOYMENT IN EUROPE* 209 (Jonathan Michie & John Grieve

from breakdowns in national regulatory capacities, as liberalization spreads worldwide, there is a need to monitor high and variable real interest rates, volatility of asset prices, poor national economic performances and the contagious spread of market instabilities worldwide. These developments could create the possibility for massive upheavals even in the large and integrated financial markets of the industrialized states. A WFA could be the appropriate institution to monitor and coordinate these crises.³¹² A WFA could also handle currency crises and speculative schemes of exchange rates in developing and transition economies, which are normally associated with rapid capital market liberalization and the absence of appropriate regulatory procedures designed to deal with the flow of capital.

Because of the prospect of major financial crisis in the future, a WFA may well become politically feasible. If that happens, it would be important to have given advance thought to how a WFA would actually work. Taking preparatory and preventive measures makes it possible to minimize the spread of financial crisis in other economies, as well as to lessen the impact of these crises internationally.³¹³ Other components of a WFA's functions would be the control and accountability of the management of risk, macroeconomic policy, and industrial policy, all of which can stimulate efficient operation of financial markets. This becomes particularly clear in periods of relative deregulation when the authorities lose control of credit and a speculative financial bubble first inflates and then bursts. Examples are the Japanese financial market crisis early in the 1990's and the U.S. savings and loan crisis around 1980.³¹⁴

In the global economy, a WFA's central role would be to cure inefficiencies in the financial marketplace that are outside the ju-

Smith eds., 1994) (arguing for the increased coordination between international financial communities).

³¹² See JOHN EATWELL, *INTERNATIONAL FINANCIAL LIBERALIZATION: THE IMPACT ON WORLD DEVELOPMENT* 47 (Off. Dev. Stud., U.N. Dev. Programme, Discussion Paper Series No. 12, 1997) (challenging financial liberalization trends to expand macroeconomically), available at <http://www.undp.org/ods/pdfs/interl-fin-liberal.pdf> (last visited Oct. 14, 2004).

³¹³ See John Eatwell, *Unemployment: National Policies in a Global Economy*, 21 INT'L J. MANPOWER 343 (2000) (stating the effects of deregulation globally in the 1970's on unemployment increases).

³¹⁴ See THE GOLDEN AGE OF CAPITALISM: REINTERPRETING THE POSTWAR EXPERIENCE V (Stephen A. Marglin & Juliet B. Schur eds., 1990) (compiling papers which survey international examples of capitalistic rises and falls).

risdiction of any one country but not outside the jurisdiction of the society of nations.

There have been increasing attempts to forge cooperation among financial regulators to accomplish this global task. As global financial markets have achieved greater integration so cooperation among financial regulators has consolidated into regular coordination. An international WFA would make these relationships more effective.³¹⁵ The growth of a world financial market has created interrelationships we only begin to understand and risks we can barely imagine. The benefits of a WFA, with all regulatory and supervisory powers concentrated at the world level, are increasingly perceived.³¹⁶

A WFA should be given the power to guide and dictate to national financial markets. Obviously, this can be achieved by blessing BIS with enforcement and authoritative powers. But how these powers can be entrusted to BIS remains a challenging task. A supreme global regulatory body should have the power to impose mandatory sanctions for violation of its edicts and even to oversee such global financial institutions as the IMF and the World Bank. At present, there is no systematic evaluation of the activities of the Bretton Woods institutions; yet their operations are regularly subject to severe criticism. BIS, albeit a source of less than binding law, has begun this task and can serve as a step towards creation of a WFA.

As the shape of a WFA evolves, it can be related to the operations of securities and futures markets, hedge funds, foreign currency traders, fund managers, and other institutions that use borrowed money for speculative purposes, therefore avoiding or reducing destabilizing leveraged activities and systemic bank risk.³¹⁷ Making international financial institutions accountable to a WFA would introduce a "safety valve" consisting of evaluation

³¹⁵ John Eatwell, *Markets Must Be Regulated or They Will Fail to Prosper*, TIMES, Oct. 5, 1998, at 49.

³¹⁶ See, e.g., Ajit Singh, *Openness and the Market-Friendly Approach to Development: Learning the Right Lessons from Development Experience*, 22 WORLD DEV. 1811 (1994) (observing global issues with the World Bank and the world economy).

³¹⁷ See Roy Culpeper, *Systemic Reform at a Standstill: A Flock Of "Gs"* In Search Of Global Financial Stability (May 2000) (unpublished paper presented at Critical Issues in Financial Reform Latin-American/Caribbean and Canadian Perspective) (focusing on how to achieve financial stability in the global capital market), available at http://www.nsi-ins.ca/ensi/pdf/flock_of_Gs_eng.pdf (last visited Oct. 14, 2004).

and accountability.³¹⁸

A WFA would quite naturally assist national bank regulators in improving their regulatory and control functions with respect to their national financial systems (by way of example, through the imposition of capital and/or reserve requirements on all major banks and financial institutions). A WFA should ensure that the capital control programs implemented in one country are consistent with such programs in other countries of the same region, thereby preventing one country from attracting finance capital at the expense of its neighbors. In many countries, a WFA might simply certify that domestic regulatory procedures are effective. In others, a WFA would assist with regulatory reform.

A WFA would establish an institution where national financial authorities could create and adapt international banking and financial initiatives. Until such institution (or a forum) is formed, a WFA may play the role of initiating the bringing together of national financial authorities in order to implement their initiatives and transform them into domestic regulation. Despite supporting issuance of international banking and financial initiatives, a WFA must make sure that national financial authorities help and encourage each other in implementation of these initiatives.³¹⁹ Presently, the IMF seeks to shape its position as leader in solving international financial and economic troubled markets. In this aspect, a WFA would significantly contribute by becoming a trusted and efficient international financial authority.

Recent decades of international financial liberalization have removed almost all distinctions between national and international capital markets. In the event of a rapid development of financial markets, the same regulatory tasks required in national markets will be needed internationally. BIS was the first institution to create international financial regulation with the formation of the Committee on Bank Supervision and Regulation in 1975. It formu-

³¹⁸ See *Economists Trace Russian/Asian Crises to Liberalization of Capital Markets, IMF Policies*, U.S. NEWSWIRE, Aug. 26, 1998 ("World Financial Authority . . . would provide a framework for international financial regulation and hold the IMF and World Bank accountable for policy implementation."); see also Rosemary Right, *Blair May Have Swallowed A Seriously Bad Big Idea*, TIMES, Sept. 29, 1998, at 33 (noting that the WFA, as "an executive authority with surveillance capability," would "ensure transparency and accountability at the IMF and the World Bank").

³¹⁹ See S. Griffith-Jones & J. Kimmis, *The BIS and its Role in International Financial Governance* (1999) (noting the role of BIS in mediating national financial policies), available at <http://www.ids.ac.uk/ids/global/finance/pdfs/bis2.pdf> (last visited Oct. 14, 2004).

lated the bank capital adequacy requirements in the 1980's, which all members of BIS agreed to observe in addition to barring from their markets foreign banks not adhering to the requirements.³²⁰ More countries have voluntarily agreed to BIS standards in order to achieve market credibility.³²¹

Existing international institutions are not up to the task of regulating the global financial system. This is due to such factors as a gap between effective regulation and "bail-outs," a vital precondition for the effective minimization of moral hazard, inadequate surveillance powers, and a still incomplete definition of capital requirements and best practice risk management techniques. The IMF and the World Bank were set up to handle, respectively, the balance of payments and economic/financial development problems worldwide. Due to the restricted focus of each, however, they do not seem to be the right organizations to deal with today's international financial markets. Increasing consideration is being given to a WFA, and BIS seems to be the logical starting point.³²²

The concept of establishing a WFA is based mainly on two factors. First, banks and other financial institutions that carry out activities across borders have developed the need to be supervised and regulated under uniform international rules and regulations. Second, increase of the free flow of investment worldwide and creation of more open markets to foreign investors requires a safe environment of domestic financial markets.

A WFA can contribute to the improvement of these factors related to the stability of international financial structure.³²³

Presently there is an ongoing collaboration among national fi-

³²⁰ See JOHN EATWELL & LANCE TAYLOR, *THE PERFORMANCE OF LIBERALIZED CAPITAL MARKETS* (Ctr. for Econ. Pol'y Analysis, CEPA, Working Paper Series III No. 8., 1998) (describing the evolution of capital market liberalization and its effect on global economies), available at <http://www.newschool.edu/cepa/papers/archive/cepa0308.pdf>; see also Corbin Cowley, *International Monetary Fund Reform*, 2 HINCKLEY J. POL. 15, 22 (2000) (discussing the duties of the WFA).

³²¹ See generally de Swaan, *supra* note 200 (discussing BIS core principles as they would work to prevent further financial crisis).

³²² See generally *Democratizing Global Finance: Civil Society Perspectives on People Centered Economics*, *supra* note 305 (discussing the political and economic challenges and opportunities facing the international community).

³²³ See YILMAZ AKYÜZ & ANDREW CORNFORD, *CAPITAL FLOWS TO DEVELOPING COUNTRIES AND THE REFORM OF THE INTERNATIONAL FINANCIAL SYSTEM* 28 (U.N. Conference on Trade & Dev. [hereinafter UNCTAD], Discussion Paper No. 143, U.N. Doc. UNCTAD/OSG/DP/143, 1999) (stating that "the increasingly global character of financial markets and growing links between different categories of financial business" have given rise to proposals for the WFA).

nancial authorities at various levels, such as between/among state(s), regions, etc. Nevertheless, there is still a lot of work to be done in order to bring all national financial authorities rules under a common legal and financial framework. In this regard, the role of existing international financial institutions, such as the IMF, is recognizable. Notwithstanding the fact that there is no clear evidence to show that a WFA (or a new similar international institution) will play a better role in improvement of the global financial stability, it seems that an institution like a WFA might positively contribute to strengthening the international regulatory regime currently in place.³²⁴

The creation of a new body with senior responsibility for setting regulatory standards for all financial enterprises worldwide would be an almost unreasonably ambitious approach. National regulators would remain responsible for implementing its standards and the function of the new institution would be largely one of surveillance, although it is expected to act as a brake on a country's capital influx. A less ambitious approach would be for a WFA to serve simply as an umbrella organization under which existing local or national bodies would operate.³²⁵ International financial supervision, through a global WFA, would be necessary in either case for the survival of an efficient liberal international system.

As the ultimate worldwide financial authority without accountability, there is the danger that a WFA would be so singly focused to prevent financial crisis that it would set an excessive regulatory burden. This would create—but on a global scale—the problems already faced by local regulators: overregulation, with the consequence that the world community would pay the cost of stymied competition; absence of innovation; and product stultifica-

³²⁴ *The Financial Crisis and Its Impact on Growth and Development, Especially in the Developing Countries: Report of the Secretary-General*, U.N. GAOR, 54th Sess., Agenda Item 97(b), para. 12, U.N. Doc. A/54/471 (1999), available at <http://www.un.org/esa/policy/publications/a54471.htm> (last visited Oct. 14, 2004).

³²⁵ The Financial Stability Forum, consisting of representatives from the finance ministries, central banks and senior regulatory authorities of the G-7 countries as well as from the IMF, the World Bank, the CBS, IOSCO, the International Association of Insurance Supervisors (IAIS), BIS, the OECD, the Committee on Payment and Settlement Systems, and the Committee on the Global Financial System (formerly the Euro-Currency Standing Committee), is arguably of this kind. Objectives include pooling and sharing of information on vulnerability in the international financial system among different bodies, monitoring of the implementation of internationally agreed regulatory and supervisory standards, and codes of conduct.

tion. This is, of course, a well-known existing problem both on the national and international level. Regulatory agencies in the United States are routinely criticized for abusing their powers. Internationally, the IMF is regularly accused by both consumer and industry groups of demanding sacrifices that recipients of its largess cannot deliver. It is accused of eliminating public financial benefits and destroying the environment among many other perceived derelictions.

There are various complex issues with respect to the role of a WFA in an international financial system, which are still unanswered. Those issues concern the ability of a WFA to spot and handle local (regional) financial crisis better than national financial authorities, level of recognition of a WFA from governments, etc. Politicians are skeptical in granting away their power. For example, governments of the countries that are members of the EU have fiercely resisted giving up their authority over national financial supervision and regulation to the EU institutions. Even with the creation of the European Central Bank, the EU faced resistance from member states to give away their privileges of national banking supervision.³²⁶

These are known problems without a known solution. To the extent that a solution exists, it is in the construction of the enterprise—a system of checks and balances that gives a WFA sufficient authority to do its job, but also enables its leaders to be challenged if they abuse their positions.

Generally speaking, there are various proposals for world financial reform, ranging from suggestions for pre-emptive crisis mechanisms to recommendations for the reform of the IMF to several proposals for establishment of a WFA. However, three main proposals have been given serious attention.

The first proposal, which is the most discussed and given serious consideration among experts, is provided by Eatwell and Taylor. The problem with this proposal is that the United States (including the Federal Reserve and other federal and state banking authorities) does not support it. Like other industrialized economies in the world, the United States is not ready to give up its regulatory authorities to a WFA or similar international institution. For better or worse, because the U.S. economy serves as the locomotive of international financial stability, it tends to impose on

³²⁶ Fratianni & Pattison, *supra* note 125, at 211.

other nations U.S. laws and regulations in the financial industry.³²⁷ Furthermore, the U.S. position is that the current financial architecture is sound and there is no need for major financial reform. Whatever reform is needed is seen simply as a question of improving the system's wiring.³²⁸

This "the wiring not the architecture" approach gives primacy to "reforming" financial sectors along the lines of more transparency, tougher bankruptcy laws, prudential regulation using BIS recommendations, and encouraging more foreign capital to recapitalize shattered banks as well as to "stabilize" the local financial system by making foreign interests integral to it.³²⁹ As a consequence, it would be advantageous for BIS, short of being a formal and central regulator, to play a co-coordinating role in rapidly assembling financial packages by G-10 central banks, combined where feasible with private credit lines, for countries in currency

³²⁷ See Will Hutton, *America's Global Hand*, 11 AM. PROSPECT (1999) (noting the American influence on world organizations), available at <http://www.prospect.org/print/V11/2/hutton-w.html> (last visited Oct. 14, 2004).

³²⁸ See, e.g., BARRY EICHENGREEN, *TOWARD A NEW INTERNATIONAL FINANCIAL ARCHITECTURE: A PRACTICAL POST-ASIA AGENDA* (1999) (proposing improvements to the international monetary and financial system); MORRIS GOLDSTEIN, *THE ASIAN FINANCIAL CRISES: CAUSES, CURES, AND SYSTEMIC IMPLICATIONS* (1998) (citing the difficulties in the Asian system); Stanley Fischer, *On the Need for an International Lender of Last Resort*, 13 J. ECON. PERSP. 85 (1999) (proposing improvements on the current practices of the Central Bank); The Working Group on Int'l Fin. Crises, *Report of the Working Group on International Financial Crises* (Oct. 1998) (identifying a "range of policies and institutional innovations that could help prevent international crises and facilitate the orderly resolution of the crises that do occur"), available at <http://www.bis.org/publ/othp01d.pdf> (last visited Oct. 14, 2004); The Working Group on Strengthening Int'l Fin. Crises, *Report of the Working Group on Strengthening Financial Crises* (Oct. 1998) (developing "concrete methods to strengthen financial systems in industrial and emerging market economies"), available at <http://www.bis.org/publ/othp01c.pdf> (last visited Oct. 14, 2004); The Working Group on Transparency and Accountability, *Report of the Working Group on Transparency and Accountability* (Oct. 1998) (describing ways to improve transparency and accountability), available at <http://www.bis.org/publ/othp01b.pdf> (last visited Oct. 14, 2004); *Summary of Reports on the International Financial Architecture* (Oct. 1998) (summarizing the above mentioned reports), available at <http://www.bis.org/publ/othp01a.pdf> (last visited Oct. 14, 2004); Robert Rubin, *Strengthening the Architecture of the International Financial System*, Speech at The Brookings Institution (Apr. 14, 1998) (stating, "how we can strengthen the architecture"), available at <http://www.brook.edu/comm/transcripts/19980414.htm> (last visited Oct. 14, 2004).

³²⁹ See Anoma Srisukkasem, *Delay in Adopting BIS Accord*, NATION, Oct. 13, 2001 (describing Thailand's efforts to adopt BIS standard), available at <http://www.nationmultimedia.com/page.acrview/php3?clid=7&id=497528usrse ss=1> (last visited Oct. 14, 2004).

crises not caused by policy mistakes and not requiring policy changes.³³⁰ There would be countries that BIS, operating in its present mode (or perhaps the related CBS), deemed to be well managed. If these countries had a run on their currency, and a crisis started to unfold, a nonconditional financial package could be assembled by BIS, drawing possibly on its own resources, but mainly on those of the central banks of the most centralized countries and, if feasible, on private lending.³³¹

Other countries, after consultation with BIS might agree to a "shadow program" of conditionality, similar to the current demands of the IMF. If local authorities fully implemented the program, and a crisis still broke out, BIS would disburse financial aid automatically. If a larger package was necessary, BIS could coordinate additional financing from the central banks of the most centralized countries and private banks. There would still be countries that would not want to accept a "shadow program" with BIS and would not improve their economic policies. If these countries were hit by a currency crisis, they would have to go to BIS for conditional lending as a first step. Such a procedure would provide strong incentives for countries to have sound policies and decrease the likelihood of crises. However, if crises occurred, then large lending by facilities of BIS and/or lending by central banks and commercial banks coordinated by BIS would take place quickly and without additional conditionality.³³²

The purpose of redefining the role of international financial institutions and pertinent regulations is that, unfortunately, financial markets are not thoroughly rational and risk-free in the international financial system. The debate on the "architecture" of the in-

³³⁰ See S. Griffith-Jones, *A New Financial Architecture For Reducing Risks and Severity of Crises* (1999) (paper prepared for CEPAL-Jacques Maritain Foundation Conference in Santiago, Chile) (discussing ways in which BIS can provide aid in response to a currency crises), available at <http://www.ids.ac.uk/ids/global/Finance/pdfs/finarch1.pdf> (last visited Oct. 14, 2004).

³³¹ See David Folkerts-Landau et al., *Toward a Framework for Financial Stability*, WORLD ECON. FIN. SURVEYS, 4-6, 27-31 (1998) (discussing the ways in which the IMF promotes financial stability), available at <http://www.imf.org/external/pubs/ft/wefts/toward> (last visited Oct. 14, 2004).

³³² See generally Joseph Stiglitz, *The Role of International Financial Institutions in the Current Global Economy*, Address to the Chicago Council on Foreign Relations (Feb. 27, 1998) (discussing ways in which institutions may work to prevent crises and provide remedies when crises occur), available at <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20024294~menuPK:34474~pagePK:34370~piPK:34424~theSitePK:4607,00.html> (last visited Oct. 21, 2004).

ternational financial system has generated various proposals to re-define responsibilities among international institutions and sometimes to create new bodies. We believe that the niche now occupied by BIS can, with continued fine-tuning, start to serve this purpose. To retain the image, we can continue to use the present architecture; we don't have to build a new building.

Nevertheless, proposals addressing the role of a WFA in financial crisis management have some logic.³³³ Globalization of markets inevitably opens the debate about the usefulness of a global regulator, such as a WFA, which would set standards, monitor their implementation, supervise the functioning of international financial markets, and take preventive action.

As financial markets become more global, the influence of increasing numbers of countries with their own laws and practices creates a more diverse system. This in turn raises the issue of harmonization of standards and regulations and good communication among supervisors. Regrouping responsibilities could generate synergies and favor unity of vision and concept in the regulation and surveillance fields, similar to the objectives assigned to national financial regulatory authorities.

Clearly, establishing an international consensus on such far reaching reforms is extremely ambitious. National financial authorities would have to give up a significant part of their current responsibilities. It is unlikely that national financial authorities would unanimously agree to such transfer of authority. Such a change would have to be reached gradually and over the course of time. Reaching agreement on fundamental adaptations at the international level, where each participant remains sovereign, is feasible – but not now.³³⁴

Another question pertaining to the concentration of powers is whether the advantages of common international understandings can be achieved in the context of large financial institutions and

³³³ See William R. White, *New Strategies for Dealing with the Instability of Global Financial Markets*, in MGMT. OF GLOBAL FIN. MKT.S 44, 55-56 (Jan Joost Teurissen ed., 2000) (providing a list of arguments supporting the creation of an "international superregulator"), available at <http://www.fondad.org/publications/management/Fondad-Management-Part1.pdf> (last visited Oct. 14, 2004).

³³⁴ See STEVEN RADELET & JEFFREY SACHS, WHAT HAVE WE LEARNED, SO FAR, FROM THE ASIAN FINANCIAL CRISIS? 17 (Harvard Inst. For Int'l Dev., Discussion Paper No. 37, 1999) (stating that the Asian financial crisis of the 1990's revealed the need for an international institution to stop international finance panics in emerging markets).

wealthy, self-absorbed states already accustomed to dealing with complex issues on their own behalf. Big is not always beautiful and efficient. Unwieldy procedures are a real risk and internal difficulties could be more damaging to the international community than a continuing debate on competencies among independent financial institutions. There is also a risk that large supranational financial institutions, such as a WFA, could progressively lose touch with the reality of markets.³³⁵

Often, it is perceived that a WFA could turn out to be a "mediocre regulator," able to deal only with common denominator problems and proposing regulation that would not be adapted and would prove insufficient in various economies and financial markets. This is a view already widely held about the World Bank and the IMF. Concerns of this sort might force a WFA into a closely regulated organizational structure. If members of a WFA individually retain the responsibility of adjusting decisions to their market needs, the new structure would not represent any particular advantage over the existing BIS.³³⁶

A WFA as an international lender-of-last-resort raises both theoretical and political questions. A lender-of-last-resort injects liquidity into the market or into individual financial institutions in order to avoid a transitory funding problem with systemic implications. A WFA would require either standby funds for this purpose or a means for raising them at short notice from its members or elsewhere. Also required would be an available method for converting funds into the particular currency required.³³⁷

The international financial scene changes very rapidly under the influence of innovations, the globalization process, and the emergence of new actors. There is, therefore, a risk that at the end

³³⁵ See Hans Tietmeyer, *Systemic Risk and Lender of Last Resort*, Address before the Center for Financial Studies (June 11, 1999) (arguing against the formation of an international "lender of last resort" if it is disconnected from market realities through its offering of "generous or even unlimited credit lines"), available at <http://www.bis.org/review/r990621a.pdf> (last visited Oct. 14, 2004).

³³⁶ See Capital Mkt Liberalization Task Force of the Initiative for Pol'y Dialogue, *Other Freedoms: A Report on the September 2002 Task Force Meeting*, 22 (Sept. 19, 2002) ("[T]here is no perfect . . . solution to the problems associated with [capital market liberalization] when individual countries are acting in isolation . . ."), available at <http://www0.gsb.columbia.edu/ipd/pub/OTHERFREEDOMS2.pdf> (last visited Oct. 14, 2004).

³³⁷ See Forrest Capie, *Can There Be an International Lender-of-Last-Resort?*, 1 INT'L FIN. 311-25 (1998) (asserting that "there can be no international lender-of-last-resort" because there is no international currency).

of a long financial institutional reform, the result would not fit the realities of the moment. Small and progressive reforms are better suited to our changing environment than an ambitious transformation like the creation of a WFA.³³⁸ When confronted with large risks of financial instability of a potentially systemic nature, national financial regulators are now expected to take concrete and rapid measures aimed at strengthening the financial system. Until a WFA becomes realistic, greater safety is achieved through institutions that exist.³³⁹

Arguments in support of a WFA point to the globalization of financial markets, the breakdown of sectoral distinctions worldwide (among banks, investment dealers, insurance companies and asset management firms), the growing integration and complexity of international financial markets, and the need for efficient information sharing by all relevant bodies. These are both comprehensive and fundamentally international, and necessitate a strategy fostering international stability.³⁴⁰ At the practical level, national supervisory authorities must oversee and supervise the national financial system in a very hands-on manner. This was one of the arguments used in Europe when it was decided that banking supervision would stay at the national financial level rather than go to the European Central Bank. One could ask whether the magnitude of the task faced by a single worldwide agency might be so great as to call for a similar strategy—supervision at the national level.

Objections to a WFA are significant. As a matter of principle, national regulators and legislators are not yet ready to give up their powers to a single WFA with authority to set standards and

³³⁸ See, e.g., ANNA SCHWARTZ, TIME TO TERMINATE THE ESF AND THE IMF (Cato Inst., Foreign Policy Brief No. 48, 1998) (stating that responses to the Asian financial crisis will come from the Asian countries themselves, not from the IMF), *available at* <http://www.cato.org/pubs/fpbriefts/fpb-048.pdf> (last visited Oct. 14, 2004).

³³⁹ See Andre Icard, Strengthening Financial Stability: Institutional Approach or Pragmatic Multitherapy?, Speech at the Federal Reserve Bank of Chicago (Oct. 2, 1999) (arguing that countries should focus on strengthening the present framework for dealing with financial instability rather than creating new institutions or radically changing the structure of the existing ones), *available at* <http://www.bis.org/speeches/sp991002.htm> (last visited Oct. 14, 2004).

³⁴⁰ See Kiichi Miyazawa, Towards a New International Financial Architecture, Speech at the Foreign Correspondents Club of Japan (Dec. 15, 1998) (discussing realization of the need for reforming the international financial architecture), *available at* <http://www.geocities.com/Eureka/Concourse/8751/versib/jp121501.htm> (last visited Oct. 14, 2004).

enforce them globally. Such a step would be widely perceived as a loss of sovereignty. Local powers are ceded to existing international organizations, not excluding the UN, but with Congress' antipathy to the IMF and the World Bank it makes it difficult for these institutions to obtain U.S. contributions. These attitudes will not change soon. However, national legislators must see that, as financial markets become more globalized, the more authority they retain at home, the more difficult it will be to maintain any measure of authority over what occurs abroad.³⁴¹

Strict applicability of corporate governance rules and creation of market discipline in an international financial architecture should be the center of attention of a WFA. However, the role of a WFA in this respect should be consistent and complimentary. There might be a risk that in the course of its mission, a WFA might tend to operate more in its own interest than the market's. This trend could lead a WFA to increase its rulemaking "domination" over national financial authorities.³⁴²

Immediately after the Asian crises of 1997-1998, there were widespread calls for a fundamental reform of the international financial architecture. Many argued that the traumas of South Korea, Indonesia, and Thailand pointed to fundamental weaknesses in the international financial system. These were countries with relatively sound fiscal positions, enjoying rapid economic growth. However, when a crisis of confidence hit their financial systems, they collapsed quickly. Such an experience, which caught the international financial institutions by surprise, demonstrated not only the inadequacy of financial institutions' surveillance, but also their lack of crisis management tools. However, it is fair to say that the financial markets also did not see the crisis coming. Experience strongly suggests that the world is not ready for a WFA.

International financial liberalization plus geometric advances in technology have caused financial markets to become closely integrated. These markets can no longer be controlled by policies formulated purely at the national level with their international aspects left unregulated. In order for countries to enjoy the benefits

³⁴¹ See S. GRIFFITH-JONES, *GLOBAL CAPITAL FLOWS: SHOULD THEY BE REGULATED?* 157-88 (1998) (describing the current "mismatch" between global markets and nationally based supervisors and suggesting structural changes).

³⁴² William R. White, *What Have We Learned From Recent Financial Crises And Policy Responses?* 18 (BIS, Working Paper No. 84, 2000) (discussing the theory of bureaucracies, which states that a financial super-regulator might be tempted to act in its own interest).

of a flexible international financial system, capable of mobilizing capital on a large scale for the promotion of growth and employment, a structure must be devised to protect both national economies and the wider world economy from the risks which financial liberalization brings.³⁴³

The objectives of national financial authorities are to protect consumers with the highest possible standards of integrity, to supervise market conduct, to hone professional skills, and to minimize systemic risk. These objectives should be the goal of an international financial regulation structure. As the Chairman of the FRB, Alan Greenspan, has argued, "a global financial system . . . is not an end in itself. It is the institutional structure that has been developed over the centuries to facilitate the production of goods and services."³⁴⁴ A financial system is efficient if it achieves that end.

There have been proposals, both within international financial institutions such as the IMF and the World Bank and also from individual countries, to design a new kind of international financial architecture. The fact is that no major new financial institution has been set up yet. A development worth noting is the creation of the Financial Stability Forum, which was established as an independent organization in 1999³⁴⁵ thanks to initiatives taken by governments of the most industrialized countries (the G-7). The Financial Stability Forum brought together financial regulators and central bankers to monitor financial stability worldwide and to exchange information and establish common assessments of vulnerabilities within the international financial system. Regardless of its impressive mission, as Howard Davies points out, "it does not hold any decisionmaking power even over its member governments (national financial regulators) or over any international financial authorities. Therefore, it is difficult to consider it even as one step in the direction of a WFA."³⁴⁶

³⁴³ See David Pearce, *Making Globalization a Positive Force for Sustainable Development* (Commonwealth Consultative Group on Environment, Feb. 12, 2002) (discussing potential problems of not having sufficient protections to deal with the increasing possibility of crises caused by globalization and proposing ways to prevent or cushion the impact of those crises), available at http://www.thecommonwealth.org/shared_asp_files/uploadedfiles/{BE14D229-3F8A-482D-84B2-72BA918D02E9}_CCGE_02_2.pdf (last visited Oct. 14, 2004).

³⁴⁴ Alan Greenspan, *The Globalization of Finance*, 17 CATO J. 243, 244 (1998).

³⁴⁵ See generally, *Financial Stability Forum*, *supra* note 119 (describing formation and functionality of the Financial Stability Forum).

³⁴⁶ Howard Davies, *Is the Global Regulatory System Fit For Purpose in the*

There is a need for unified global regulation of the financial sector. Meaningful and prudent regulation should enhance international trade and finance, moving the world to a higher state of prosperity.³⁴⁷ The senior regulator should maximize financial stability between the developed and the emerging markets in such a way as to maximize world productivity. None of the current international institutions fits the proposed model as well as BIS. BIS is very likely to increase its role as an important center for setting standards in the field of international financial stability. Perhaps, as BIS continues to run its own course of business, it may ultimately take the role of a WFA.³⁴⁸ Eatwell and Taylor's message is cogent:

[T]he WFA is needed because three decades of international financial liberalization have removed almost all distinctions between national and international capital markets. If liberal finance is to thrive, the same regulatory tasks required in national markets are now needed internationally. That is why BIS pioneered international financial regulation with the formation of the Committee on Bank Supervision and Regulation in 1975. It was that Committee which formulated the capital adequacy requirements for banks in the 1980's to which all 13 then BIS members agreed to observe, and to keep out of their markets foreign banks not adhering to the requirements. The result was that more countries signed on to BIS standards in order to achieve market credibility.³⁴⁹

21st Century, Address at the Monetary Authority of Singapore Lecture (May 20, 2003) (describing the structure of international banking regulation).

³⁴⁷ Farhad F. Ghannadian, *The Coming World Financial Crisis: More or Less World Regulations?*, 8 INT'L ADVANCES ECON. RES. 80, 80 (2002).

³⁴⁸ See *Meltzer Report*, *supra* note 126, at 12. The Meltzer Report recommends that BIS (through the various committees) remain a financial standard setter. Implementation of standards, and decisions to adopt them, should be left to domestic regulators or legislatures. The Meltzer Report was published in March 2000 by the International Financial Institution Advisory Commission established by the Congress to consider the future roles of seven international financial institutions: the IMF, the World Bank Group, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the World Trade Organization ("WTO"), and BIS.

³⁴⁹ John Eatwell & Lance Taylor, *Why We Need a World Financial Authority*, 2

7. PROPER DEVELOPMENT OF A WFA

In 1997, Professor Raj Bhala of the William and Mary School of Law wrote: "[the CBS] operates on a tenuous foundation. It is highly unlikely that the G-10 countries will confer jurisdictional authority upon the [CBS]. Allowing the [CBS] to write banking law would threaten each country's sovereignty."³⁵⁰ Professor Bhala's conclusion in its application to the CBS is correct, and is equally applicable to its affiliate, BIS. BIS was created in 1923 with no thought of international bank regulation; the CBS was created in 1975 when the thought of increasing international regulation had begun to achieve a measure of respectability. Neither is, however, yet ready to assume the mantle of international bank regulator. The banking systems of the world are highly diverse and the national regulatory systems reflect the diversity.³⁵¹ One system of regulation cannot today encompass all the realities of bank operation and, perhaps even more importantly, as Professor Bhala rightly suggests, countries are not ready to abandon their sovereignty in favor of a group of experts who meet in Basel, Switzerland.

As previously noted, there is not a question of the desirability of, perhaps even the need for, cohesive and uniform regulation of the world's financial systems.³⁵² Ideally, capital should be measured in the same way, and liquidity should be considered from the same perspective in all countries that compete for the same currencies. Level playing fields from a regulatory standpoint are desirable for all the world's banks. The inequities and the risks that result from today's bifurcated world of banks are apparent. The international banking crises that resulted from the Asian problems of 1997 exemplify massive systemic problems that are attributable in large part to different banks reading from different regulatory pages. The international system increasingly calls for a single

WIDER ANGLE (World Inst. For Dev. Econ. Research., U.N. Univ., Helsinki, Finland), Dec. 1998, at 1, available at <http://www.wider.unu.edu/newsletter/angl9802.pdf> (last visited Oct. 14, 2004).

³⁵⁰ Raj Bhala, *Equilibrium Theory, the FICAS Model, and International Banking Law*, 38 HARV. INT'L. L.J. 1, 15-16 (1997).

³⁵¹ In the United States there are different regulatory structures for national banks, state banks, national savings banks, and state savings banks, and for a host of bank-related institutions, such as mortgage companies, trust companies, and finance companies.

³⁵² The interrelationship of international banks and the risks created by unequal standards are eloquently presented in Tarbert, *supra* note 295, at 1778-81.

regulator. Eatwell and Taylor have written:

We proposed the establishment of a [WFA] to perform in the domain of world financial markets what national regulators do in domestic markets. A natural place to build the WFA is on the foundations of global financial surveillance and regulation that have already been laid at [BIS] in Basel.³⁵³

Similarly, Mario Giovanoli, General Counsel for BIS, has written that the "current process of consensus-building through committees of national experts" should be worked upon, and "might benefit from some degree of harmonization and streamlining" moving in the direction of a senior international regulator.³⁵⁴

BIS and the CBS, and their formal and informal affiliates, are not the only institutions that have assumed some measure of international regulatory control in banking and non-banking. There are, of course, a number of international organizations without formal government sanction in the financial and financially related areas. Some of these have been mentioned in this Article. They include, in addition to the CBS, the International Organization of Securities Commissions and the International Association of Insurance Supervisors, one of the newer organizations which first met in 1994. Their area of activity has been called, "the world of financial oversight."³⁵⁵ Essentially non-financial affairs have been internationally regulated by such organizations as the World Trade Organization ("WTO"), the International Atomic Energy Agency, the Marine Fish Conservation Network, the World Health Organization ("WHO"), the International Institute for Environment and Development, the International Council for the Conservation and Restoration of Monuments and Sites, and the developing regulation of

³⁵³ EATWELL & TAYLOR, *supra* note 5, at x.

³⁵⁴ Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting*, in INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM 3, 56 (Mario Giovanoli ed., 2000). Even Giovanoli acknowledges, however, that "the emergence of a supranational body would appear in any case to be rather unrealistic in the near future." *Id.*

³⁵⁵ David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L. L.J. 281, 285 (1998) (noting the influence of international financial regulatory organizations in formulating international rules, and opining that these organizations should be recognized by international law).

pharmaceuticals.³⁵⁶ All reflect the general awareness that the world is smaller, that it is interrelated, and that international problems need international solutions.

A telling example of international financial cooperation occurred during the so-called "debt crisis" of the 1980's. Mexico was the first country to announce that it would be unable to pay its obligations to foreign banks. Cooperative action averted the crisis, largely by means of financial infusions by the U.S. Federal Reserve and central banks of western Europe and Japan. Each country recognized its own vulnerability and the risks posed by a Mexican default to its own banks. The international community saw an international problem and acted collectively.³⁵⁷

Movements towards international accord in various areas are under way and we can learn from them. The UN sub-group that deals with international private law, titled the United Nations Commission on International Trade Law ("UNCITRAL"), has, in addition to its many other tasks, been working to harmonize international insolvency law since 1994. In 1997, it produced a Model Law on International Insolvency only by dint of a general agreement within UNCITRAL that it would attempt to address only some four subjects out of the scores that constitute most local insolvency laws. In general, UNCITRAL abided by the principle that the more complex a subject is, the less it is likely to be resolved on an international basis. Since adoption of the Model Law, UNCITRAL has attempted to move forward in harmonizing international insolvency law but has succeeded only in adopting a draft set of general principles for drafting a single international bankruptcy law.³⁵⁸ Any consideration of the CBS as a single international bank regulator would certainly have a similar fate.

³⁵⁶ See generally Joseph G. Contrera, Comment, *The Food and Drug Administration and the International Conference on Harmonization: How Harmonious Will International Pharmaceuticals Regulations Become?*, 8 ADMIN L.J. AM. U. 927, 927-60 (1995) (analyzing the strengths and weaknesses of the International Conference on Harmonization ("ICH"), and suggesting that, in light of the ongoing progress being made by the conference, critics should suspend judgment on the ICH's success or failure until its mandate expires).

³⁵⁷ See Brian Quinn, *A Central Banker's View About The International Debt Crisis*, in INTERNATIONAL DEBT AND CENTRAL BANKING IN THE 1980s, at 35 (Zannis Res & Sima Motamen eds., 1987). ("[A] crisis was averted only because all of the parties involved were prepared to do things which went against instinct.").

³⁵⁸ Cf. *Draft Legislative Guide on Insolvency Law*, U.N. Commission on International Trade Law, 29th Sess., U.N. Doc. A/CN.9/WG.V/WP.68 (2003) (suggesting guidelines for the creation of insolvency law).

The prestige that BIS has achieved in the international banking arena is undeniable. Section 3 of this Article demonstrates the range and significance of the issues on which it and its colleagues in Basel—the most prestigious of which is the CBS—have opined, and Section 4 shows that their opinions are not only taken seriously but also generally adopted by the major banking countries of the world.

The CBS has evolved through the years. It is clearly the senior international voice in bank regulation and has been found acceptable throughout the world for several reasons. First, the major central banks are represented in the CBS and, as in England, where the central bank does not have the power to regulate,³⁵⁹ the institution given that power also has a voice within the CBS.³⁶⁰ Each country has the ability to modify the CBS statements to suit its own banking structure and finds the CBS acceptable as a central voice for that reason. No country is required to accept the views of the CBS. It produces, as has already been mentioned, “soft law.” The CBS has gradually become the voice of reason as a result of its own sophistication and insight. When a country accepts a CBS opinion, it is not surrendering its sovereignty; it is exercising it.

Soft law promulgated by BIS or the CBS is widely adopted by the international banking community. It represents movement in the direction of a single international hard law. It is, however, still far from single regulation of the sort that is widely desired and offered by some as a requirement for a healthy international banking system. Individual countries continue to have local authority as to whether to adopt soft law. They may adopt it in different manners as suits their local societies. They may adopt some and reject some. At this time, there is no international uniformity.

Conflicts in banking are too great for there to be a single international regulator. We need name only a few:

1. What should a bank do, or, to rephrase, what is banking? Different countries define banking in different ways (or don't bother to define it at all). In the United States, the Supreme Court has acknowledged that the

³⁵⁹ Bank regulatory power is held by the Securities and Investment Board, created in 1997.

³⁶⁰ “Countries are represented by their central bank and also by the authority with formal responsibility for the fundamental supervision of banking business where this is not the central bank.” Bank for International Settlements, *The Basel Committee on Banking Supervision*, available at <http://www.bis.org/bcbis/index.htm> (last visited Sept. 3, 2004).

definition of banking, or of what a bank may do, will necessarily vary from time to time.³⁶¹ At the same time, the United States tends to have a more restrictive concept of banking than other major countries where a bank may own and operate industrial companies.

2. As a consequence of its narrow definition of banking, the United States has a complex system of bank holding company regulation. The concept is to prescribe a set of activities that are financial in nature but still may not be banking itself. These are included within a set of corporations that are affiliated with a bank but are not necessarily given as powers to the bank itself. No other country regulates its banking system in this manner. To give regulatory power over the world of options to one central regulator would probably grind the regulatory gears to a halt.
3. Different countries regulate different types of institutions within their banking structures. The United States presents the most complex regulatory pattern of all with commercial banks, savings banks, savings and loan associations, and credit unions as the prime banking—or bank type—institutions, each with its own regulatory structure multiplied by two because of the unique federal/state dual banking system. Then there are numerous institutions close to banks like finance companies, industrial banks and trust companies to name just a few. They too have regulatory structures.
4. Banking institutions offer different products, both financial and non-financial, in different countries. For example, while important compromises have been reached, there is no general agreement within the United States on the extent to which securities activities and insurance should be deemed a part of banking and should be offered by banks.³⁶² The Gramm-Leach Bliley

³⁶¹ See, e.g., *Nationsbank of N.C. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 258-59 (1995) (holding that the business of banking is not limited to certain enumerated powers, but to those activities that are within the reasonable limits of dealing in financial investment instruments).

³⁶² Both securities activities and insurance have been found “closely related to banking” under the Bank Holding Company Act, 12 U.S.C. § 1841 (2001) (listing definitions) and certain aspects of insurance have been acknowledged to be part of banking. *Id.*

Act of 1999³⁶³ has authorized bank holding companies – but not banks themselves – to offer a full range of securities and insurance products and services. At the same time, banks themselves may offer a narrower range of these same products and services.³⁶⁴ Intercompany mergers and acquisitions have blurred distinctions among banks, commercial banks, securities dealers, insurance companies, and insurance agencies. Harmonization on an international level through a single regulatory structure is hardly possible into the foreseeable future.

Given the nature of legal scholarship, it is reasonable to expect theories to arise around, explain, and predict the process of international bank regulation. One such theory is called “regime theory.”³⁶⁵ This Article does little more than name it. It applies mainly to international groupings based upon the agreement of sovereign states. Another theory, based upon lesser groups, more like the central banks that comprise the CBS, is called “neofunctional theory.” It was devised in response to the proliferation of alphabet agencies that comprised the New Deal.³⁶⁶ BIS and the CBS have generally avoided the abstruse theoretical constructs that attempt to explain their creation and predict their future. The Authors believe that the work of these organizations can best proceed without such explanations. The way has been set. New problems

³⁶³ Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (“providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial services . . .”).

³⁶⁴ For an instance of national banks in the securities business, see *Sec. Indus. Ass'n v. Comptroller of the Currency*, 577 F. Supp. 252, 260 (1982) *aff'd.*, 758 F.2d 739 (D.C. Cir. 1984) (holding that the National Bank Act “does not limit bank affiliates to securities transactions solely for pre-existing customers”); for national banks in the insurance business, see 12 U.S.C. § 92 (2001), which establishes rules for when national banking associations may solicit and sell insurance as agents of insurance companies.

³⁶⁵ As articulated by one of its foremost proponents, Robert O. Keohane, the regime theory explains the prevalence of regimes as a function of the rational choice of their members, who enter them to constrain their choices and reduce the transaction costs of cooperation in an otherwise anarchic international society. Robert O. Keohane, *The Demand for International Regimes*, in *INTERNATIONAL INSTITUTIONS AND STATE POWER* 101 (1989).

³⁶⁶ J.L. BRIERLY, *THE COVENANT AND THE CHARTER* 26 (1947) (comparing the covenants of the League of Nations with the UN). Part of neofunctional theory is that the development of some international agencies will stimulate the growth of others, an evolution called the “spillover effect.” Zaring, *supra* note 355, at 315. The Authors find this point of view consistent with their position.

will stimulate additional solutions. A theoretical superstructure will more likely impede than advance creativity. In this way, the future of international bank regulation will be a self-creating operation.

The Authors recommend that we both observe and participate in the process of international bank regulation. Internationalization is in evolution. It is moving from a past condition where there was essentially no international uniformity, to some time in the future when, we may reasonably predict, there will be uniform international bank regulation. Meanwhile, the soft law issuing out of Basel has moved us a long way. One example of the process of evolution is the gradual acceptance of the Basel Capital Accord. In 1987, a little more than a year before the accord was issued by the CBS, the United States and the United Kingdom entered into an agreement to implement common risk-based capital standards for banks in their respective countries.³⁶⁷ A year later, after the CBS adoption of the Basel Capital Accord in their first version, the full G-10 countries adopted the standards.

This is the process of evolution which has gone from no law at all³⁶⁸ to soft law. It should naturally proceed to hard law and a single law of international bank regulation. It need not be given mandatory direction; it need not be subjected to theory. There will continue to be new needs. They will be given new solutions. International bank regulation will, in this manner, continue to approach and finally to reach the goal of a single mandatory supervisory structure.

8. CONCLUSION

The pace of countries' exposure to world financial and commodity markets needs to be carefully managed. It is the time for the development of international laws and regulatory institutions to cope with globalization.

The role of an international financial institution is to fuel the expansion of business globally, and to ensure confidence and li-

³⁶⁷ Duncan E. Alford, *Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry*, 10 DICK. J. INT'L L. REV. 189, 195-96 (1992).

³⁶⁸ Three of the major international regulatory organizations in the financial area, dealing with banking, securities and insurance, "were created informally," and have evolved to highly structured, albeit soft law, institutions. Zaring, *supra* note 355, at 301.

quidity in the markets. According to its own course of activity since its inception, BIS has established itself as a credible, independent, and efficient financial institution. We have seen the bank grow gradually, fulfilling its mission, when called to step in. These are the fundamentals on which the bank stands tall today, while gradually expanding its activities.

Expansion of the bank's activities will come by increasing its authority. In the normal course, a course already set, it will naturally increase its role in coordinating and setting standards for the activities of central banks. One can see it acquiring certain powers of intervention. BIS's goal should be to reconcile and integrate different legal and policy frameworks. In the process, it should simplify existing procedures. However, it will need to offer clear benefits to existing financial institutions, since increasing BIS's authority will require major restructuring, investment, and certainly, political endorsement. Its role will need to be clearly defined to avoid overlap with other institutions and to indicate precisely how its power will be exercised.

BIS should be both allowed and encouraged to evolve towards a WFA. It should not now be transformed into a WFA. A two-tier system of supervisory responsibilities has taken over the supervision of international financial institutions. National authorities rule at the local level; supranational institutions are finding their places globally. A division of competence between national and supranational supervisory entities will be honed and pruned until the supranational authority will be a formal, lawmaking body. BIS seems the appropriate institution for this role.

Many prominent bankers, including former U.S. Secretary of Treasury, Robert E. Rubin have made speeches³⁶⁹ calling for steps to strengthen the international financial architecture. Unfortunately, this choice of words conjures up visions of an architect's blueprint and a floor-to-ceiling renovation, when this is not in fact how the international financial system evolves. It evolves incrementally, changing marginally in response to pressures from markets and governments, not discontinuously in response to radical visions. The existing system is made up of a dense network of social, economic and financial institutions. As with any network, its

³⁶⁹ See Robert E. Rubin, Speech before the House Committee on Banking and Financial Institutions (May 20, 1999) (calling for involvement of the private sector in crises prevention), available at <http://www.ustreas.gov/press/releases/rr3161.htm> (last visited Oct. 14, 2004).

components are lent inertia by their interaction and evolve incrementally in response to technological and other stimuli. So it is with the international financial system. History supports this interpretation and the associated prediction.

It is anybody's guess how far BIS will go. It is clear, however, that the bank is heading towards new challenges. As a result, its role in the international financial architecture will be closely watched by bankers, regulators, politicians, and the public. At the end, the last word in deciding whether the bank becomes a WFA will belong to the financial markets' need for a supranational financial supervisor and, assuming the existence of such a need, the ability of nations to cede a measure of their sovereignty to BIS.

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