Impacts of International Law on the Restructuring of the Global Financial System

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I. Introduction

1. The Starting Point: A Crisis-influenced System

International financial and economic crises have, in general, taught us many lessons of which there are two main ones: the first queries the capacity for global acting, revealed by severe weaknesses of public regulatory and supervisory institutions and instabilities of various market segments. The second indicates how crisis-laden economic processes allowed national and international policymakers the opportunity to modify the traditional state vs. market relationship by restructuring the global financial architecture on the international, as well as on the supranational level.

Before concentrating on the challenges of restructuring the global financial system, a short historical survey is needed. The recent diagnosis is very simple: it must be understood that the global financial system is liberalized, but it is still crisis-influenced and the impacts reach across all borders.

International financial markets became more integrated and underwent radical transformation, starting, in fact, with developed countries in the late 1970s and spreading to developing countries in the 1980s and 1990s. During the same period, international capital movements were seen to have accelerated, reaching high levels. This, in turn, led to financial innovation and a heavy use of sophisticated instruments. This development was encouraged by the fact that, in particular, under the IMF Agreement the Member States were allowed to control capital transactions,[1] and there are no relevant treaty rules under international law which impose, in general, a legal obligation on states guaranteeing a free movement of capital.[2] Therefore, the liberalization of financial services

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1 Article VI Section 3 Articles of Agreement of the International Monetary Fund (IMF Agreement), UNTS Vol. 2 No. 20 (a).

2 R.M. Gadbaw, "Systemic Regulation of Global Trade and Finance: A Tale of Two Systems", *JIEL* 13 (2010), 551 et seq. (558); C. Ohler, "International Regulation and Supervision of Financial Markets after the Crisis", *Working Papers on Global Financial Markets*, March 2009, 1 et seq. (9).

under the WTO/GATS Agreement[3] is only mandatory for members of the WTO and within the Schedules of Specific Commitments of the GATS.[4] The most outstanding multilateral approach of free movement of capital and financial services was set up by the European Union (EU) within the internal market for financial services.[5] As a result of the European and international processes of liberalization and deregulation, the cross-border offering of financial services and transactions by financial intermediaries dealing world-wide, e.g. banks, financial institutions, rating agencies and hedge funds, has assumed unexpected and alarming proportions.

This article is not the right place to emphasize the economic rationales[6] of the crisis, but rather it will concentrate on the efforts, which have been made in international affairs and on the global "gubernative" stage to stabilize the global financial system.

The breakdown of the US investment firm, Lehman Brothers, on 15 September 2008 was one of the main focal points of the global financial crisis which has persisted to date. A further peak of the crisis occurred in spring 2010, when sovereign financial crisis and public debt problems commenced in several countries of the Eurozone.

Nevertheless, since 2008 several milestones have been reached; in particular the informal, but powerful *Group of Twenty* (G20) attempted to tackle the crisis by concerted and decisive initiatives with macro as well as micro prudential content and replaced the central position of the *Financial Stability Board* (FSB) as an international financial institution.[7] The process of rethinking global structures also became apparent, when the Member States of the IMF carefully paved the way for a governance

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3 General Agreement on Trade in Services (GATS), 15 April 1994, supplemented with regard to Financial Services by the Second Protocol to the GATS, 24 July 1995, and the Fifth Protocol to the GATS, 3 December 1997. See for the interplay of IMF and WTO as two global regulatory systems, Gadbaw, see note 2.

4 Specific Commitments are set out in Schedules, integrated in the GATS (Article XX Section 3), and concern e.g. Market Access (Article XVI) and National Treatment (Article XVII).

5 Arts 63-66 Treaty on the Functioning of the European Union (TFEU), OJ, 9 May 2008, C 115, 47.

6 See for a detailed analysis R. Lastra/ G. Wood, "The Crisis of 2007-09: Nature, Causes and Reactions", *JIEL* 13 (2010), 531 et seq.; Ohler, see note 2, 4.

7 See in Detail, II. 4.a.; III. 2.b. and c.

reform of the Fund in October 2010 by strengthening the position of the emerging Member States; somewhat later, aiming to represent some emerging countries more adequately in the IMF, the G20 decided upon the next modification of quota and shares. The changed position of the FSB as the "fourth pillar" of global economic, monetary and financial governance structures may also be mentioned as one of the important milestones. Nevertheless and from the perspective of the EU, the response to the financial crisis that has to be put on record was an institutional one: the *European System of Financial Supervision* (ESFS).

The full effects of the last crisis are still not foreseeable[8] and have not been managed entirely. New threats, such as the European, as well as the US problems with public debt, are on the horizon. Therefore, it is necessary to stress that all challenges identified must be reconsidered in combination with institutional issues of global economic governance, as well as international financial and monetary structures. Considering the multiplicity of factual occurrences having appeared during the crisis, as well as the related legal efforts of the relevant actors, the following explanations do not intend to provide an in-depth analysis. However, it is hoped that this article will give a structured overview of the main composition of the global financial system and will be a basis for some food for thought.

2. Methodology

This article sketches some conceptual aspects of the ongoing international debate on the restructuring of the global financial system. Its purpose is to analyze the impact of international law on the global financial system and its stability, as well as to query to what extent a stronger and more effective international cooperation in this area is needed in the future.

For this reason, the first step will be a short review of the development after the crisis of the last years, starting at the initial causal point for the current crisis-influenced system: the breakdown of the US investment firm, Lehman Brothers, in September 2008. Based on this initial situation, the collaboration of the relevant actors who have an impact on the global financial system, will be analyzed in more detail.

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8 See for an "interim view" until March 2009, Ohler, see note 2, 1 et seq.

Because this study aims to spotlight global "rules" for financial markets, the focus centers on global governmental structures, which have the rule-making power to set international standards and establish legal structures (see below, Part II.). In this context, the Bretton Woods Institutions, in particular the IMF, are of particular importance due to their position as the nucleus of an international financial framework. Beyond that, various organizations and organs of the UN system, as well as informal forums of international cooperation beyond the United Nations, must be looked at, with regard to their impact on the global financial system. Finally, the special role of the *Bank for International Settlements* (BIS) as well as its "satellite", the *Basel Committee on Banking Supervision*, as standard setters are highly important. After discussing the position of and interactions between the defined relevant actors, the article will turn to the question of the impact which international law currently has and, with regard to the future, the challenges which have to be met (see below, Part III.).

First of all, global financial stability will be dealt with as the outstanding objective of global acting and the main intention of a transnational macro prudential supervision. Then, the institutional aspects of the relevant actors and the standard-setting bodies will be considered insofar as they are suitable for restructuring the global financial "architecture". This leads to the question of the (legal) effectiveness of "rules", in particular the dichotomy between hard and soft law, which should not be argued in a general way, but rather in the context of international financial markets. Hence, the protection of financial stability determines whether a hard or a soft binding effect is needed or adequate. The impact of legal provisions should be demonstrated in respect of selected issues, which are highly relevant for the management of the recent crisis, e.g. the much used term of "macro prudential" supervision of systemic risks or the issue of legitimacy of (governance) reforms of the institutional framework. Thereafter, the challenges should be translated to those actors defined as being relevant on the international level, i.e. IMF, G20, FSB, United Nations and BIS.

Although the focus is more on the global, rather than on a specific European perspective, the exceptional role of the EU, in particular the *European Central Bank* (ECB) and the *European System of Central Banks* (ESCB), has to be examined with regard to its external relationship to international financial issues.[9] The article will end by outlining

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[9] See under III. 2.f.

the main findings in a Summary and by drafting a short forecast of lessons for the future (see below, Part IV.).

A (re)structuring of the global financial markets might also have many side-effects relating to the ecological and sustainable development of the world-wide economy or might imply constraints leading to a re-thinking of questions pertaining to social policy. These relationships would, however, justify a separate article, therefore they will not be part of the subsequent explanations.

II. Main Actors in the Global Financial System

1. Overview

Before dealing with the challenges of the financial crisis, the relevant actors with any impact on the global financial system will be characterized. At this point, the analysis focuses on the actors of the global financial "architecture", as they stood on the eve of the (first) crisis in 2008. Such a general review seems necessary in order to realize that the global financial system has always been characterized by a plurality of subjects, a coexistence of actors and a variety of controlling instruments. The subsequently disputed cooperation of the actors has been pre-conditional for a deeper understanding of changes and modifications in the international context since the crisis.

At the starting point, the analysis shows a very heterogeneous picture with many actors on a global and intergovernmental, as well as on the regional level with connections and networks between the various levels and systems. Although a heterogeneous pluralism characterizes institutions, in particular in international law, it is inhomogeneous,[10] and at times somewhat confusing, with regard to "competences" in the field of international financial institutions. Concurrently, the "institutional framework" is very fragmentary, and more labeled by a parallel coexistence than by effective cooperation of the actors.[11] One incentive for reorganization should be a more effective coordination and cooperation which in the past did not function resulting in troubles in the relationship network.

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[10] M. Ruffert/ C. Walter, *Institutionalisiertes Völkerrecht*, 2009, marginal number 559.

[11] Also mentioned by Ruffert/ Walter, see note 10, marginal numbers 210 et seq.

The article returns to the subject of defining the actors and their relevance in a global financial system. The terminology of (legal) subjects or actors may be viewed from two perspectives: a private and a public one. Private actors, like financial enterprises, in particular banks, are relevant insofar as they take an economic advantage of their influential market power, partly with systemic importance.[12] This is due to the fact that private actors, in particular *Multi National Corporations/Enterprises* (MNC/MNE), give distinction to global business activities.[13] But these actors are only indirectly relevant, because of the economic consequences which are enormous and globally noticeable.

This article aims to spotlight global "rules" for financial markets. Therefore, its focus is less on pure subjects belonging to the private sector, but more on global governmental structures, having the rule-making power to establish international legal structures which are effective, and in the best case legally binding and applicable in cross-border relations. Above all, the relevant actors are from the state or governmental sector and/or "public donors" founding and financing institutional structures, partly as international governmental organizations; they should function as "stability anchors" for the global financial system in uncertain times. But the "classical pattern" of international governmental organizations will frequently be absent with regard to the entities acting as global financial institutions. One reason for this may be found in the limited leadership of the United Nations in this area. Although the IMF and the World Bank[14] were established successfully after World War II, the "third" economic pillar in the shape of an *International Trade Organization* failed in the first instance.

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12 See for the Systemically Important Financial Institutions (SIFIs) problem, under III. 1.a.

13 See for the discussion of the international legal personality of Multi-National Corporations, K. Nowrot, "Steuerungssubjekte und - mechanismen im Internationalen Wirtschaftsrecht", in: C. Tietje (ed.), *Internationales Wirtschaftsrecht*, 2009, § 2 marginal numbers 26 et seq.; C.D. Wallace, *The Multinational Enterprise and Legal Control*, 2002, 101 et seq. and 1071 et seq.

14 The term World Bank generally refers to IBRD and IDA, whereas the term World Bank Group is used to refer to a family of five institutions encompassing IBRD, IDA, International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA) and International Center for the Settlement of Investment Disputes (ICSID).

In 1995, the GATT 1947[15] was replaced by the WTO.[16] Regardless of all criticism about the governance structure, the IMF might nonetheless be seen as the hub of an international financial framework.[17] Moreover, the role of various organizations and organs of the UN system, in particular ECOSOC, must be discussed in this context.[18] Outside the UN system, there are several formations, working together within an informal cooperation, like the *Group of Eight/Twenty (G8/20)* and the FSB. The more formally structured institutions, like the BIS and the Basel Committee on Banking Supervision must be observed with regard to their impact on the global financial system.[19] Although their commitments are not legally binding, they direct *de facto*, which means that they have a strong impact on the further development of transnational issues. This is due to their high-ranking "members" who are able to make preliminary decisions, which again give the direction for consecutive resolution of e.g. the IMF or the World Bank.

2. Bretton Woods Institutions, in particular the International Monetary Fund

a. Origin and Development

At the United Nations Monetary and Financial Conference, convened in July 1944 in Bretton Woods, 44 Member States met to negotiate the design of a global framework for cooperation in trade, monetary and financial affairs. By signing the multilateral treaties of Bretton Woods two new and permanent international institutions were founded: the *International Bank for Reconstruction and Development* (IBRD),[20] later called the World Bank, and the *International Monetary Fund* (IMF). Although proposed at the Bretton Woods Conference, the International Trade Organization project failed because the Havana Char-

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15 General Agreement on Tariffs and Trade 1947/1994.

16 Agreement Establishing the World Trade Organisation, <http://www.wto.org/english/docs_e/legal_e/04-wto.pdf>.

17 See under II. 2.c.; III. 2.a.

18 See under II. 3.

19 See under II. 4.c.bb.; III. 2.e.

20 International Bank for Reconstruction and Development (IBRD), Articles of Agreement, UNTS Vol. 2 No. 20 (b).

ter[21] was not ratified by the US Senate. Due to the fact that the trade pillar flat lined, for a long time, IMF and World Bank have been the core of the international financial "architecture", even though "there is no agreed definition of what it constitutes."[22]

The discussions at the Conference were characterized by two rival plans and opposing political debates, dominated by *Harry Dexter White*, representing the United States, and his British counterpart, *John Maynard Keynes.*[23] Although a compromise was reached on some points, the former, i.e. the US position became largely accepted.[24] The main question of the Conference was the issue of exact macroeconomic adjustment with respect to the monetary institution that would emerge. Closely connected was the issue of whether the source for international liquidity should be structured similarly to a world central bank able to create new reserves at its will (lender of last resort).[25] The founding members decided in favor of a high degree of voluntary coordination of economic policy, including capital controls.[26] Because of the limited borrowing mechanism finally implemented, the IMF was deliberately restricted to its liquidity resources, given to it by the donor Member States. Another result of the Conference was the establishment of an international monetary system of fixed exchange rates, consisting of a fixed gold parity of the US$ and a dollar parity of the other currencies of the Member States and the establishment of special drawing rights (SDRs).[27] As is well known, this system of fixed exchange rates ended on 15 August 1971, because of the United States' disentanglement from

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[21] Final Act of the United Nations Conference on Trade and Employment: Havana Charter for an International Trade Organisation, 24 March 1948. See for details Gadbaw, see note 2, 557 et seq.

[22] "[I]t refers broadly to the framework and set of measures that can help prevent crises and manage them better in the more integrated international financial environment" <http://www.worldbank.org/ifa/ifa_more.html>.

[23] See for details A.F. Lowenfeld, "The International Monetary System: A Look over Seven Decades", *JIEL* 13 (2010), 575 et seq.; C. Tietje, "Architektur der Weltfinanzordnung", *Beiträge zum Transnationalen Wirtschaftsrecht* 109 (2011), 1 et seq. (10).

[24] Cf. J.M. Boughton, "Why White, not Keynes? Inventing the Post war International Monetary System", *IMF Working Paper*, Doc. WP/02/52, March 2002 <http://www.imf.org>.

[25] See for details Lowenfeld, see note 23, 579 et seq.

[26] See for the "fight over capital controls", Gadbaw, see note 2, 558 et seq.

[27] Gadbaw, see note 2, 558; S. Schlemmer-Schulte, "Internationales Währungs-und Finanzrecht", in: Tietje, see note 13, § 9 marginal number 46.

the gold standard. Based on the *Rambouillet Agreement* of the G7[28] and later framed by the re-adjustment of the IMF Agreement in 1976,[29] the currencies of the Member States have been free floating and convertible.[30] Hence, the IMF was restricted to monitoring the national policies of exchange rates and insofar retained surveillance over economic policies of its members. Although *Keynes* emphasized that a rule-based regime was very important to stabilize business expectations and predictability, originally, the IMF would not, in fact, possess any impact on structural macroeconomic issues to establish global and/or mandatory provisions.

b. Structure of the IMF

aa. Legal Status

As an international governmental organization, the IMF does possess "full juridical personality".[31] Currently, the Fund consists of 187 members[32] which are all "countries", i.e. states in the terms of international law – the only formal precondition of IMF membership.[33] Therefore no other subject of international law shall be accepted for membership. All 27 Member States of the EU are members of the Fund, but, with regard to the rules of the IMF Agreement, neither the Union nor the ECB are members.[34] The IMF and the World Bank are specialized agencies in the sense of Article 57 UN Charter.[35] This means that the Fund and the World Bank are institutions within the UN system, whereas the WTO

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28 *G7 Declaration of Rambouillet*, 17 November 1975, *IMF Survey* No. 4, 350 of 24 November 1975. See for details Lowenfeld, see note 23, 583.

29 2nd Amendment of the IMF Agreements. Modifications approved by the Board of Governors in Resolution No. 31-4, adopted on 30 April 1976, and amended effective on 1 April 1978.

30 Cf. Lowenfeld, see note 23, 581 et seq.

31 Article IX Section 2 of the IMF Agreement.

32 IMF, "About the IMF" <http://www.imf.org>.

33 Article II Sections 1, 2 IMF Agreement.

34 Cf. D.E. Khan, "Article 219 TFEU", in: R. Geiger/ D.E. Khan/ M. Kotzur (eds), *EUV/AEUV, Kommentar*, 5th edition 2010, marginal number 12; U. Häde, "Article 219 TFEU", in: C. Calliess/ M. Ruffert (eds), *EUV/AEUV, Kommentar*, 4th edition 2011, marginal number 20. See under III. 2.a. and f.

35 They are connected with the United Nations by way of an agreement based on Article 63 UN Charter.

is only a "related or associated" intergovernmental organization. But there does exist an agreement-based cooperation between IMF and WTO on relevant issues.[36]

bb. Organizational Structure

Regarding the internal organizational structure, the IMF consists of three main bodies:[37] the Board of Governors, the Executive Board and the Managing Director.

The *Board of Governors*[38] is the highest decision-making body at the top of the institutional structure of the Fund and the only general body representing all members, because the Member States did not install a council at the ministerial level. Several powers are reserved for the Board only,[39] like electing and appointing the Executive Directors or being the ultimate arbiter in the interpretation of the IMF's Articles of Agreement; all powers not conferred directly to other institutions shall be vested in the Board.[40] It consists of one Governor and one alternate for each Member State. The Governor is appointed by the respective Member State and is usually the minister of finance or the governor of the national central bank. The Board meets annually and is advised by two ministerial committees,[41] the *International Monetary and Financial Committee* (IMFC) and the *Development Committee*, a committee established jointly with the World Bank for dealing with development issues. The IMFC[42] is responsible for discussing fundamental issues of the international monetary policy and financial stability including global liquidity, in particular in acute crisis situations. It has 24 members, drawn from the pool of currently 187 Governors. Its structure mirrors that of the Executive Board (see below). As such, the

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36 See for the full text Decision No. 11381-(96/105), 25 November 1996, Selected Decisions and Selected Documents, 35th issue.

37 Article XII Section 1 IMF Agreement. See for details L. Gramlich, "Eine neue internationale 'Finanzarchitektur' oder: Der IMF in der Krise?", *AVR* 38 (2000), 399 et seq. (411 et seq.).

38 Article XII Section 2 of the IMF Agreement.

39 E.g. the right to approve quota increases, special drawing right (SDR) allocations, the admittance of new members, compulsory withdrawal of members, and amendments of the Articles of Agreement and By-Laws.

40 Article XII Section 2 (a) of the IMF Agreement.

41 Article XII Section 2 (j) of the IMF Agreement.

42 See under <http://www.imf.org/external/np/exr/facts/groups.htm#IC>.

IMFC represents all Member States of the Fund; at the IMFC no formal voting takes place, but it operates by consensus.[43]

In particular within the Board of Governors, but also in the Executive Board, the "quota based" weighted voting is manifest. Each IMF Member State is assigned a specific quota[44] of SDRs, their scope based broadly on macroeconomic data representing its relative position in the world economy. A Member State's quota determines its maximum financial commitment to the IMF (quota share) as well as its voting power (voting share), and has also relevance in respect to its access to IMF financing. Unlike the United Nations and the WTO/GATT, which provided one vote for each Member State, the IMF uses a system of voting based on Member States' quotas in the Fund.[45]

The *Executive Board* is the central administrative body of the Fund; because of this position most of the powers of the Board of Governors were delegated to it.[46] It is composed of 24 (Executive) Directors, appointed or elected by the Member States or by groups of states, and the Managing Director, who serves as its Chairman. The formation is also determined by respective member quotas[47] and can be changed, as could be seen in the last reform in 2008,[48] which entered into force in March 2011,[49] when quota and voting shares were changed.

The third main position is held by the *Managing Director*, who is neither a Governor nor an Executive Director.[50] The Managing Director is the chief of the operating staff and the chairman of the Executive Board, but he/she shall have no vote, except for a deciding vote in the event of a tie.

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[43] See for an explanation R. Wolfrum, "Consensus", in: R. Wolfrum (ed.), *United Nations: Law, Policies and Practice*, 1995, 350 et seq.

[44] Article III of the IMF Agreement.

[45] Lowenfeld, see note 23, 577.

[46] Article XII Section 3 (a) of the IMF Agreement.

[47] Article XII Section 3 (b), ibid.

[48] "Directors Back Reforms to Overhaul IMF Quotas and Voice", *IMF Survey,* 28 March 2008 <http://www.imf.org>.

[49] "The IMF's 2008 Quota and Voice Reforms Take Effect", Press Release No. 11/64, 3 March 2011 <http://www.imf.org>.

[50] Article XII Section 4 of the IMF Agreement.

cc. Governance Reforms

Regarding governance reforms of the IMF's internal structure, the subject of legitimacy concentrates predominantly upon the question of how Member States are adequately represented in the decision-making bodies because of the decisive function of quotas and shares. Since the formation of the Fund, almost every reform of the founding documents of the Fund, except for the (second) amendment after the breakdown of the exchange rates system in 1976,[51] was accompanied by controversial disputes about criteria of presumptive adequate representation of the Member States, with different results. The reform of 1997[52] took 11 years to come into force, leading to a small increase in the voting shares and quotas of the members; the minor or governance reform of 2008,[53] was initiated long before the current crisis, involving an aggregate shift of 5.4 percentage points to under-represented countries. The article will come back to the post-crisis development at a later point.[54]

c. Tasks of the IMF

aa. Mandate

The mandate of the IMF, stated very generally in article I of the IMF Agreement, includes the following six main purposes:

> "(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
>
> (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
>
> (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

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51 See note 29.

52 Modifications approved by the Board of Governors in Resolution No. 52-4, adopted on 23 September 1997 and amended effective on 10 July 2009.

53 Modifications approved by the Board of Governors in Resolution No. 63-3, adopted on 5 May 2008, amended effective on 18 February 2011.

54 See under III. 2.a.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them (...) .

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members."

bb. Tasks and Instruments

Based on these core purposes, four main tasks of the IMF can be deduced: (1) the "supervision" of settlement and payment,[55] (2) the function of surveillance,[56] (3) the granting of credits (lending),[57] and (4) the information function, i.e. the Fund's acting as a base of knowledge, information and data.[58] Due to the fact that the lending function and, in particular, the function of surveillance are of high importance for the matter at hand, they will be described in more detail.

With regard to precise instruments put at the disposition of the IMF, the Agreement refers only very vaguely to "policies" and "decisions".[59] The categories of "principles", e.g. described as "specific principles for the guidance"[60] of national policies of exchange rates or "other principles"[61] for operations and transactions in SDRs, as well as of "recommendations"[62] occur. Although the Agreement itself remains silent as to the legal quality of the instruments mentioned, it can be noticed with regard to the legal diction that the binding effect is relatively weak, because of the absence of effective sanctions, i.e. the instruments are hardly mandatory for the Member States. In most cases the Fund is lim-

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55 Article VIII of the IMF Agreement.

56 Article IV, ibid.

57 Article V, ibid.

58 Article IV Section 3 lit. b.) sentence 4; article VIII Section 5; article XVI Section 3, ibid.

59 Article I, last sentence, ibid.

60 Article IV Sections 1 and 3, ibid.

61 Article XIX Section 5 lit. a.), ibid.

62 Article VII Section 2, ibid.

ited to mere guidance,[63] meaning that these “principles” do not contain any strict or close binding effect. The loan agreements are excepted insofar as they are given under special conditions (so called conditionality), its increasing importance shall be discussed in detail later.[64]

cc. Lending Function

The financial assistance or lending function is designed to help countries to relaunch growth and to restore macroeconomic stability by rebuilding their international reserves, stabilizing their currencies, and paying for imports.[65] The IMF also provides concessional loans to low-income countries to help them develop their economies and reduce poverty. Especially when a Member State faces an exceptional situation that threatens its financial stability, the Fund can provide rapid response to contain the damage to the international monetary system. The purpose of the IMF’s lending has changed dramatically since its creation. Prior to the financial crisis the IMF had rather aged resulting in its declining importance, but there seems to have been a revival of its main tasks, caused by the assistance given by the Fund to financially suffering countries.

The financial assistance has evolved from helping countries, which have to cope with short-term trade fluctuations, to a wide range of assistance activities that deal with problems originating from trade shocks, sovereign debt restructuring and currency crises. Since the 1990s there has been a revival of the lending function, in particular the Rapid IMF Lending in highly-developed countries. Examples can be found in the support given during the Asian crisis in 1997.[66] In 2001 the *Emergency Financing Mechanism* was used for Turkey and again in 2008/2009 *inter alia* for Hungary, Iceland and Latvia, and – considering the public debt crisis in the Eurozone – in 2010 for Greece.[67] The granting of credits is implemented under several conditions, stated in a *Letter of Intent* as the result of negotiations between the grantor – the Fund –

63 Article IV Section 3 lit. b.), ibid. Cf. C. Schiller, “Improving Governance and Fighting Corruption: An IMF Perspective” of 31 March 2000 <http://www.oas.org>.

64 See under III. 2.a.

65 See for details Gramlich, see note 37, 406 et seq.

66 Cf. Lowenfeld, see note 23, 589 et seq.

67 IMF Factsheet, “IMF Crisis Lending”, 29 March 2011.

and the borrower – the Member State in need.[68] With the country asking for help the Fund discusses the economic policies that may be expected in order to address the problems most effectively, and both agree on a program of policies aimed at achieving specific, quantified goals in support of the overall objectives of the borrowing government's economic program.

Although the idea of a condition-based lending is a positive one, the mode of conditionality has often been criticized because of its slightly intangible macroeconomic requirements, as well as the rather general and hardly binding surveillance of the economic and monetary policy of the borrower.[69] Even before the recent crisis emerged, the IMF was in the process of reforming how it lends money to countries finding themselves in a cash crunch. Creating different kinds of loans for the very different needs of the Member States was the aim of the new Lending Framework, installed in March 2009; the article will deal with this in detail at a later point.[70]

dd. Surveillance Function

The surveillance function, as it stands today, is the result of the (second) amendment of the IMF Agreement in 1976.[71] After the gold standard broke down, the Member States revised the strict scope of the monetary and exchange rate matters and enlarged the Fund's mandate by authorizing the institution to set up guidance in structural macroeconomic issues, which are relevant for the observation of the international monetary system.[72] Therefore, the IMF "oversees" the international monetary system and monitors the financial and economic policies of its members.[73] It keeps close track of economic developments on a regional, national and global basis. In detail, the Fund monitors and gives

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68 Lowenfeld, see note 23, 580.

69 Gramlich, see note 37, 404 et seq.

70 See under III. 2.a.

71 *G7 Declaration of Rambouillet*, see note 28, and 2nd Amendment of the IMF Agreement, see note 29.

72 See for a former version of article IV of the IMF Agreement S. Hagan, "Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework", 28 June 2006, 1 et seq. (18 et seq.) <http://www.imf.org>; Lowenfeld, see note 23, 584 et seq.

73 See for details D.W. Arner/ R.P. Buckley, "Redesigning the Architecture of the Global Financial System", *Melbourne Journal of International Law* 11 (2010), 1 et seq. (10 et seq.); Gramlich, see note 37, 404 et seq.

advice on exchange rates, monetary and fiscal policies, as well as on specific financial sector issues. Those institutional and structural issues have an increasing impact upon the financial crisis and in the context of some countries' transition from planned to market economies.

This leads to the central role of the IMF (and the World Bank) in developing, implementing and assessing internationally recognized standards and codes. As a result of the IMF's access to information and data of high quality and quantity, the surveillance function[74] has a strong tie to the role of the Fund as a standard setter. Although a legal source or an explicit statutory basis for standard-setting can hardly be found in the Fund's Agreement, this task has become more and more important concerning establishing an international financial architecture.

For a long time and last reviewed in 2005,[75] the IMF has attempted imposing pressure on the economic governance in its Member States by developing internationally recognized standards and codes in 12 areas identified by the Fund as being crucial to the efficient functioning of a modern economy, and developed in cooperation with other standard-setting bodies like the World Bank,[76] the Basel Committee and the *OECD's Financial Action Task Force*.[77] Amongst others, main areas concerned are banking supervision; monetary and financial policy transparency; data dissemination; fiscal transparency and payments systems. The *Reports on the Observance of Standards and Codes* summarizing countries' observance of these standards are prepared and published by the IMF, although the Member States do have a certain influence on their own report.[78] The reports covering financial sector standards are usually prepared in the context of the *Financial Sector Assessment Programs* of the World Bank.

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74 Article IV IMF Agreement.

75 Cf. M. Allen, "Standards and Codes – Implementing the Fund's Medium-Term Strategy and the Recommendations of the 2005 Review of the Initiative", 29 June 2006 <http://www.imf.org>; M. Allen/ D.M. Leipziger, "The Standards and Codes Initiative – Is It Effective? And How Can it be Improved?", 1 July 2005 <http://www.worldbank.org>.

76 The World Bank Group, *International Financial Architecture* <http://www.worldbank.org/ifa/ifa_more.html>.

77 Financial Action Task Force <http://www.fatf-gafi.org>.

78 IMF, *Reports on the Observance of Standards and Codes* <http://www.imf.org>.

In this context, the range of activities of the IMF and World Bank should be distinguished. Although both share the same goal, their approaches to further a more stable and prosperous global economy are complementary, partly overlapping and sometimes mixed with regard to their similar features, like members, annual meetings or headquarters. In brief, the Fund focuses more strongly on macroeconomic issues with regard to the stability of the global financial and currency system. In contrast, the World Bank concentrates more on long-term economic development assistance as well as poverty reduction in less and least developed countries by providing technical and financial support to help those countries reform particular sectors or implement specific projects, e.g. building schools and health centers, providing water and electricity, fighting diseases and protecting the environment.[79] But in many areas of their very similar, partly overlapping activities the IMF and the World Bank collaborate, as laid down in a concordat.[80] Therefore, *Keynes* was probably right when he accentuated at the inaugural meeting that the Fund should be called a bank, and the Bank should be called a fund. Confusion has reigned ever since.[81]

3. Economic and Social Council of the United Nations

The United Nations, in particular the General Assembly and the Security Council are less focused on the global financial and monetary system due to their main tasks. Although the Economic and Financial Committee (Second Committee) of the UN General Assembly is engaged in issues of economic growth and development, such as macroeconomic policy questions including international trade, the international financial system and sustainability of external debt, it deals with the questions from the perspective of development cooperation and aid only.

With regard to the matter at hand, ECOSOC was established in order to coordinate international economic, social and related work.[82]

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79 IMF Factsheet, "The IMF and the World Bank" <http://www.imf.org>.

80 Cf. J.M. Broughton, "Silent Revolution: The IMF 1979-1989", 1 October 2001, Chapter 20 – Managing the Fund in a Changing World <http://www.imf.org>.

81 D. Driscoll, "The IMF and the World Bank: How do they differ?" <http://www.imf.org>.

82 Arts 62 et seq. UN Charter.

Within the UN system, the Council serves among others as the central forum for discussing international economic and social issues and is, *inter alia*, responsible for promoting higher standards of living, full employment, and economic and social progress, as well as for identifying solutions to pressing problems in these areas. Relating to these issues, the Council has the power to make or initiate studies and reports and to formulate recommendations, addressed to the General Assembly, the Member States and the specialized agencies concerned.[83] In particular, it may enter into agreements with agencies referred to in Article 57 of the UN Charter, e.g. IMF and World Bank defining the terms of relationship with the United Nations.[84] But for the mentioned historical reasons, the capacity of ECOSOC to influence international policies in trade, finance and investment is very limited.

Already in 2005, the World Summit requested the establishment of ECOSOC as a quality platform for high-level engagement among Member States and with the international financial institutions, the private sector and civil society to debate on emerging global trends, policies and action.[85] In November 2006, subsequent proposals by the report of the *High-level Panel on System-Wide Coherence*[86] aimed to establish a *Global Leaders' Forum of the Economic and Social Council* as a counter-model to the G8 and G20. The Forum should comprise 27 heads of state (L27), corresponding to half of the ECOSOC membership, and meet annually to provide international leadership in the development area. But unfortunately, this ambitious proposal was not approved by the General Assembly.

4. International Cooperation beyond the United Nations System

a. "Groups"

One of the most remarkable facts, underlining the multiplicity of actors, is the existence of several groups and institutions, settled beyond the UN system, but with considerable influence. Primarily, the outstanding functions of informal groups, like the G7/8 and the G20, as

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83 Article 62 UN Charter.

84 Article 63 UN Charter.

85 Doc. A/59/2005 of 21 March 2005, paras 171 et seq.

86 Doc. A/61/583 of 20 November 2006, para. 59.

well as the FSB must be stressed. Moreover, the role of the more institutionalized BIS and the Basel Committee on Banking Supervision should be mentioned.

The G7's origin stems from meetings held in the 1970s between politicians from France, *Valéry Giscard D'Estaing*, and Germany, *Helmut Schmidt*, when both were finance ministers.[87] Each subsequently assumed the leadership of their respective countries, just as the mid-1970s oil crisis was buffeting the world's largest economies. *Giscard D'Estaing*, then the President of the French Republic, urged the leaders of Germany, Canada, Italy, Japan, the United Kingdom and the United States to meet in 1975 to discuss how to adequately respond to the oil crisis.[88] Enlarged by the Russian Federation in 1998, the G8 is a forum of eight of the world's most industrialized nations, aimed at finding common ground on key topics and solutions to global issues.

In addition, the G7/8 developed a network of supporting ministerial meetings, which allows ministers to meet regularly throughout the year in order to continue the work set out at each annual summit.[89] Since 1992, as reaction to various financial crises after the breakdown of the gold standard, the G7 increasingly was concerned with the stability of the global financial system. The 1995 collapse of the Barings Bank had already demonstrated the fragile and interconnected nature of the modern financial system. With regard to the suggested inherent dangers of contagion and systemic breakdown, several international organizations (e.g. IMF, World Bank, WTO) were invited to work together with the G7 in improving financial market stability. These organizations had their debut at the *Lyon Summit* (1996)[90] and subsequent meetings continued to explore new avenues for cooperation. In 1998, the formation of the G7-finance ministers addressed the report "Strengthening the Architecture of the Global Financial System"[91] to the G7-leaders, but no specific action plans resulted until the financial crisis occurred.[92]

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87 Cf. details A. Brouder, "G8", in: C. Tietje/ A. Brouder (eds), *Handbook of Transnational Economic Governance Regimes*, 2009, 95 et seq.

88 Gramlich, see note 37, 415.

89 G8 Information Centre, "What is the G8?" <http://www.g8.utoronto.ca>.

90 Finance Ministers Report to the Heads of State and Government on International Monetary Stability, Lyon G7 Summit, 28 June 1996 <http://www.g8.utoronto.ca>.

91 Report of G7 Finance Ministers to G7 Heads of State or Government for their meeting in Birmingham, May 1998 <http://www.g8.utoronto.ca>.

92 See for the role of G7 until 2000 Gramlich, see note 37, 425 et seq.

At the *Cologne Summit* in June 1999, in addition to the G7, the new G20-forum of finance ministers and central bank governors, formed by the 19 largest national economies of the world[93] plus the European Union, was established. In addition to these members, the respective chief executive officers of some of the important global financial forums and institutions, like IMF, World Bank and IMFC, participate in meetings of the G20.

Emphasizing that new international organizations are not required, the new G20-forum should form a "mechanism for informal dialogue in the framework of the Bretton Woods institutional system to broaden the dialogue on key economic and financial policy issues among systemically significant economies and to promote cooperation to achieve stable and sustainable world growth that benefits all."[94] In fact, the existing institutions should "adapt their roles to meet the demands of today's global financial system: in particular [...] to have the right tools to help countries to manage crises; and to take steps to enhance their effectiveness, accountability and legitimacy."[95] Moreover, the G20 welcomed the creation of the Financial Stability Forum (see below) and the IMFC, working together to establish an informal mechanism for dialogue among systemically important countries, within the Bretton Woods institutional framework.

From the point of international law it is difficult to characterize the legal quality of the G8/20. The "groups" are gubernative committees, but they are not institutionalized as an international governmental organization and do not possess international legal personality. Without having any designated linkage to the Bretton Woods institutions or to the UN system, the *de facto* impact of such an informal dialogue cannot be underestimated.[96] The impact their meetings have given to the global financial system since the crisis will be explained later.[97]

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93 Australia, Argentina, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russian Federation, Saudi-Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States.

94 Statement of G7 Finance Ministers and Central Bank Governors, Washington D.C., 25 September 1999, para. 19 <http://www.g8.utoronto.ca>.

95 Report of G7 Finance Ministers to the Cologne Economic Summit, Cologne, Germany, 18-20 June 1999 <http://www.g8.utoronto.ca>.

96 In this context, Tietje, see note 23, 25 et seq., advocates for a more "functional approach" with regard to the definition of the international legal personality of actors.

97 See under III. 2.b.

b. Financial Stability Forum/Board

The *Financial Stability Board* (FSB) is the successor of the former *Financial Stability Forum* (FSF). The Forum was founded in 1999 by the G7 in reaction to the Asian crisis of that time.[98] Previously, the G7 (Ministers of Finance) had commissioned *Hans Tietmeyer*, one of the former governors of the German Central Bank, to recommend new structures for enhancing cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system. It is remarkable that *Tietmeyer* already criticized the same facts which were repeated in the context of the management of later crises. Particularly, faults were found within the isolated work of various international institutions which seemed contradictory to the existence of systemic risks in a global financial world.[99] Following the proposal, the G7-Finance Ministers and leaders in 1999 endorsed the establishment of a Financial Stability Forum as an informal group of finance ministers, central bankers and financial supervisors of about a dozen industrialized economies as well as of representatives of international financial and economic institutions, like the IMF or BIS.[100] However, emerging markets and developing countries were excluded from the Forum.[101] A small Secretariat was hosted in Basel, Switzerland, and the Forum was first convened in April 1999 in Washington.

In accordance with its own self-concept, the Forum should bring together:

- national authorities responsible for financial stability in significant international financial centers, namely treasuries, central banks, and supervisory agencies;

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98 Cf. for details T. Porter, "Financial Stability Board", in: Tietje/ Brouder, see note 87, 345 et seq.; C. Tietje/ M. Lehmann, "The Role of International Law in Financial Regulation and Supervision", *JIEL* 13 (2010), 663 et seq. (675 et seq.).

99 Cf. Gramlich, see note 37, 433 et seq.; D. Ruddigkeit, "Das Financial Stability Board in der internationalen Finanzarchitektur", *Beiträge zum Transnationalen Wirtschaftsrecht* 111 (2011), 1 et seq. (7 et seq.).

100 Finance Minister Welcomes G-7s Progress on Promoting Stability in the International Financial System, Bonn, 20 February 1999 <http://www.g8.utoronto.ca>.

101 Tietje/ Lehmann, see note 98, 675.

- sector-specific international groupings of regulators and supervisors engaged in developing standards and codes of good practice; international financial institutions charged with surveillance of domestic and international financial systems and monitoring and fostering implementation of standard;
- committees of central bank experts concerned with market infrastructure and functioning.[102]

Although these functions are important ones, the Forum neither had strict organizational structures nor precise obligations for its members, laid down in a founding charter. The article will return later to modifications in the membership and mandate, which had been made to the Forum since the crisis.[103] The Forum neither possessed a legal personality, nor was it founded as an international governmental organization. Although it is an informal institution, its assumed position as one of a few international standard setters should not be undervalued. Due to the fact that international financial standards can hardly be qualified otherwise than as soft law because they are not legally binding, they are basically accepted as being important for sound, stable and well functioning financial systems.

The *Compendium of Standards*, first developed in 1999, as a joint product of the few standard-setting bodies represented by the Forum (currently: FSB), consists of various economic and financial standards, divided into 12 policy areas;[104] the Compendium shall be periodically reviewed and updated in light of international policy development. The *Key Standards for Sound Financial Systems*, in particular, have to be highlighted since they represent the "minimum requirements for good practice that countries are encouraged to meet or exceed."[105] Albeit the Forum stressed that the Standards represent and deserve priority implementation in domestic circumstances, the international endorsement was not successful in itself. The periodical review of progress of their

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102 Financial Stability Board, "About the FSB History" <http://www.financialstabilityboard.org>.

103 See under III. 2.c.

104 Monetary and financial policy transparency; Fiscal policy transparency; Data dissemination; Banking supervision; Securities regulation; Insurance supervision; Crisis resolution and deposit insurance; Insolvency; Corporate governance; Accounting and auditing; Payment, clearing and settlement; Market integrity.

105 Financial Stability Board, "Key Standards for Sound Financial System" <http://www.financialstabilityboard.org>.

implementation at the national level was left to the IMF's consultation and oversight mechanisms, i.e. that the IMF was entitled to monitor the implementation of the Key Standards in Member States through *Reports on the Observance of Standards and Codes* and *Financial Sector Assessment Programs*. In particular, the Programs did not consist of binding provisions for the Member States of the Fund and the Forum did not have the ability to assert its own standards; its analyses were widely disregarded. In part they were criticized by the affected subjects and jurisdictions.[106]

c. Bank for International Settlements

aa. Development and Organizational Structure

As the world's oldest international financial institution, the BIS[107] was established on 17 May 1930 by an international treaty between eight Member States (Belgium, France, Germany, Italy, Japan, Switzerland, the United Kingdom, the United States).[108] The BIS currently has 58 member central banks.[109] As an international governmental organization the Bank shall foster international monetary and financial coopera-

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[106] Also stressed by Ruddigkeit, see note 99, 8 et seq.

[107] Cf. for details K. Alexander, "Bank for International Settlements", in: Tietje/ Brouder, see note 87, 305 et seq.; Gramlich, see note 37, 417 et seq.

[108] Statutes of the Bank for International Settlements (BIS), 20 January 1930. Amendments to the original text of the Statutes of 20 January 1930 were adopted by Extraordinary General Meetings held on 3 May 1937, 12 June 1950, 9 October 1961, 9 June 1969, 10 June 1974, 8 July 1975, 14 June 1993, 13 September 1994, 8 November 1999, 8 January 2001, 10 March 2003 and 27 June 2005. The amendments adopted in 1969 and 1975 were sanctioned in accordance with the conditions laid down in article 1 of the Convention. Text as amended on 27 June 2005 <http://www.bis.org>.

[109] Members are the central banks or monetary authorities of Algeria, Argentina, Australia, Austria, Belgium, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Chile, China, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong SAR, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Macedonia FYR, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Peru, the Philippines, Poland, Portugal, Romania, Russian Federation, Saudi Arabia, Serbia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, the United Kingdom and the United States, plus the ECB. Cf. BIS, "About BIS", Organisation <http://www.bis.org>.

tion and serve as a bank for central banks, but it is not a central bank itself.

The governance of the Bank is determined by two decision-making bodies: the General Assembly[110] and the Board of Directors.[111] All of the 58 central banks of the BIS are entitled to be represented and vote at the annual meeting of the General Assembly (General Meeting). Other financial authorities not being members can take part as observers at the meetings. The voting power is proportionate to the number of BIS shares issued to the state of each member represented at the meeting.

According to its mandate "The objects of the Bank are: to promote the co-operation of central banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international financial settlements entrusted to it under agreements with the parties concerned."[112] In special areas advisory committees are created;[113] in particular, the previously mentioned Basel Committee on Banking Supervision[114] and the *Committee on the Global Financial System* (CGFS) should be put on record.

The CGFS, formerly known as the Euro-currency Standing Committee, was established in 1971 with a mandate to monitor international banking markets. Its initial focus was the monetary policy implications of the rapid growth of off-shore deposit and lending markets. Its attention increasingly shifted to financial stability topics and to broader issues related to structural change in the global financial system, which finally led to the renaming and revising of the mandate in 1999 by a decision of G10-Central Bank Governors.[115] Although the mandate was broadened to include threats towards the stability of financial markets and the global financial system, the CGFS places particular emphasis on assistance to member central banks. Consequently, its instruments are non-binding, but contain politically important recommendations.

The existence of the CGFS as well as that of the Basel Committee on Banking Supervision, which will be described in more detail below, points out that the BIS is meanwhile mainly acting as a standard setter.

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110 Arts 26 et seq. BIS Statutes.

111 Arts 44 et seq., ibid.

112 Article 3, ibid.

113 Arts 42 and 43, ibid.

114 Cf. for details B. Rost, "Basel Committee on Banking Supervision", in: Tietje/ Brouder, see note 87, 319 et seq.

115 BIS Factsheet, "Committee on the Global Financial System" <http://www.bis.org>.

The task of setting international standards is justified and determined by fostering monetary and financial stability. It could be emphasized that these two objectives are mentioned explicitly as well as separately of each other, i.e. they focus on nearly related, but different issues.[116] With regard to these objectives the BIS, particularly the special committees, publish recommendations, reports, standards and principles. All of these documents are not explicitly mentioned in the BIS Statutes, and thus, they are, in general, soft law and not legally binding. Although the standards are *de facto* complied with by many Member States, there neither exists a legal obligation to implement BIS principles and standards within the respective jurisdiction nor do there exist sanctions in case of non action.

bb. The Basel Committee on Banking Supervision

Caused, amongst other reasons, by the bankruptcy of the German Herstatt Bank in 1974, the Central Bank Governors of G10-states and Switzerland founded a "Standing Committee on Banking Regulations and Supervisory Practices", later renamed as Basel Committee on Banking Supervision. Like the CGFS, the Basel Committee provides a forum for regular cooperation, but neither possess any formal supranational authority. Nevertheless, its impact carries a heavier weight, which might have been potentially caused by the experience of the Herstatt bankruptcy felt by the affected banks. Based on its objective – improving the quality of worldwide banking supervision – it uses the common understanding of its members to develop guidelines and supervisory standards as well as to recommend statements of best practice in areas where they are considered adequate. Regarding this, it is best known for its international standards on capital adequacy, called *Basel Capital Accord*, the *Core Principles for Effective Banking Supervision*,[117] as well as for the *Concordat on Cross-Border Banking Supervision*. In particular, the Basel Capital Accord (Basel I), based on a minimum capital standard of eight per cent to be reached by the end of 1992, was revised in 2004 by a Capital Adequacy Framework,[118] called Basel II, and con-

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116 See for details under III. 1.a.

117 "Core Principles for Effective Banking Supervision", Basel Committee, September 1997 <http://www.bis.org/publ/bcbs30a.pdf>.

118 International Convergence of Capital Measurement and Capital Standards, "A Revised Framework of June 2004" <http://www.bis.org>.

sisting of three pillars.[119] A third step, the response of the Basel Committee to the financial crisis – Basel III – will be dealt with in more detail below.[120]

All of those "Basel Accords" should serve as a basis for national rule-making in the expectation that national authorities will take steps to implement the standards through detailed arrangements, tailored to the national legal system. The Basel Committee's conclusions were never intended to have a binding legal effect; rather, the Committee induced only a convergence framework without attempting a detailed or full harmonization of the Member States' supervisory systems. Its standards have been progressively introduced in most, but not all member jurisdictions and also in other states with banks engaged in cross-border transactions. The EU completely recognized the standards of Basel I and II and enacted two supranational directives which had to be implemented by the EU Member States.[121] This example shows how harmonizing a global standard-setting process could work, if standards are legally binding and mandatory for the Member States. But it also manifests that an integration level like the European one may not be realistic on the global stage for an indefinite period of time.

With regard to the relationship of BIS and its committees to other global financial institutions, it can be stated that, *de facto*, diversified information exchange does exist. But there is no formal basis for collaboration between BIS and the IMF or with the FSB or G20. Rather, BIS provides for a similar output and a kind of a parallel structure which promotes the plurality of its actors. Although "competition is good for business", a concerted and coordinated action on the part of BIS, in particular with the IMF and the FSB, would possibly lead to an acceleration in decision-making on the global stage which seems essential for survival in times of crisis. Insofar, the recommendations of the Basel

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119 The three pillars were described by BIS as: "minimum capital requirements, which seek to refine the standardised rules set forth in the 1988 Accord; supervisory review of an institution's internal assessment process and capital adequacy; and effective use of disclosure to strengthen market discipline as a complement to supervisory efforts." <http://www.bis.org>.

120 See under III. 2.e.

121 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), OJ, 30 June 2006, L 177, 1, and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast), OJ, 30 June 2006, L 177, 201.

Committee, announced for December 2011, for cooperation with the FSB would be a big step forward.[122]

III. Changes and Challenges after the Start of the Crisis

1. General Remarks

Having discussed some interactions between the relevant institutional actors, the article now turns to questions relating to the impact that international law currently has and the challenges that must be coped with in the future.

First of all, financial stability, often qualified as the main objective, has to be scrutinized with regard to its global importance and its essential aspects. After paraphrasing its objectives, attention should be paid to the institutional aspect and the actors who are capable of achieving the aim. Subsequently, those legal instruments which can turn the objectives into effective "rules" ought to be analyzed more closely. Due to the serious impacts of soft law in the context of international financial regulations, its relationship to hard law provisions and the systematic position of both categories in international law should be looked at in the context of the global financial system.

a. Global Financial Stability as the Objective

The objective or intent of a legal provision mainly determines the tasks and responsibilities of the relevant actors who, on the other hand, are responsible for deciding whether a hard or a soft binding effect is needed or adequate. As mentioned before, the stability of the financial system, often referred to as "macro prudential supervision", is the outstanding intention of global action on this issue. While micro prudential supervision is focused on "the day-to-day supervision of individual financial institutions", "the focus of macro prudential supervision is the safety of the financial and economic system as a whole, the prevention of a systemic risk."[123] From an economic point of view, global financial

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[122] FSB/IMF/BIS, "Macroprudential policy tools and frameworks - Update to G20 Finance Ministers and Central Bank Governors", 14 February 2011, 1 et seq. (13) <http://www.bis.org/publ/othp13.pdf>.

[123] R. Lastra, "Systemic risk, SIFIs and financial stability", *Capital Markets Law Journal* 6 (2011), 197 et seq., referring to the definition of the House

stability will be qualified as a global public or social good[124] with the consequence that governance structures and a rule-oriented system, being predictable and stable, are needed. But before dealing with the single elements of such a rule-based system, the term of financial stability or macro prudential supervision has to be described briefly.

According to the first use of the term "macro prudential supervision" by *Cooke* and *Lamfalussy* in BIS documents, dated from 1979,[125] a common definition did not yet exist. Even though there hardly evolved a consensus on how to define financial stability from a macroeconomic point of view,[126] its importance in relation to financial stability is nonetheless widely accepted. For a long time, central banks, in particular, have recognized financial stability as an important and self-contained objective, as shown by several definitions of the respective institutions in *Financial Stability Reports* (FSR). In 2006, *Čihák* pointed out that "[T]he FSRs often make clear that they are not focused on problems in individual institutions, but rather on system-wide issues. Furthermore, there is a general understanding that financial stability refers to smooth functioning of the components of the financial system (financial institutions, markets and payments, settlement and clearing systems). The prevailing view is that the analysis of financial stability covers phenomena that (i) impair the functions of the financial system; (ii) create vulnerabilities in the financial system; and (iii) lead to a nega-

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of Lords' European Union Committee, *The Future of EU Financial Regulation and Supervision*, 14th Report of the Session 2008-2009, 17 June 2009 <http://www.publications.parliament.uk>.

124 See M. Camdessus, "International Monetary and Financial Stability: A Public Good", in: P. Kenen/ A. Swoboda (eds), *Reforming the International Monetary and Financial System*, 2000, 9 et seq.; H. Dieter, "The Stability of International Financial Markets: A Global Public Good?", in: S.A. Schirm, *New Rules for Global Markets*, 2004, 23 et seq.; Ohler, see note 2, 15 et seq.; Tietje/ Lehmann, see note 98, 670.

125 Cf. P. Clement, "The term 'macroprudential': origins and evolution", *BIS Quarterly Review*, March 2010, 59 et seq. <http://www.bis.org>.

126 Outlined by O. Issing, "Monetary and Financial Stability: is there a trade-off?", *BIS Papers* No. 18, "Monetary Stability, Financial Stability and the Business Cycle: Five Views", September 2003, 16 et seq. (16 et seq.) <http://www.bis.org>. A very good overview gives G. Schinasi, "Defining Financial Stability", *IMF Working Papers*, Doc. WP/04/187, October 2004.

tive impact on the financial system and thereby on the economy as a whole."[127]

Although central banks mainly focus on monetary issues, central bankers point to certain interferences between price stability and financial stability.[128] This is due to the fact that serious disruption in the financial system would affect the implementation and effectiveness of monetary policy, while macroeconomic stability helps to reduce risks for the financial stability. Even though the interconnection between financial stability and monetary policy may be controversial,[129] it is not the focal point of the issue at hand. Concerning its lender of last-resort-function, every central bank functions as a stabilizing (and ordering) institution for financial stability regardless of whether one "global", e.g. within the framework of the Bretton Woods Institutions, or several national, respectively supranational, central banks should have direct or indirect supervisory responsibilities.[130]

Insofar and with regard to the legal impacts, an ordering function that a global macro prudential supervision would have on the stability of the global financial system cannot be underestimated. Due to the missing universally recognized definition of what must be understood by the stability of a financial system, the "macro" approach has to be separated from micro prudential (supervisory) objectives[131] and might be generally paraphrased by two terms: firstly, the systemic objective,

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[127] M. Čihák, "Central Banks and Financial Stability: A Survey of Financial Stability Reports, Seminar on Current Developments in Monetary and Financial Law", Washington D.C., 23-27 October 2006, 1 et seq. (12) <http://www.imf.org>.

[128] See for the relationship between price stability and other objectives of central banks F. Amtenbrink, "Central Bank Challenges in the Global Economy", *European Yearbook of International Economic Law* 2 (2011), 19 et seq. (23 et seq.).

[129] K. Alexander/ R. Dhumale/ G. Eatwell, *Global Governance of Financial Systems*, 2006, 24; R. Ferguson, "Should Financial Stability be an explicit Central Bank Objective?", *BIS Papers* No. 18, see note 126, 7 et seq.; G. Hufbauer/ D.D. Xie, "Financial Stability and Monetary Policy: Need for International Surveillance", *JIEL* 13 (2010), 939 et seq.; Ohler, see note 2, 10 et seq.

[130] Cf. L. Garciano/ R. Lastra, "Towards a New Architecture for Financial Stability: Seven Principles", *JIEL* 13 (2010), 597 et seq. (609); also stressed by Amtenbrink, see note 128, 38.

[131] Amtenbrink, see note 128, 38.

and secondly, the actors (institutes) with systemic importance.[132] A similar description is used by the ECB formulating that "Financial stability can be defined as a condition in which the financial system – which comprises financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unravelling of financial imbalances. This mitigates the likelihood of disruptions in the financial intermediation process that are severe enough to significantly impair the allocation of savings to profitable investment opportunities. Understood this way, the safeguarding of financial stability requires identifying the main sources of risk and vulnerability."[133]

(1) Firstly and in contrast to the micro prudential approach, which concerns the financial stability of each individual regulated institution in order to achieve the overriding goal of protection of the institution's customers (e.g. depositors and individual investors), the macro prudential one is determined by an overriding *objective of maintaining financial stability* of the financial system as a whole. This intention is thought to be appropriate given the significant decline in economic wealth and activity that a system-wide failure could bring about and, therefore, it seems quite fit to prevent and avoid systemic risks from unfolding uncontrollably in the market. In a common working paper, prepared by IMF, BIS and FSB, the systemic risk will be referred to as "[…] a risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy […]."[134] Emphasizing that negative effects might have come from events caused by a (single) financial institution (e.g. Lehman Brothers or the German Hypo Real Estate), from a single market segment (e.g. government/public bonds market) as well as from a specific group of assets (e.g. credit default swaps), "all types of financial intermediaries, markets and infrastructure can potentially be systemically important to some degree."[135]

(2) By stressing the systemic aspect, the second element of macro prudential supervision is fixed on the *systemic importance of subjects,* in

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132 Cf. Lastra, see note 123, 197 et seq.

133 ECB "Financial Stability Review", June 2011, 1 et seq. (9) <http://www.ecb.eu>.

134 Cf. Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations. Report to the G-20 Finance Ministers and Central Bank Governors, October 2009, 1 et seq. (2) <http://www.bis.org>.

135 Ibid.

particular on those institutions, activities and attitudes that are seen to threaten financial stability most. A key factor for understanding systemic risks is that financial institutions do not operate in isolation, but are mutually bound to each other by a broad range of business transactions.[136] Therefore, "systemic risk" means a risk of disruption in the financial system not confined to a single institution, but threatening to jeopardize the proper functioning of at least a larger part of the market and potentially having serious spill-over or contagion effects on the real economy.[137] Systemic risks contain both a cross-sectional and sectoral dimension, i.e. combining a risk concentration in individual institutions, in particular those which are systemically important, as well as a contagion risk caused by the interconnectedness, and a time dimension. The diversity of these dimensions, the intricate interplay between them and the fact that there are many factors affecting the various dimensions, like incentives, risk management, standards and the real economy add to the complexity of the task of macro prudential supervision. Referring to the working paper, mentioned above, "[t]hree key criteria […] are helpful in identifying the systemic importance of markets and institutions: size [the volume of financial services provided by the individual component of the financial system], substitutability [the extent to which other components of the system can provide the same services in the event of a failure] and interconnectedness [linkages with other components of the system]."[138]

"Systemically important" subjects, also called *Systemically Important Financial Institutions* (or shortly SIFIs), could e.g. be large institutions, the infrastructure of the financial system as well as linkages between financial institutions and markets. From a global perspective the globally acting SIFIs (G-SIFIs) are particularly relevant. One important sub-group of SIFIs, amongst others,[139] are financial institutions which are very large and, therefore, considered to be *Too-Big-To-Fail* (TBTF).[140] Often such institutions are financial conglomerates which should be subject to specific compliance with quantitative requirements (e.g. accounting and capital adequacy, liquidity, consolidated risk supervision, intra-group transactions) and with qualitative requirements (e.g.

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136 Alexander/ Dhumale/ Eatwell, see note 129, 24.

137 Ibid.

138 Guidance to Assess the Systemic Importance, see note 134, 2.

139 See for the three situations as well as the "too big to fail" problem, Ohler, see note 2, 18 et seq.

140 See for a detailed analysis Lastra, see note 123, 198 et seq.

adequate group organization, risk management, group-wide reporting, "fit and proper" test). An obvious lesson learned during the financial crisis is that special emphasis must be put on the role of SIFIs, in particular on G-SIFIs. Due to the fact that a stronger regulatory framework and global supervisory standards have to be installed, the G7 already in October 2008 politically agreed to "take decisive action and use all available tools to support systemically important financial institutions and prevent their failure."[141] In 2010 the FSB[142] in cooperation with the IMF prepared the "Recommendations for Enhanced Supervision"[143] of SIFIs.[144]

Although neither the FSB nor the IMF possess an explicit mandate for obligatory measures in macro prudential supervision,[145] those initiatives must be appreciated because they show how soft law instruments can take effect. Due to the fact that the regulation of global systemic risks is the task of international "lawmakers", clear and robust mandates for macro prudential supervisors, acting on the transnational stage, need to be enacted. Potential conflicts between micro and macro objectives need to be managed by a clear mandate and effective mechanisms for conflict solution. Moreover, a close interplay between macro supervision and other policy fields is required.

b. Aspects of Governance, Legitimacy and Effectiveness

As pointed out by *L. Garciano* and *R. Lastra*, the "multiplicity of actors and the mushrooming of international fora,"[146] acting on issues of cross-border financial stability and global monetary affairs must be underlined as a very important aspect. Bodies within the UN system, in particular the IMF, institutions beyond it, like the FSB or the BIS, as well as informal "gubernative" formations, like the G20, are co-existing

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141 G7 Finance Ministers and Central Bank Governors, Plan of Action of 10 October 2008, Washington D.C., para. 1 <http://www.g8.utoronto.ca>.

142 Cf. Reducing the moral hazard posed by systemically important financial institutions-FSB Recommendations and Time Lines, 20 October 2010 <http://www.financialstabilityboard.org>.

143 Cf. <www.imf.org/external/np/mcm/financialstability/papers/sifisup.pdf> "Intensity and Effectiveness of SIFIs Supervision, Recommendations for Enhanced Supervision", 2 November 2010.

144 See for a detailed analysis of the FSB and IMF recommendations Lastra, see note 123, 209 et seq.

145 Stressing for the IMF Tietje/ Lehmann, see note 98, 675 et seq.

146 Cf. Garciano/ Lastra, see note 130, 619.

side by side and dealing with the most urgent questions simultaneously. Or in other words: in this area there is a deep truth in the saying that too many cooks can spoil the broth. The personnel at the top of those institutions is formed out of high-ranking members, partly government representatives, and moreover, they are employing skilled staff, therefore the very coexistence of the "stakeholders" ought to be refined and replaced by a stronger and more effective ***collaboration***.

At the same time, the variety of actors and of mostly non-binding instruments accentuate how urgently an institutional restructuring of the acting institutions as well as clear mandates, given by the Member States, are needed.[147] For historical reasons, the governance of the multilateral system is complex and fragmented. The global financial architecture is more characterized by the parallel existence of the several international actors than through cooperation based on a clear division of powers. Although the details and the "optimal degree"[148] of such a tangible collaboration are very debatable and require an open dialogue among the relevant actors, the duty to collaborate, laid down by international law, should be seen as a fundamental cornerstone. One potential basis for such a general international legal obligation can be found in Article 56 of the UN Charter, stating "[a]ll Members pledge themselves to take joint and separate action in co-operation with the Organization [...]" in order to achieve the purposes set forth in Article 55 UN Charter. This cooperation is oriented toward the purposes of and fixed within the UN system, the obligation to collaborate unfolds as a weak and not enforceable duty.[149] Therefore, the need for a system, which is strictly legally binding as well as effective rules, is obvious.

Taking a look "beyond" the UN system, the Charter of the FSB states that this Board shall "promote coordination and information exchange among authorities responsible for financial stability", collaborate with the IMF and "will promote and help coordinate the alignment of the activities of the standard setting bodies."[150] This seems a very pragmatic solution, but it is arguable whether the diction includes a le-

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[147] Also pointed out as one of seven principles for "a new architecture for financial stability" by Garciano/ Lastra, see note 130, 619 et seq.

[148] This question is discussed by Tietje/ Lehmann, see note 98, 680 et seq.; see also R.H. Weber, "Multilayered Governance in International Financial Regulation and Supervision", *JIEL* 13 (2010), 683 et seq.

[149] Cf. Tietje, see note 23, 34.

[150] See article 2 para. 1 lit. b. and h., and para. 2 Financial Stability Board Charter <www.financialstabilityboard.org/publications/r_090925d.pdf>.

gally binding effect or even allows sanctions in the case of an infringement.[151]

The very evident need for action in form of binding international rules is a long drawn-out process, at the end of which a reallocation of powers or rather a transfer of competences to a "higher" level might be reached. But the short-term solution, to be agreed upon much more easily, might be found in a more effective coordination and collaboration among those international financial institutions and organizations having a similar spectrum of tasks and a range of activities focusing on global (macro and micro prudential) issues. Effectiveness could be improved by a better reconciliation and a more intensified collaboration on a "horizontal" level. In this context the overlapping between "programs" of the IMF and "projects" of the World Bank, which emerged in the 1980s and 1990s, has widely disappeared. One reason for this change might result from the fact that both institutions have been more strongly restrained to their core competences and comparative advantages.[152] One could also discover substantial interfaces in content between the IMF and the FSB whereby a clear separation of the mandates and responsibilities of each one is urgently needed.[153] The IMF and the BIS are cooperating in a loose manner in international banking supervision. The same remark also applies for the relaunch of the "Joint External Debt Hub", installed in 2006 between the IMF, BIS, World Bank and the OECD.[154] But with regard to redundant results there is a strong need for a more structured collaboration because of similar infrastructures as well as of specialized expertise, found in both Bretton Woods Institutions. Finally, the position of the informal bodies in relationship to the IMF, FSB and BIS should be clarified, in particular the changing role of the G20 resulting from its role as the preliminary decision makers and standard setters on the gubernative level.

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151 Cf. Tietje, see note 23, 34.

152 Cf. M. Allen, "Macroeconomic and Structural Policies in Fund-Supported Programs: Review of Experience"; J.W. Adams/ M. Allen/ G.T. Nankani, "Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality, Progress Report"; see for both <http://www.imf.org>.

153 See under II. 2.c. bb., II. 4.b.

154 JEDH was jointly developed by BIS, IMF, World Bank and OECD, <http://www.jedh.org> and BIS Press Release of 30 March 2006 <http://www.bis.org>.

Another important fact is the interdependency between the WTO and the IMF. Although GATT[155] and GATS[156] accept the functional equivalence of the IMF Agreement and provide for a "co-ordinated policy with regard to exchange questions" with the Fund, interactions beyond the permanent exchange of information might be much better coordinated not least due to the role of the IMF relating to capital account liberalization.[157]

The demand for stronger collaboration leads also to analyzing the matter of ***legitimacy and credibility*** of the acting institutions, i.e. that the results of the cooperation should be accepted, if possible, by all affected parties and subjects.

The issue of legitimacy centers upon the adequate representation of Member States in the decision-making bodies of an international governmental organization. This matter has to be strictly divided from the more European-based question of whether there is a direct democratic "chain of legitimation" between the voting public and the representative acting for the Member State in international organizations. With regard to the formation of global actors, it has to be realized that a direct "chain of legitimation" can hardly be effective and thus should not be reclaimed. It is known that almost every international governmental organization suffers from a certain "lack of democracy"[158] (or "democratic deficit") which cannot be eliminated off-hand.[159] In fact, the main bodies of an international governmental organization are executive-oriented, i.e. the representatives of the Member States are sent by administrative or governmental entities, and are at best indirectly legitimated by national parliaments. The impact of experts needed, because of the highly complex interrelations of economic and legal questions concerning financial stability, should not lead to "preliminary" decisions, taken or controlled solely by some powerful countries from the

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155 See Article XV paras 1-2 GATT.

156 See Article XI para. 2 GATS.

157 Cf. M. Camdessus, "Capital Account Liberalization and the Role of the Fund"; S. Hagan, "The Fund's Mandate – A Legal Framework", Sections 29 et seq.; see for both <http://www.imf.org>.

158 Cf. V. Epping, in: K. Ipsen (ed.), *Völkerrecht*, 5th edition 2008, § 31 marginal number 34.

159 See for a detailed analysis of the impacts of the financial crisis on issues of democracy M. Goldmann, "The Financial Crisis as a Crisis of Democracy: Towards Prudential Regulation through Public Reasoning", *German Law Journal* 12 (2011), forthcoming.

start, and only later, formally being finalized by the relevant international body. Therefore, the issue of (parliamentary) accountability and democratic legitimacy of standard-setting bodies and rule-making institutions becomes relevant in this context. With regard to the great importance of financial stability as the objective which comes very close to a "constitutional" aspect, it must be commended that those bodies and forums dealing with macro (and micro) prudential supervisory issues should be functionally independent, i.e. autonomous with regard to the proper fulfillment of their tasks.[160] Such a high level of independence could be justified by the high technical expertise those institutions must possess with regard to their global responsibility. At the same time independence has to be accompanied by transparency.[161] Finally one becomes aware of the fact that every independent institution must be controlled and its failures should be sanctioned by another legitimated authority.

A further challenge results from the upgraded position of G20 as an informal body consisting of high-ranked gubernative representatives.[162] The term "gubernative" "captures more precisely than the notions of 'executive', 'government' or 'administration' what is meant here. The notion is based on the distinction between the politically responsible leadership of the executive branch (the gubernative) and the hierarchically subordinated administration or bureaucracy. Both together form the executive branch. The term 'government', which is often used to name the political pinnacle of the executive branch, is too vague, since it can also mean all branches of government and the process of governing."[163] At present, the G20 represents gubernative structures of a global financial regulatory framework, therefore it is called a "soft organsiation".[164] It is not unproblematic that its declarations are not legally binding, although they include important pre-decisions giving a rather strict direction for subsequent decisions of international financial institutions. Moreover, the formation of informal groups, like G8 or

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160 Stressed as one of seven principles by Garciano/ Lastra, see note 130, 616 et seq.

161 Garciano/ Lastra, see note 130, 616.

162 See under III. 2.b.

163 P. Dann, "The Gubernative in Presidential and Parliamentary Systems", *ZaöRV/HJIL* 66 (2006), 1 et seq. See for a detailed discussion of the term "gubernative", A. von Bogdandy, *Gubernative Rechtssetzung*, 2000, 108 et seq.

164 J. Klabbers, "Institutional Ambivalence by Design: Soft Organisations in International Law", *NJIL* 70 (2001), 403 et seq.

G20, is mainly determined by influential economic criteria, like the Gross Domestic Product, but hardly by democratic measures,[165] evidenced by the fact that the G20 as well as the FSB only include representatives from developed economies and, since 2008, from emerging countries. Therefore, the democratic legitimacy of the G20 as well as the lacking judicial "review" of its activities are problems.[166]

c. Dichotomy between Hard and Soft Law Instruments

The questions of effectual cooperation and legitimation of governance structures lead inevitably to the matter of rule-and law-making and the ability of the actors of the global financial system to create law. The creation of law consisting of norms is one of the primary functions of international governmental organizations. The capacity of rule-or law-making is even considered as constitutive for the very existence of such organizations. Norms produced by organizations vary significantly according to their subject-matter, the binding legal effect for the addressees, the kind or lack of sanctions and the form under which they are adopted. There are no rules of general international law which determine *a priori* the kind of norms that organizations can establish. Consequently, the only indication for determining the power to produce norms (*pouvoir normatif*) has to be sought in the "constitutional document",[167] i.e. the founding agreement or Charter of the international governmental organization.

In the context of general international law, the matter of rule-making is characterized by a dichotomy between hard and soft law. With regard to "rules" of the global financial system, the mentioned dualism is very characteristic and typifies the dichotomy of international hard and soft law. The corpus of hard law gives rise to enforceable obligations and therefore has to be reasonably certain and predictable so that the subjects can determine what is expected of them.[168] It consists of authorizing and mandatory rules (e.g. legal acts, directives, regulations, treaties or agreements) and results in legally binding com-

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165 See for a detailed analysis Goldmann, see note 159.

166 Also stressed by Ruffert/ Walter, see note 10, marginal number 100.

167 E. Klein/ S. Schmahl, in: W. Graf Vitzthum (ed.), *Völkerrecht*, 5th edition 2010, Chapter 4, marginal numbers 37 et seq.

168 Cf. E. Ferran/ K. Alexander, "Can Soft Law Bodies be Effective? The Special Case of the European Systemic Risk Board", *European Law Review* 35 (2010), 751 et seq. (755).

mitments for states and other subjects of international law.[169] In opposition, the term soft law refers to other, quasi-legal instruments (e.g. statements, principles, objectives, declarations of principles, guidelines, standards, action plans), which often take on some features of a formal treaty, which is a source of international law and governed by it,[170] but fall short of the requirements to be one. Due to the fact that "the states involved do not intend to be bound by international law",[171] those commitments and standards are usually not binding and enforceable in a legal sense, or their binding force is not strict and is somewhat "weaker" than that of traditional law.[172] But nevertheless they are "capable of exerting powerful influence over the behaviour"[173] and "regulate" through the acceptance of the members (states), which originally created them. Although there is a very controversial debate whether soft law is a separate category of international law,[174] in particular in the context of international financial regulation and supervision, it cannot be ignored that it plays an important role.

Rather different categories of "soft law" are commonly used, whereupon standardization, e.g. in the so-called Basel Accord,[175] is the typical international soft law instrument.[176] Due to the fact that soft law consists of flexible standards, which otherwise are hard to monitor, it

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[169] W. Graf Vitzthum, in: id., see note 167, Chapter 1, marginal number 14.

[170] Under the terms of article 2 para. 1 (a) of the Vienna Convention on the Law of Treaties, a treaty is defined as an international agreement that is, among other things, "governed by international law". Article 38 para. 1 (a) of the Statute of the ICJ, lists several sources of international law including "international conventions […] establishing rules expressly recognized by […] states".

[171] Cf. A.T. Guzman/ T.L. Meyer, "International Soft Law", *Journal of Legal Analysis* 2 (2010), 171 et seq. (188 et seq.).

[172] Cf. Vitzthum, see note 169, marginal numbers 14, 68 et seq.; W. Heintschel von Heinegg, in: Ipsen, see note 158, Chapter 4 marginal number 20; M. Krajewski, *Wirtschaftsvölkerrecht*, 2nd edition 2009, marginal number 90; D. Shelton, *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System*, 2004.

[173] Cf. Ferran/ Alexander, see note 168, 754.

[174] Cf. P. Kunig, in: Vitzthum, see note 167, Chapter 2, marginal numbers 166 et seq.; Ruffert/ Walter, see note 10, marginal number 95.

[175] See under III. 2.e.

[176] Tietje/ Lehmann, see note 98, 674 seq.

might be established in a low-risk proceeding.[177] However, the "softening" of international law may also be viewed as a threat to the transparency of the international law-making process and an attempt to escape accountability. In other words: the legitimacy of hard law, resulting from institutional and procedural discipline, is confronted with soft law's efficiency of a competitive standard-setting driven by market forces.

It should be realized though that the boundaries between the various categories are fluid.[178] Besides, an evolutionary process between both categories of "law" is possible, insofar as soft law can evolve into hard law ("qualitative transition"[179]) by incorporation through institutionalized and, at best, legitimated proceedings. Insofar, the relationship between hard and soft law can be described as a model of two concentric circles sharing the same origin, but having different radii. While the inner circle contains hard law provisions, the outer circle consists of soft law standards, but both circles are focusing on the same objective.

Applying this model to the global financial system, the common objective thereof might be defined as systemic or macro prudential stability, aforementioned as a global public good,[180] safeguarding global common welfare. Global common welfare and normative structures as a part of a global regulating function are interacting due to the fact that they are interdependent: on the one hand, common welfare functions as the cultural medium to establish global normative structures (not only, but especially) for financial markets, and on the other hand, a global economic and financial governance formed by tightened legal structures are well suited to secure economic prosperity and investment protection.[181] Therefore, the stable inner legal circle needs to be formed by mandatory rules from hard law, whereas the outer circle consists of soft law standards, both aimed at reaching financial stability as the same objective.

In this context, hard law encompasses legal rules in their truest sense, i.e. provisions obliging legal subjects. These are, in particular, the Member States of an international governmental organization or the

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[177] See for the different theories of a state's intentions to enter soft law agreements Guzman/ Meyer, see note 171, 171 et seq. See also Ferran/ Alexander, see note 168, 755 et seq.

[178] Kunig, see note 174, marginal number 166.

[179] Vitzthum, see note 169, marginal number 15.

[180] See under III. 1.a.; see note 124.

[181] Cf. Krajewski, see note 172, marginal numbers 128 et seq.

governments submitting themselves to the legal effect of the agreed provisions. It is common practice that such hard law may evolve from former soft law standards which have been globally established and accepted in a transnational context. Insofar international governmental organizations, in particular the IMF (and the World Bank), play an important role as they can exert pressure on countries to adopt internationally recognized standards and codes.[182] In this respect, the outer circle of soft law has the ability to influence the future development of hard law commitments by being a bridge between no commitments at all and legally binding commitments. However, this concept assumes that the legal effect and the binding force of the instrument, used by the relevant actor, can be determined explicitly. This task could be mastered by classification in the founding documents or by internal rules of procedure, i.e. established by a self-classification of the institution.

Based on its Agreement, the IMF may use hard law instruments and strict rules in relation to its members as well as to third parties. As to the lending activities, in particular the recently expanded *New Arrangements to Borrow* (NAB),[183] the IMF depends on a legally binding "concurrence of the member".[184] Furnishing of information,[185] ineligibility to use the Fund's general resources[186] and compulsory withdrawal[187] are further examples of mandatory decisions, unilaterally made by the Fund. But in general, a well prepared legal "toolbox" is not existing. This is due to the fact that "decisions", depending on their content, can vary between "abstract-general" and "concrete-individual" ones. Besides, the facts and the results are often rather diverging. "Principles" and "policies"[188] shall be substantial for fulfilling the Fund's tasks, but they have a soft law character because juridical remedies on the part of the Member States against IMF "law" do not exist.

In this context, the Reports on the Observance of Standards and Codes[189] might be an excellent example. As "benchmarks of good prac-

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182 Cf. Ferran/ Alexander, see note 168, 754.
183 See under III. 2.a.
184 Article VII Section 1 lit. i.) of the IMF Agreement.
185 Article VIII Section 5, ibid.
186 Article V Section 5, ibid.
187 Article XXVI Section 2, ibid.
188 E.g. article IV Section 3 lit. b.), article V Section 3 or 7, ibid.
189 See under II. 2.c. dd.

tice",[190] they do not consist of any performance obligations imposed upon the Member State concerned. "Compliance" with the standards will be merely observed only upon request and a "pass-fail judgement" in a report will only be published if it has been accepted by the state. This should not cover the fact that, particularly in the field of standard-setting by the way of soft law, the principle that self-imposed rules must be followed was accepted by the standard-setting institutions. But after ten years of practice with such Reports, one may say that almost three quarters of the IMF Members have complied with one or more models of reports and the reports publication rate has been fairly stable at around 75 per cent.[191] Besides, the participation by states in standard assessments is voluntary. Thus, effective mechanisms to observe the implementation in the respective jurisdiction are missing, which has also been realized by the IMF.[192]

But the IMF as well as other standard setters should turn their attention likewise to elaborating distinct internal rules of procedure, established and self-classified by the governing body of the acting institution; e.g. the formation of the Board of Governors in case of the IMF.[193] A public announcement would cater for transparency and accountability. Simultaneously, those rules of procedure could deliver structural criteria for the internal formation and the major shareholders, as well as for the external cooperation with other related standard-setting bodies, e.g. World Bank, BIS and the Basel Committee.

2. Role of Selected Global Financial Institutions after the Start of the Crisis

After having discussed general questions of restructuring of the global financial system, the aforementioned challenges should be met by those actors defined as being relevant. First of all, these are the IMF, the G20

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190 IMF Factsheet, "Standards and Code, The Role of the IMF" <http://www.imf.org>.

191 Allen/ Leipziger, see note 75, 5.

192 IMF, "Assessing the Implementation of Standards-An IMF Review of Experience and Next Steps"; IMF, "Executive Board Reviews Experience with the Financial Sector Assessment Program, Options for the Future, and Complementary Reforms in Surveillance and the Assessment of Standards and Codes", see for both <http://www.imf.org>.

193 See for details under II. 2.b. bb.

and the FSB; furthermore, one has to deal with the United Nations, the BIS and the Basel Committee. Finally, the special role of the European Union as a highly integrated regional economic organization, and in particular of the *European Central Bank* (ECB) and the *European System of Central Banks* (ESCB) should be observed with regard to its external relationship concerning international financial issues.

a. International Monetary Fund

Without any doubt, the IMF was one of those international financial organizations which has been confronted with major challenges since the beginning of the crisis.

The G20 stressed at their Washington Summit (2008) that due to its "universal membership and core macro-financial expertise" the IMF seems to be ideally predestined to be a global actor and take "a leading role in drawing lessons from the current crisis."[194] It is remarkable that such a clear ***mandate*** for dealing with macro prudential issues of systemic importance is not yet explicitly stated, in particular in the IMF Agreement. In a wider sense, it can be possibly construed from the Fund's surveillance function,[195] which authorizes the Fund together with the World Bank, to work out *Reports on the Observance of Standards and Codes* (ROSCs) and *Financial Sector Assessment Programs* (FSAPs). But as previously mentioned, those programs have a limited scope due to the fact that participation is voluntary and they do not consist of binding provisions for the Member States.[196] Therefore, the Fund is restricted to the "Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments",[197] meaning that the "principles", as before are not strictly binding for the Member States.[198] Although the Fund has been able to contribute to the enforcement of those standards and principles through its ***surveillance function***, since

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194 Declaration of the Summit on Financial Markets and the World Economy, Washington D.C., 15 November 2008 <http://www.g20.org>.

195 Also mentioned by R. Lastra, "The Role of the IMF as a Global Financial Authority", *European Yearbook of International Economic Law* 2 (2011), 121 et seq. (124).

196 See for ROSCs and FSAPs under II. 2.b. bb.

197 Guidance to Assess the Systemic Importance of Financial Institutions, see note 134.

198 Article IV Section 3 lit. b.) sentence 4 of the IMF Agreement. Cf. C. Schiller, "Improving Governance and Fighting Corruption: An IMF Perspective", 31 March 2000 <http://www.oas.org>.

before the crisis, there has been a widespread accord that this surveillance needs to be made more effective.[199] The IMF should use in a much better way its global macroeconomic expertise as a comparative advantage and focus on core tasks, framing essential issues in a global context.

The debate on the future global monitoring role-to-be of the Fund as a guarantor for stability of the global financial system was also stressed at the IMF-World Bank spring meeting 2011.[200] As requested by the G20 in 2008,[201] the collaboration with the FSB on regular *Early Warning Exercises* (EWE) is now part of the IMF's efforts to strengthen surveillance.[202] Early Warning Exercises are quite useful instruments because they deliver integrated macroeconomic and financial perspectives on systemic risks as well as on cross-sectoral and cross-border spill over effects. As to a clearer setting of tasks there are certain signs that the IMF tends somewhat more to a macro prudential approach, also taking a leading role in economic, macro-financial and sovereign risk concerns, while the FSB seems to focus more on financial system regulatory and supervisory issues.[203] Another example of a more effective multilateral surveillance is the development of *Spillover Reports*, which could be combined with reports already required under article IV of the IMF Agreement.[204]

The ***lending activities*** were reviewed and reformed as well. They had become less important before the crisis because almost all debtors could refinance themselves better on the private financial markets.[205] As a result thereof two new, insurance-like instruments were introduced: the *Flexible Credit Line* (FCL) and the *Precautionary Credit Line*

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199 Cf. Lastra, see note 195, 124 et seq.

200 "New Emphasis on IMF's Global Monitoring Role", *IMF Survey*, 17 April 2011 <http://www.imf.org>.

201 "The IMF, with its focus on surveillance, and the expanded FSF, with its focus on standard-setting, should strengthen their collaboration, enhancing efforts to better integrate regulatory and supervisory responses into the macro-prudential policy framework and conduct early warning exercises", see Summit Declaration, see note 194.

202 Cf. R. Moghadam/ S. Hagan, "Modernizing the Surveillance Mandate and Modalities", 26 March 2010, 1 et seq. (6) <http://www.imf.org>.

203 IMF Factsheet, "IMF-FSB Early Warning Exercise", 13 April 2011 <http://www.imf.org>.

204 Cf. Moghadam/ Hagan, see note 202, 11 et seq.

205 See under II. 2.c. cc.

(PCL).[206] In both cases the increased impact of conditionality resulted in creating "hard" structural criteria. By means of the FCL the IMF provides a short-term funding to weather the crisis and to reassure financial markets as well as investors. Because this lending instrument is primarily destined for countries with robust policy frameworks and very strong track records in economic performance, it contains an *ex-ante* conditionality component which is tied to strict "pre-qualification criteria" instead of *ex-post* "program conditions", as well as "social conditionality". Until now, three countries, Poland, Mexico and Colombia, have accessed the FCL.[207] By contrast, the PCL was designed in 2010 and functions, as the name says, as a "precautionary", i.e. a crisis prevention tool in order to meet the needs of countries which have some remaining vulnerabilities that preclude them from using the FCL. PCLs combine a qualification process with focused *ex-post* conditionality aimed at addressing vulnerabilities identified during qualification.[208] Moreover and because the crisis highlighted the necessity for effective global financial safety nets, the IMF, in response to G20 demands, is now dealing with the proposed arrangements of a Global Financial Safety Net.[209]

In comparison to the not formalized G20-forum or the less structured FSB, the IMF is already "institutionalized", i.e. well organized, equipped with staff and strives for consistency. Moreover, the IMF possesses unique legitimacy as a treaty-based international governmental organization of more than 65 years standing,[210] therefore it has been characterized as "the international monetary institution *par excellence*"[211] "best placed to adopt the role of a 'global sheriff' with regard to international financial stability."[212]

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206 C. Anderson, "New Rules of Engagement for IMF Loans", *IMF Survey* <http://www.imf.org>.

207 IMF Factsheet, "The IMF's Flexible Credit Line (FCL)", 31 March 2011 <http://www.imf.org/external/np/exr/facts/fcl.htm>.

208 IMF Factsheet, "The IMF's Precautionary Credit Line (PCL)", 31 March 2011 <http://www.imf.org/external/np/exr/facts/pcl.htm>.

209 J. Lipsky, "Lunchtime Speech: Assessing the Agenda for Economic Policy Cooperation", 7 March 2011 <http://www.imf.org>.

210 Cf. Lowenfeld, see note 23, 595.

211 Lastra, see note 195, 122, 194.

212 Garciano/ Lastra, see note 130; see also S. Hagan, "Enhancing the IMF's Regulatory Authority", *JIEL* 13 (2010), 955 et seq.

Still with regard to reforming the internal structure and ***governance*** of the IMF, most endeavors focused on the – rather permanent – question of quotas and shares which, due to the current IMF Agreement, are the only possibility to modernize the organization step by step. Also the last "governance reform", agreed upon by the IMF in November 2010 and planned to be implemented in 2012, was mainly about rearranging voting shares; in this case, the change intended to react to the increasing importance of emerging market countries and, by a shift of six per cent of quota shares, to give a stronger impact to some countries known as the BRICS (Brazil, Russian Federation, India, China and South Africa).[213] But the most serious fault in the proposed reforms seems that any changes in the composition and size of the IMF's Executive Board have been neglected. Debates about the size and the distribution of chairs as well as the disproportionate dominance or "overrepresentation" of European "chairs" were taken off the agenda completely. But the composition and procedures of the Executive Board are those aspects of the IMF governance which need to be reformed urgently.

In any case, on the external side, the horizontal and vertical interconnection between other global financial institutions is highly relevant, thus a re-adjustment of the International Monetary and Financial Committee[214] could be combined with the integration of the changing role of the G20 as an informal gubernative institution.[215] Referring to the internal structure, the Fund needs a better institutional balance in such a way that the position and adequate division of labor and responsibilities of the main bodies would be reorganized by effectuating board procedures. The double role of the Managing Director who is both chairman of the Executive Board and Chief Executive Officer should be scrutinized. Moreover, the representatives in the main bodies are executive-oriented.[216]

A further organizational deficit seems to be the absence of judicial restraint with regard to actions of the main bodies. An external arbitration tribunal is only competent for special cases which neither include the temporary suspension of membership nor the withdrawal of a

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213 *IMF Survey Magazine* "Governance Reform: IMF Board Approves Far-Reaching Governance Reforms", *IMF Survey*, 5 November 2010, <www.imf.org>.

214 IMF "Executive Board Report to the IMFC on Reform of Fund Governance", paras 6-7 , ibid.

215 See under III. 2.b.

216 See under II. 2.b. bb.

Member State.[217] A Dispute Settlement Mechanism, like that in the WTO,[218] neither exists for the IMF nor is one intended to be established.

b. Group of Twenty

Since the beginning of the financial crisis the dominance on issues of financial markets has shifted from the G7/8 to the larger forum of G20. As a consequence of the October 2008 agreement of the G7 (Ministers of Finance) the former US President, *George W. Bush*, invited the leaders of the G20 countries to meet in order to coordinate the global response in the aftermath of the Lehman case as "the current situation calls for urgent and exceptional action."[219] While there had been a meeting of the finance ministers at the level of G20 since 1999,[220] the Washington Summit in 2008 upgraded this forum to the level of Heads of State and Government. Thus the crisis entailed an upgrading of the G20 to a gubernative level, partly characterized as the "centre of really new international financial architecture."[221]

However, the Summit's participants were satisfied, for the time being, with identifying the root causes of the crisis. "Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in the financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions. Major underlying factors contributing to the current situation were, among others, inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These developments, together, contributed to excesses and ultimately resulted in severe market disruption."[222] Moreover, the first response to the crisis led the G20 to the basic insight that all financial

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[217] Article XXIX (c) conjunction with article XXVII Section 1 respectively article XXVI of the IMF Agreement.

[218] Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding, DSU), Annex 2 of the WTO Agreement, 15 April 1994.

[219] G7 Finance Ministers and Central Bank Governors, Plan of Action, see note 141.

[220] See under II. 4.b.

[221] Cf. Tietje, see note 23, 24.

[222] Summit Declaration, see note 194, paras 3-4.

markets, products and participants must be subject to appropriate regulation and supervision.[223]

The subsequent summit in London in 2009 revealed the necessity for a concrete and concerted action plan called "The Global Plan for Recovery and Reform"[224] which was, no doubt, a landmark in the development of international financial architecture and has been the initial point for practical measures on the global level.[225] Then, the G20 agreed that the global financial system should be based in the future on two pillars, namely the IMF and a reinforced and enlarged FSF, renamed FSB (see above), under the overall guidance of the G20.[226] The cooperation among the international financial institutions (IMF, World Bank, FSB, Basel Committee) should be strengthened, in particular, by creating – macro prudential oriented Early Warning Exercises as well as micro prudential related – supervisory colleges for all significant cross-border activities of subjects.

The Pittsburgh Summit (2009) endorsed "to reform the global architecture to meet the needs of the 21st century."[227] By designating "the G-20 to be the premier forum for our international economic cooperation,"[228] the G20 stressed the increased importance of this broader-defined, global gubernative circle of policy makers. Furthermore, the FSB was reshaped.[229] Afterwards, by pointing out the need for a financial sector reform "Principles for Innovative Financial Inclusion"[230] were adopted at the Toronto Summit (2010). At the Seoul Summit (2010)[231] the G20 agreed to tighten the capital requirements (Basel III)

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[223] Cf. M. Giovanoli, "The Reform of the International Financial Architecture after the Global Crisis", *International Law & Policy* 42 (2009), 81 et seq. (93).

[224] "The Global Plan for Recovery and Reform: the G20 London Summit", 2 April 2009 <http://www.g20.org>.

[225] See for a detailed description of the London Summit's Decisions Giovanoli, see note 223, 98 et seq.

[226] Giovanoli, see note 223, 94.

[227] "Leaders Statement: The Pittsburgh Summit", 24-25 September 2009, paras 1 and 18 <http://www.g20.org>.

[228] Ibid., para. 19.

[229] See under III. 2c.

[230] "The G20 Toronto Summit Declaration", 26-27 June 2010 <http://www.g20.org>. "Principles for Innovative Financial Inclusion" <http://www.g20.utoronto.ca>.

[231] "The G20 Seoul Summit Leaders' Declaration", 10-12 November 2010 <http://www.g20.org>.

and demanded less transnational, but stronger international regulatory control. It is also not surprising that the priorities of the current French G20 presidency refer to "Reforming the International Monetary System" and "Strengthening financial regulation."[232]

Precisely because of its upgraded role, the informal legal status of G20 has to be seen critically. The G20 possesses neither a statute setting up rules for, e.g., the rotating presidency, nor do exist headquarters or an administrative staff of its own. Declarations of G20 are legally non-binding, but include important pre-decisions, giving straight direction for subsequent formal decisions of international financial institutions. Although the internal assignment of tasks of those international governmental organizations will not be affected legally, the "institutionalized structures" (IMF, World Bank) run the risk of losing their weight with regard to the assembled G20 representatives. The democratic legitimacy of G20, as well as the missing judicial restraint is not unproblematic because the G20, at present, represents an important cross point in the global framework of regulation of the financial system.

Since the beginning of the crisis, the G20 has impressively demonstrated that this forum has the ability to act quickly and unconventionally and to develop "global" solutions, which at least unite very important (industrial) countries, as evidenced by the proposals for "Reinforcing International Cooperation and Promoting Integrity in Financial Markets"[233] of a G20 working group. Future challenges should not ignore this development but it would also be necessary to ensure that the decisions were soundly guaranteed and continuously accepted and, in the best cases, legally binding.[234] Otherwise and similar to the G8 in earlier times, the credibility of the G20 would be at stake. For this reason, the political impact of G20 must be consolidated institutionally, which could be achieved by giving it an explicit mandate and clear organizational structures as well as responsibilities.[235] Therefore, the G20 could be reshaped, perhaps as a committee in the IMF, e.g. a follower of the International Monetary and Financial Committee.[236] But that would, at first, require that the G20 members were willing not to act on

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232 "Priorities of the French Presidency" <http://www.g20-g8.com>.

233 "G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets (WG2)", Final Report, 27 March 2009 <http://www.minefe.gouv.fr>.

234 Cf. Tietje/ Lehmann, see note 98, 677.

235 Cf. Giovanoli, see note 223, 105.

236 See under II. 2.b. bb.

behalf of the relevant countries, but to transfer the group's responsibility for global financial affairs to one original international governmental organization, thus resulting in more consistency.

c. Financial Stability Board

Regarding modifications to the FSB since the start of the crisis, the G20 Washington Summit (2008) set the initial point by calling for a larger FSF membership by extending it to G20-countries which were not yet members of the Forum, such as China. In 2008, the FSF delivered a report on "Enhancing Market and Institutional Resilience"[237] to the G7 Finance Ministers. Based on this report as well as on a wide consensus reached at the G20 meeting in Pittsburgh,[238] the London Summit (2009) re-established the Forum as the FSB, elaborating upon its internal structure and broadening its mandate to include the promotion of financial stability, by inserting both into the *Financial Stability Board Charter.*

The FSB consists of three groups of participants:[239] (1) member jurisdictions, comprising 23 countries (i.e. their finance ministers, central bank governors, leading banking supervisors) as well as the ECB and the European Commission; (2) International Financial Institutions (IMF, World Bank, BIS, OECD); (3) six international standard-setting, regulatory, supervisory and central bank bodies,[240] e.g. Basel Committee.

The establishment of the FSB Charter had legal impacts on the internal structure and governance of the re-named Board and placed it on a stronger institutional ground. However, the founding document remains a purely political one. As before, the FSB possesses no legal per-

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[237] "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience", 7 April 2008 <www.financialstabilityboard.org>.

[238] Leaders' Statement, The Pittsburgh Summit, see note 227, para. 19: "We established the Financial Stability Board (FSB) to include major emerging economies and welcome its efforts to coordinate and monitor progress in strengthening financial regulation."

[239] Financial Stability Board Charter, Annex A, List of FSB Members <http://www.financialstabilityboard.org>.

[240] Basel Committee on Banking Supervision (BCBS); Committee on the Global Financial System (CGFS); Committee on Payment and Settlement Systems (CPSS); International Association of Insurance Supervisors (IAIS); International Accounting Standards Board (IASB); International Organisation of Securities Commissions (IOSCO).

sonality and thus it is not an international governmental organization. The Board is "not intended to create any legal rights or obligations,"[241] therefore reports, principles, standards, re-commendations and guidance, in short: all documents developed by the FSB,[242] might be qualified in terms of a self-commitment of the Board's members or as soft law.

The FSB has a complex internal structure.[243] The Plenary as the decision-making body, the Steering Committee, the Chairperson and the Secretariat. All enactments of the Plenary "shall be taken by consensus,"[244] meaning that a positive vote is not required. Each of the 64 Plenary Representatives can formally prevent by its veto that a commitment will be made. This possibility of rejection might complicate an effective exercise of functions. If the FSB really should be the "nucleus" or "fourth pillar" of a global network of economic governance, as often demanded,[245] the "constitutional basis" of the Board has to be developed and changed to an institutionalized organization under international law, supplemented by legally binding instruments for implementing the Board's mandate.

According to the Charter, the objective of the FSB includes a clear commitment to the interest of global financial stability,[246] which can be characterized as a global and macro prudential intention. The broadening of the mandate contains several tasks which can be divided into two groups regarding the two sentences explaining the objective: firstly, a coordination function to encourage "the work of national financial authorities and international standard-setting bodies (SSBs) in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies", and secondly, to address "vulnerabilities affecting financial systems in the interest of global financial stability"[247] in collaboration with the international financial in-

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241 Article 16 FSB Charter.

242 Article 7 para. 3 lit. c.), ibid.

243 Article 6, ibid. In the FSB Charter, detailed tasks are described for the Plenary (arts 7 et seq.), for the Steering Committee (arts 12-13), for the Chairperson (article 14) and for the Secretariat (article 15).

244 Article 7 para. 2 FSB Charter.

245 Cf. Tietje, see note 23, 31.

246 Article 1 FSB Charter.

247 Article 1 ibid., to the first group, mentioned in article 2 FSB Charter, particularly belong lit. b.), c.), d.), e.) and f.); to the second group can be counted in particular lit. a.), g.) and h.).

stitutions. Whereas the first task will strengthen the role of the FSB as an international moderator and coordinator of standard-setting bodies, the second one obliges the Board to cooperate with the international financial institutions in fighting systemic threats to the global financial system.[248]

By focusing on global financial stability as the main objective, the Board's tasks are not limited to macro or micro supervision, but rather face two sides of the same coin by mentioning "prudential *and* systemic risk, market integrity *and* investor and consumer protection, infrastructure, *as well as* accounting and auditing."[249] It seems beyond dispute that a micro prudential dimension needs to be added by a macro perspective,[250] which should be integrated in a single sound and consistent legal framework. However, the tasks for both dimensions ought to be strictly limited. In this context, a well-defined obligation to collaborate is not excluded, but, in fact, actually desired. For the FSB the Charter expressively declares its intent of collaborating "with the IMF to conduct Early Warning Exercises",[251] but there is no distinct division between IMF and FSB regarding macro and micro surveillance. Although one may be in doubt, there is a general tendency that the FSB is "better situated to take the lead on the more specialized work of *micro-prudential* and regulatory oversight", while the IMF should "take the lead in identifying and prioritizing *macro-systemic* risks."[252]

Certainly, effective collaboration between the FSB and the IMF has been substantially strengthened through the Early Warning Exercises. As background for Early Warning Exercises, the work on data dissemination makes it obvious that the IMF relies on data which can be better delivered by the FSB because its members (central banks, supervisory authorities) have direct access to the relevant data.[253] But this example

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248 Cf. Giovanoli, see note 223, 14.

249 Article 2 para. 2 FSB Charter. (Emphasis added.)

250 Cf. A. Crockett, "Marrying the micro- and macro-prudential dimensions of financial stability", *BIS Paper* No. 1, 21 September 2000 <http://www.bis.org>; G.J. Schinasi/ E.M. Truman, "Reform of the Global Financial Architecture", *Bruegel Working Paper* 2010/05, 1 et seq. (26) <http://papers.ssrn.com>.

251 Article 2 para. 1 lit. h.) FSB Charter. Cf. also IMF, "The IMF-FSB Early Warning Exercise", September 2010 <http://www.imf.org>.

252 Emphasis in the original, "IMF, The Fund's Mandate-An Overview", 22 January 2010, para. 11 <http://www.imf.org>.

253 Also stressed by the IMF, ibid., para. 12.

also indicates the need for a better shaped framework for appropriate tasks, which only the G20 could allocate to the FSB. Thus, it should be clear that the Board currently functions as a bridging link in the network of global economic and financial governance, i.e. as a mediator between the standard-setting bodies and the national level, and as a distributor between G20 and IMF. In the future the FSB should strive not to be caught in the net of the plurality of actors, but liberate itself "from a 'very soft' forum to – albeit still non-binding – a more rule-based institution"[254] and thus as a more independent player in the global concert.

d. United Nations

At first sight, the United Nations do not really appear in the context of restructuring the global financial system. However, looking more closely, the question does arise which role the United Nations could play in the international financial architecture and whether they can assume the gubernative part.

The final, so-called Outcome Document of the "Conference on the World Financial and Economic Crisis and its Impact on Development" having taken place in June 2009 in New York,[255] is remarkable. The UN General Assembly accepted the Outcome Document by Resolution 63/303 without a vote which is unique concerning global economic and financial issues. It pointed out:

"We reaffirm the purposes of the United Nations, as set forth in its Charter, including 'to achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character' and 'to be a centre for harmonizing the actions of nations in the attainment of these common ends'. The principles of the Charter are particularly relevant in addressing the current challenges. The United Nations, on the basis of its universal membership and legitimacy, is well positioned to participate in various reform processes aimed at improving and strengthening the effective functioning of the international financial system and architecture [...]. This United Nations Conference is part of our collective effort towards recovery. It builds on and contributes to what already is being undertaken by diverse actors and in various forums, and is intended to support, inform and provide political impetus to future actions. This Conference also

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254 Tietje/ Lehmann, see note 98, 676.

255 A/RES/63/303 of 9 July 2009.

highlights the importance of the role of the United Nations in international economic issues."[256]

However, it should be emphasized that the fundamental structures of global economic governance were established decades ago in the form of ECOSOC.[257] Already the Bretton Woods conference had designed a clear mandate for this body and had delegated the role of political leadership and coordination to ECOSOC.[258] In fact and up to now, ECOSOC has been hardly successful in its attempts to establish a political governance structure which would allow identifying the factual issues, to delegate them to the responsible expert committees and coordinate their work, as well as to aggregate the main results. Anticipating not only the "weaknesses" of ECOSOC, but of the whole UN system, the President of the UN General Assembly convened a Commission of Experts on Reforms of the International Monetary and Financial System chaired by the highly respected US economist and Nobel laureate, *Joseph E. Stiglitz*. In its report[259] presented in 2009, the *Stiglitz* Commission made a proposal to re-arrange the mandate of ECOSOC and to set up a Global Economic Coordination Council (GECC) at the level of the UN General Assembly and the Security Council, meeting annually, as well as a Global Financial Regulator and a Global Competition Regulator.[260] The GECC should include not only the G20 but all UN Member States and would link the UN system to existing international financial institutions, like the IMF or the World Bank.

While ECOSOC at present rather holds the role of a technical and administrative coordination body, the proposed GECC would have a broader mandate including the authority for contributing a coherent and efficient global financial system as well as realizing the conflicts of objectives and giving structural input to the collaboration among the acting institutions. For these purposes, the new Council would be empowered with political leadership within the UN system, i.e. in particular towards the Bretton Woods Institutions, probably even the

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256 Ibid., Annex, para. 2.

257 See under II. 3.

258 Cf. Arner/ Buckley, see note 73, 4 et seq.

259 Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, 21 September 2009, Doc. A/CONF. 214/CRP.1.

260 Ibid., pages 90 et seq.; cf. also Arner/ Buckley, see note 73, 53 et seq.; Giovanoli, see note 223, 96 et seq.

WTO.[261] The Council would also have the advantage of being established within the UN system, wherefore it would be under the obligation to act accordingly.[262] Due to the fact that financial (in)stability increases its "constitutional" importance for global economic and financial governance, the threat of a conflict of interests that such a Council would, without doubt, be caught in, could only be adequately resolved by an institution being independent in its operations. The characteristic criterion of independence, nevertheless, demands that the Council's members would agree to far-reaching concessions relating to sovereign powers and it seems rather uncertain that they would be willing to make such concessions.[263] Indeed one wonders whether the creation of such a "super institution" is really desired by some of the powerful governmental "players" and thus, is realistic in the current geopolitical situation.

e. Bank for International Settlements

As one of the various actors dealing with global financial issues, BIS established parallel structures in several areas. Particularly in the field of standards for capital and liquidity requirements – the aforementioned Basel I and II Accords.[264] The BIS built up its own specific expertise which, on the one hand, should be used extensively by other international financial institutions. On the other hand, the Basel Standards should be extended and reformulated taking regard of the post-crisis experiences. Responding to the demands of the *Pittsburgh Summit* (2009),[265] the Basel Committee developed a reform program to address the lessons learned,[266] concentrating on mandates for banking sector reforms established by the G20. The total body of the new global standards to address both firm-specific and broader, systemic risks is referred to as Basel III.[267] Building upon Basel II, of which the regulatory

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261 Cf. Ruddigkeit, see note 99, 10; Tietje, see note 23, 36 et seq.
262 Arts 55 and 56 UN Charter.
263 Cf. Ruddigkeit, see note 99, 11.
264 See under II. 4.c.
265 See under III. 2. b.
266 "The Basel Committee's Response to the Financial Crisis: Report to the G20", October 2010 <http://www.bis.org>.
267 BIS, "Compilation of Documents that form the Global Regulatory Framework for Capital and Liquidity" <http://www.bis.org>.

and the macro economic effects on the current crisis are uncertain,[268] the "new" international regulatory framework for banks (Basel III) is a comprehensive set of reform measures in order to strengthen the regulation, supervision and risk management of the banking sector. The broadened measures aim at (1) improving the banking sector's ability to absorb shocks arising from financial and economic stress, whatever their source; (2) enhancing risk management and governance; and (3) strengthening banks' transparency and disclosures. The revised framework refers primarily to the level of micro prudential regulation, helping to raise the resilience of individual banking institutions in periods of stress, but also deals with macro prudential issues, i.e. system wide risks.[269] From the Basel Committee's perspective the two approaches to supervision – micro and macro prudential – are complementary because greater resilience at the individual bank level would reduce the risk of system wide shocks. The focus on both micro and macro objectives shows again that an adjustment of the actors' mandate is imperative. At the same time, an intensified cooperation and collaboration between BIS and the IMF, FSB and G20 could help avoid or at least diminish redundancies.

In order to ensure that the Basel standards contain stronger binding obligations within the Member States than before, the mandate of the *Standards Implementation Group* (SIG) was broadened in January 2009 and now concentrates on the implementation of the Basel Committee guidance and standards in general.[270]

In this context of implementation the forward-looking approach of the EU must be taken account of. In July 2011, the EU Commission adopted a new legislative package to strengthen the regulation of the banking sector by replacing the current Capital Requirements Directives (2006/48 and 2006/49) through two different legal acts, i.e. a directive, governing the access to deposit-taking activities, and a regulation, establishing the prudential requirements which institutions will have to respect.[271]

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268 See for detailed analysis, Ohler, see note 2, 26 et seq.

269 BIS, "International Regulatory Framework for Banks (Basel III)" <http://www.bis.org>.

270 BIS, "About the Basel Committee, Main Sub-Committees, Standard Implementation Group" <http://www.bis.org>.

271 European Commission, "Commission wants stronger and more responsible Banks in Europe", 20 July 2011, IP/11/915 <http://ec.europa.eu>.

f. Special Relationship between the European Union and International Financial Institutions

Finally, the special role of the EU, in particular of the ECB and the ESCB as the leading institutions of the common monetary policy in Europe, with regard to its relationship to international financial issues, should be acknowledged.

Since 1957, the Member States of the EU (then: Community) first started to set up a highly integrated customs union, which included a common market with fundamental freedoms, *inter alia* the free movement of capital and payment,[272] "based on balanced economic growth and price stability and a highly competitive social market economy"[273] and fixed by "hard" law, legally binding for the Member States. Later on, the EU established an economic and monetary union whose currency is the Euro.[274] Up to 2011, 17 Member States were authorized to introduce the common currency.[275] This process of integration, in particular the creation of a Monetary Union, which is second-to-none worldwide, was based upon the principle of supra nationalization of sovereign powers to original European bodies and institutions.

In the case of the common monetary policy for the Member States whose currency is the Euro,[276] the ESCB has been endowed with exclusive competences. While the ECB Council is responsible for the general formulation of the monetary policy of the Union,[277] the national central banks, as integral parts of the ESCB, "shall act in accordance with the guidelines and instructions of the ECB."[278] Besides shaping the common monetary policy,[279] the "ESCB shall contribute to the smooth

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272 Arts 63 et seq. TFEU.

273 Article 3 para. 3 Treaty on the European Union (TEU), OJ, 9 May 2008, C 115, 13.

274 Article 3 para. 4 TEU.

275 The Eurosystem, defined in article 282 para. 1 sentence 2 TFEU encompasses 17 Member States (Austria, Belgium, Cyprus, Germany, Estonia, Finland, France, Greece, Italy, Ireland, Luxembourg, Malta, Portugal, the Netherlands, Slovakia, Slovenia, Spain).

276 See article 3 para. 1 lit. c.) TFEU.

277 Article 12.1 Protocol No. 4 on the Statute of the European System of Central Banks and of the European Central Bank (ESCB Statute), OJ, 9 May 2008, C 115, 230.

278 Article 14.3 ESCB Statute.

279 Article 127 para. 2, 1st indent TFEU.

conduct of policies […] relating to the prudential supervision of credit institutions and the stability of the financial system."[280] With regard to the "prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings"[281] the Council (of the EU) is only authorized to transfer specific tasks to the ECB. Due to this limitation of powers and the strict focus of the independent ECB[282] on price stability, the EU built up a separate *European System of Financial Supervision* (ESFS),[283] initiated by the *de Larosière*-Report in 2009.[284] The ESFS was established almost two years later as an integrated institutional framework for macro – as well as for micro – prudential supervision of the cross-border financial markets within the Union. The ESFS consists of a *European Systemic Risk Board* (ESRB)[285] on the macro prudential level,[286] three *European Supervisory Authorities* (ESAs) – relating to Banking;[287] Securities and Markets;[288] Insurance

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280 Article 127 para. 5, ibid.

281 Article 127 para. 6, ibid.

282 Arts 130 and 282 para. 3, ibid.

283 Cf. Garciano/ Lastra, see note 130, 603 et seq. See for a detailed analysis of the new European structures M. Lehmann/ C. Manger-Nestler, "Das neue Europäische Finanzaufsichtssystem", *Zeitschrift für Bankrecht und Bankwirtschaft/Journal of Banking Law and Banking* 2011, 2 et seq.

284 The High-Level Group on Financial Supervision in the EU, Report, 25 February 2009 <http://ec.europa.eu>.

285 Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ, 15 December 2010, L 331, 1. Council Regulation (EU) No. 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ, 15 December 2010, L 331, 162.

286 See for the role of the ECB within the ESRB Amtenbrink, see note 128, 38 et seq.; see for the question of "effectiveness of soft law bodies" in respect of ESRB Ferran/ Alexander, see note 168, 751 et seq.

287 Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ, 15 December 2010, L 331, 12.

288 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision

and Occupational Pensions[289] – which are responsible for micro prudential supervision in cooperation with the supervisory authorities of the Member States, and a Joint Committee of the ESAs.

Although both systems have different objectives, the ESCB as well as the ESFS are organized as self-contained systems, referring to the typical quasi-federal structure of the EU with a uniform decision-making on the supranational level and an obligation forcing the national authorities to implement the mandatory requirements. From the external perspective of international law, this seems to be a proper solution for an effective collaboration in a multi-level system. However, it must be stressed that such close cooperation will only occur upon the basis of an outstanding level of integration and, as may now be seen, particularly in respect of a common currency area, as well as of its current problems, of highly convergent economies in the Member States. Therefore, the success of both systems remains to be seen.

With regard to the subject matter at hand, it is necessary to clarify how the EU is linked to the described international "players" and to what extent the Union is involved in global opinion making for issues such as concerted (re-)acting in crisis situations or global financial stability.

In external relations regarding common currency and monetary policy, the primary law of the Treaty on the Functioning of the European Union reveals an ambiguous picture. Although the ESCB as well as the new ESRB should both contribute to financial stability. "Formal agreements on an exchange-rate system for the euro in relation to the currencies of third States"[290] are assigned solely to the power of the Member States, assembled in the Council. What seems like a "dilemma", at a first glance, is not so hard to handle in practice. Moreover, it is a typical issue of appropriate allocation of rights and duties between Central

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No. 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ, L 331, 15 December 2010, 84.

[289] Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ, 15 December 2010, L 331, 48.

[290] See article 219 para. 1 TFEU.

Banks and states because the main task of Central Banks is monetary policy while their involvement in exchange-rate policy is minimal.[291]

Regarding the involvement of the EU in international financial institutions, it must be observed that the ECB has not yet "arrived" in the global concert. This derives from the fact that in the majority of international governmental organizations,[292] only states shall be entitled to membership. Therefore, neither the ECB nor the EU or its institutional bodies possess a "full" membership, whereas this privilege is reserved to all Member States of the Euro system.[293] In general, a "double membership" of states, being a member of the EU as well as of the IMF, is not excluded explicitly but it would lead to the problem that the obligations entered into, towards each institution, would be different so that there would be a need for conflict resolution. Although the ECB possesses an observer status in the IMF,[294] its involvement in the Fund is inadequately organized and thus hinders rather than helps an effective cooperation. This is due to the fact that a general exchange arrangement regarding the Euro,[295] which is a currency accepted by the IMF,[296] could only be agreed upon by the Euro Member States themselves, not by the ECB, notwithstanding it is the exclusive authority for issuing the Euro.[297]

In fact, the European countries possess a strong factual impact on global financial issues, as the Bretton Woods conference has already

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291 C. Zilioli/ M. Selmayr, "The external relations of the euro area: Legal aspects", *CML Rev.* 36 (1999), 273 et seq. (336 et seq.).

292 An exception makes the WTO, stated in Article XI para. 1 WTO Agreement. Cf. Ruffert/ Walter, see note 10, marginal number 117; Krajewski, see note 172, marginal numbers 217 et seq.; generally K.E. Jorgensen (ed.), *The European Union and International Organisations*, 2008.

293 Article II Sections 1, 2 of the IMF Agreement. See for details D.C. Horng, "The ECB's membership in the IMF: Legal approaches to constitutional challenges", *ELJ* 11 (2005), 802 et seq.

294 Cf. IMF Decision No. 12925-(03/1), 27 December 2002, as amended by Decision Nos 13414-(05/01), 23 December 2004, 13612-(05/108), 22 December 2005, and 14517-(10/1), 5 January 2010, Selected Decisions and Selected Documents, 35th issue, 31 December 2010, 1 et seq. (698 et seq.). See also Khan, see note 34.

295 Admissible under article IV Section 2 of the IMF Agreement. Cf. C.R. Henning, "Regional Arrangements and the IMF", September 2005 <http://www.iie.com>.

296 IMF "SDR Valuation" <http://www.imf.org>.

297 Article 128 TFEU.

shown. Already represented by staff in international governmental organizations, they, in particular, have maintained the right to nominate the Managing Director of the IMF while the United States designates the President of the World Bank, which is just a tradition followed, but is not explicitly stated in the IMF Agreement.[298] But the choice of top personnel is right now more pressing than ever before. The nomination of the former French Finance Minister, *Christine Lagarde*, who is a well-known advocate of the supranational integration process, as Managing Director of the IMF, replacing *Dominique Strauss-Kahn*, has been most eagerly anticipated.[299] Another prominent example and *vice versa*, the Chairman of the FSB, *Mario Draghi* (Italy), might be confronted with enormous stability problems of the Euro zone when he takes over as President of the ECB in November 2011.[300]

IV. Summary

Before and after the beginning of the last crisis, the blueprint of the global financial architecture is somewhat discouraging. It is unquestionable that the global financial system is at the commencement of an ongoing process of fundamental change, but it is too soon to evaluate whether the "reforms" agreed upon globally shall bear fruits. Therefore, the main findings should be summarized as follows:

(1) less coexistence but more collaboration

(2) structural reforms in governance, and

(3) justification and codification in a rule-based system.

The plurality of actors leads at the very moment to a coexistence of institutions, which vary in their grade of legal solidification from informal network structures (G20) and personalized cooperation (FSB) to the United Nations as such and the IMF in particular; moreover, entities were established at the multilateral (e.g. BIS) as well as at the supranational level (e.g. ECB, ESRB).

Avoiding redundancies and using the comparative advantages of the expertise, this parallelism has to be replaced by a more structured coop-

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298 Lowenfeld, see note 23, 577.

299 "IMF Executive Board Selects Christine Lagarde as Managing Director", Press Release No. 11/259, 28 June 2011 <http://www.imf.org>.

300 European Council, Cover Note, 24 June 2011, EUCO 23/11, 13 <http://www.consilium.europa.eu>.

eration and an intensified collaboration, e.g. by an openness to dialogue combined with a better and swifter exchange of information. It is of outstanding importance that a consolidation process should lead to certain gubernative or maybe hierarchical structures. Either by linking the powerful G20 and the original actors being responsible for global financial system issues, like the IMF and the BIS as well as the renewed FSB. Or, with regard to the existing structures, the United Nations should be willing to redesign ECOSOC, in particular by extending its mandate to that of a Global Economic Coordination Council.

These necessities underscore the importance of creating explicitly defined mandates, focusing on global financial stability as the main objective, as well as essential governance reforms for establishing more effective multilateral institutions. The road towards these targets must be tackled by a justification and codification of "guidance", "principles" and "declarations". In other words: the principle-based approach of soft law has to be shifted more and more towards a rule-oriented and obligation-based system which would be transnationally applicable.

Finally, it can be summarized that some lessons have been learned, but there are still many more to be learned in the future. Hopefully, there is a truth in the saying that times of crisis will always be times for recovery too.