

INTERNATIONAL FINANCE - SPRING 2023

INTRODUCTION

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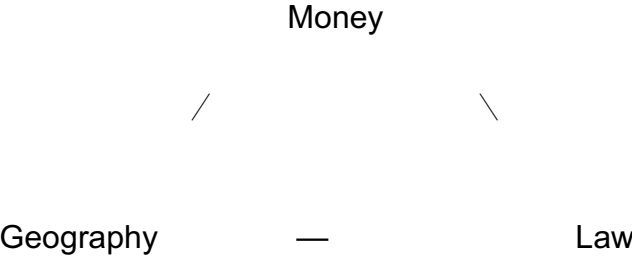
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1.0 MONEY, GEOGRAPHY, LAW

This section of the course materials is designed to introduce you to the class. You will all come to the class with different backgrounds, in terms of study and/or work experience. The class is intended as an introduction to legal issues in international finance, but the subject is large and we will study selected issues during the semester.

As we proceed through the semester I would like you to bear in mind an idea of intersections between money, geography and law.



Money and Geography: money, in the form of coins and notes individuals carry around with them, is located in the same physical space as the individuals who carry them. But

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financial transactions - even those which represent exchanges of money for goods - often involve transfers of value which are not clearly connected to physical space. Increasingly people make payments using cards or smartphones rather than cash. And whereas the ledgers in which payments are recorded were once physical books located in physical space, now records of payments are separated from physical locations: even if the information is kept on a hard disk of a computer it will also be backed up to a cloud or at least one other computer.

Coins and notes are connected to geographies not only by their locations but also by issuance: most currency is issued by states which control physical territories. Virtual currencies are generally means of payment which are not issued by states, and which do not depend on territory for their creation or maintenance (except that they may depend on states' recognition for the legitimacy of their use in transactions). However there are beginning to be digital versions of fiat currencies— the Bahamas introduced the sand dollar in 2020 and Nigeria introduced the eNaira in 2021.² But currencies which are linked to national territories may also be linked to locations outside their territory of origin formally (for example jurisdictions outside the EU have adopted the euro as their currency) or because they are used to denominate transactions. The US dollar is a significant currency for trade invoicing.³

Law and Geography: law is generally territorial, although it may also be international, transnational or even personal. The jurisdictions of legislatures, regulators and courts are generally determined by reference to territory. Treaties and less formal agreements may harmonize law across jurisdictions. Force (conquest or peer pressure applied by some states to others) or unforced policy learning transplant legal rules across geographic boundaries. Whether or not money is connected to geography as such, the law relating to money connects money to geography.

Money and Law: money both depends on law for recognition and regulation and helps to produce or influence law. Sometimes law controls money and the power it generates, but at other times money controls law.

In a class focusing on international finance we can focus on actors that operate across territorial borders, such as financial firms that lend money, process payments, facilitate the issuance of securities or derivative instruments or provide insurance. And, connected to these firms there are other firms that provide the plumbing for the international system

² Andrew Stanley, *The Ascent of CBDCs*, FINANCE & DEVELOPMENT (Sep. 2022).

³ Cf. Ozge Akinci, Gianluca Benigno, Serra Pelin & Jonathan Turek, *The Dollar's Imperial Circle*, FRBNY Staff Reports No. 1045 (Dec. 2022).

(sometimes described as financial market infrastructures or FMIs): exchanges on which securities and other instruments are traded, and clearing houses that facilitate transactions.⁴ Or we could look at investors, borrowers and people who want to make payments to people in other countries. These various actors could be based in many different jurisdictions. Even one banking group may have subsidiaries or branches in different jurisdictions. We could focus on transactions, such as a cross-border loan or securities issuance or an initial coin offering. Often in law school classes we examine legal issues through the lens of decided cases. And in this class we will study some cases. But we will also study some policy/regulatory/enforcement documents that take different perspectives on the actors involved in international financial processes and transactions.

2.0 INTRODUCTION TO THE TRANSNATIONAL FINANCIAL SYSTEM

Transnational finance includes many different types of activity. Firms buy and sell currencies; people buy debt or equity securities issued by companies established in foreign jurisdictions, banks lend money to foreign borrowers; foreign firms enter the US markets and sell their securities to US persons or lend money to US borrowers; insurance companies pass on the risks associated with policies they have written to reinsurers based in other jurisdictions; people and businesses use different mechanisms to send money around the world.

International financial activity involves the payment system, whereby funds are transmitted around the world, and a number of different financial markets: foreign exchange markets, securities markets, debt markets and markets for derivative financial instruments.⁵ In all of these markets regulators worry about ensuring that the architecture of the systems and markets is sound, and that market participants behave properly. The scale of transnational financial activity is such that risks can be transmitted across geographic borders easily, as illustrated by the global financial crisis (the Great Recession) which began

⁴ See, e.g., Committee on Payment and Settlement Systems & Technical Committee of the International Organization of Securities Commissions, Principles for Financial Market Infrastructures (Apr. 2012). See also, e.g., https://www.bis.org/cpmi/info_pfmi.htm.

⁵ Derivatives are instruments whose value derives from the value of an underlying asset (for example a loan or a commodity such as coffee), index (for example interest rates or exchange rates) or phenomenon (such as weather conditions). Futures, options and swaps are derivatives.

in 2007, so regulators are concerned to limit risk transmission.⁶ At the beginning of 2023 we are in a situation where financial regulators (along with other policy-makers) are concerned about a number of different evolving challenges, including the effects of the covid pandemic and policy responses to the pandemic, the war in Ukraine, geopolitical tensions and inflation and policy responses to inflation (increasing interest rates risk making public debt for some countries unsustainable, leading to defaults on sovereign debt).⁷ Kristalina Georgieva, the Managing Director of the IMF, has warned that a third of the world's economy will be affected by recession in 2023.⁸

Financial regulators also worry about other issues, such as whether the payment system and the financial markets are being used to launder money derived from illicit sources.⁹ With respect to these issues financial institutions are regulatory choke-points: regulators want to be able to rely on financial institutions to report or prevent illicit activity.¹⁰

The regulation of financial market activities which take place in different jurisdictions is a matter for the domestic regulators in the jurisdictions involved: regulation is linked to territorial jurisdiction. In a federal system such as that in the US, financial regulation may be carried out by the states or at the federal level, or both. Domestically there are issues about the allocation of regulatory responsibilities within federal regimes. In addition, different national regulators may have an interest in the regulation of financial market activity which

⁶ Cf. James Crotty, *Structural Causes of the Global Financial Crisis: a Critical Assessment of the 'New Financial Architecture'*, 33 *Cambridge Journal of Economics* 563, 564 (2009) (tracing the financial origins of the crisis to light regulation: "After 1980, accelerated deregulation accompanied by rapid financial innovation stimulated powerful financial booms that always ended in crises. Governments responded with bailouts that allowed new expansions to begin. These in turn ended in crises, which triggered new bailouts. Over time, financial markets grew ever larger relative to the nonfinancial economy, important financial products became more complex, opaque and illiquid, and system-wide leverage exploded. As a result, financial crises became more threatening. This process culminated in the current crisis, which is so severe that it has pushed the global economy to the brink of depression.")

⁷ See, e.g., Jonathan Derbyshire, *Year in a Word: Polycrisis*, FINANCIAL TIMES (Dec. 31, 2022). We will look at issues relating to sovereign debt later. Meanwhile, see, e.g., Robin Jaspert (trans. Adam Baltner) *Central Bank Capitalism Is Forcing the Global South Into a Debt Crisis*, Jacobin (Dec. 23, 2022).

⁸ Patrick Temple-West & Lauren Fedor, *Recession Will Hit a Third of the World this Year*, IMF Chief Warns, FINANCIAL TIMES (Jan. 1, 2023).

⁹ See, e.g., New York Department of Financial Services, Superintendent Adrienne A. Harris Announces \$100 Million Settlement with Coinbase, Inc. after DFS Investigation Finds Significant Failings in the Company's Compliance Program (Jan. 4, 2023).

¹⁰ We will look at some examples of regulatory noncompliance later in the semester, including non-compliance with anti-moneylaundering regulation.

crosses borders. If a bank based in one country wants to do business in another country the banking regulators in both countries may have an interest in regulating the bank's activities. But the imposition of two sets of different rules on a financial institution which engages in cross-border business increases the cost to the bank of doing business, so regulators based in different jurisdictions may agree to harmonize the rules which apply to financial institutions engaged in cross-border business. The International Organisation of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision (Basel Committee), and the International Association of Insurance Supervisors (IAIS) are supranational bodies which work on developing harmonized principles of financial regulation.

The European Union (EU) has worked to create a single market in financial services with harmonized rules, and some uniform rules. The EU system is analogous to a system for allocating regulatory responses within a federal system. And, since the global financial crisis, the Eurozone (or euro area),¹¹ a subset of EU Member States which use the Euro as their currency, has developed a European Banking Union,¹² and is developing a European Capital Markets Union.¹³

Although transnational financial activity involves issues for regulators, it is accomplished by businesses establishing branches and subsidiaries in other jurisdictions and through contracts. Thus transnational financial activity involves issues of interpretation and validity of contracts, and issues of choice of law and jurisdiction. Financial contracts may be short term contracts, such as a sale of securities, but they may also be medium or longer term contracts, establishing ongoing relationships between the parties. And where a party to a financial transaction becomes insolvent, courts in different jurisdictions may be interested in the resolution of matters to do with the insolvency. So the law relating to international finance involves issues of the harmonization of regulatory law and of conflicts of laws and the harmonization of private law.

The global financial crisis raised questions about the regulation of transnational financial transactions. Although networks of financial regulators had spent many years developing standards and codes for financial regulation to limit cross-border transmission of

¹¹ See, e.g., https://economy-finance.ec.europa.eu/euro/what-euro-area_en

¹² See, e.g., <https://www.bankingsupervision.europa.eu/about/bankingunion/html/index.en.html>.

¹³ See, e.g., https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union_en.

risks,¹⁴ these standards and codes did not prevent the crisis.¹⁵ Although the IMF¹⁶ had been involved in evaluating states' compliance with standards and codes of financial regulation leading up to the financial crisis, and had been subject to challenges over the years leading up to the crisis,¹⁷ the IMF saw a new role for itself as a monitor of systemic risk at the international level.¹⁸

As an organization with 190 members the IMF is in a better position to monitor risk in the international financial system than organizations with smaller memberships.¹⁹ The IMF engages in surveillance, which is bilateral (focusing on individual member countries) and multilateral. With respect to multilateral surveillance the IMF publishes regular reports, including the World Economic Outlook and Global Financial Stability Report.²⁰

As noted above, the IMF's reviews of its members include Reports on the Observance of Standards and Codes, which assess the extent to which the member States's laws conform to international standards, including standards of financial regulation. These reports are a component of the joint World Bank/IMF Financial Sector Assessment Program (FSAP) which

¹⁴ See, e.g., Beth A. Simmons, *The International Politics of Harmonization: The Case of Capital Market Regulation*, 55 INTERNATIONAL ORGANIZATION 589 (2001).

¹⁵ The IMF for some years has had a program for monitoring compliance by IMF member countries with harmonized principles of governance and regulation, called Reports on the Observance of Standards and Codes (ROSCs). See <https://www.imf.org/en/Publications/rosoc>. Cf., Independent Evaluation Office of the International Monetary Fund, *IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004–07* (2011).

¹⁶ See <https://www.imf.org/en/About>.

¹⁷ The IMF has been criticized over the years, for example, critiques of conditionality and the Washington consensus, and of the IMF's non-representative governance arrangements. The IMF responded to the critiques by introducing governance reforms.

¹⁸ See, e.g. Olivier Blanchard, *Cracks in the System: Repairing the Damaged Global Economy*, Finance and Development, 9 (Dec. 2008) available at <http://www.imf.org/external/pubs/ft/fandd/2008/12/pdf/blanchard.pdf> .

¹⁹ See, e.g., IMF Policy Advice at <https://www.imf.org/en/About/Factsheets/IMF-Surveillance> (“A core responsibility of the IMF is monitoring the economic and financial policies of member countries and providing them with policy advice, an activity known as *surveillance*. As part of this process, which also takes place at the global and regional levels, the IMF identifies potential risks and recommends appropriate policy adjustments to sustain economic growth and promote financial stability.”)

²⁰ See <https://www.imf.org/en/Publications>.

was established in 1999 to “reduce the likelihood and severity of financial sector crises.”²¹ After the Global Financial Crisis the IMF decided to improve its financial surveillance to address new challenges created by the increased complexity and interconnectedness of financial systems and national economies.²²

As the IMF focused more attention on financial stability, so did the G20,²³ which established a Financial Stability Board to monitor the implementation of regulatory reforms to address issues of financial stability.²⁴ By November 2018 the FSB Chair was noting new challenges involving tightening financial conditions, capital outflows from emerging market economies, and structural changes in the financial system due to Fintech and non-bank finance.²⁵ In December 2018, David Lipton, the Deputy Managing Director of the IMF worried about “storm clouds building” and that crisis prevention work had not been completed.²⁶ A decade after the onset of the global financial crisis while some observers were noting new

²¹ See World Bank, Financial Sector Assessment Program (FSAP) at <https://www.worldbank.org/en/programs/financial-sector-assessment-program>.

²² IMF, The IMF’s Financial Surveillance Strategy, 4 (Aug. 28, 2012) at <http://www.imf.org/external/np/pp/eng/2012/082812.pdf> (“Only a few decades ago, most national economies were barely connected to the global financial world. Today, cross-border flows are the norm and large financial institutions dominate the global economy. Then, domestic financial systems were small, with banks performing simple deposit-taking and lending functions. Today, domestic financial sectors are often enormous and complex, performing a wide range of financial services and offering products that are sometimes opaque. Capital now moves at lightning speed to advanced and emerging markets alike, reverses suddenly, and spreads shock waves that can be devastating. These seismic changes have inexorably linked national economies to each other, transferring risks across borders in ways that have become increasingly difficult to track. The realization that the failure of one bank in one country can bring the global economy down, transmitting shocks to economies far removed geographically, has fundamentally shaken the contours of our thinking and policy making.”)

²³ The members of the G20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, European Union. France, Germany and Italy are members of the European Union.

²⁴ See <https://www.fsb.org/>.

²⁵ FSB Chair’s letter to G20 Leaders meeting in Buenos Aires (Nov. 27, 2018) at <http://www.fsb.org/2018/11/fsb-chairs-letter-to-g20-leaders-meeting-in-buenos-aires/> (“After a decade delivering the G20’s ambitious reforms to address the fault lines that caused the global financial crisis, the FSB is pivoting to focus on implementing those reforms, evaluating their effectiveness, and adjusting them where necessary. In parallel, new policies are being developed to address new risks to financial stability.”)

²⁶ David Lipton, IMF First Deputy Managing Director, Why a New Multilateralism Now?, Bloomberg Global Regulatory Forum, London (Dec. 11, 2018).

concerns and vulnerabilities in the international financial system,²⁷ others were arguing for deregulation to reduce compliance costs for businesses.²⁸ In 2020 the FSB noted a range of risks to financial stability from the Covid-19 pandemic,²⁹ and, in particular, stresses to the non-bank financial sector which induced central banks to intervene in the markets.³⁰ The costs incurred in addressing the pandemic raise concerns about future debt crises.³¹ In addition to focusing on the pandemic the FSB has continued with other aspects of its work on financial stability, including financial stability risks associated with climate change,³² work on the transition away from the Libor benchmark,³³ and non-bank financial activities.³⁴

The global financial crisis caused financial difficulties for people around the world, and

²⁷ See, e.g., IMF, World Economic Outlook, October 2018 at <https://www.imf.org/en/Publications/WEO/Issues/2018/09/24/world-economic-outlook-october-2018>; OECD Economic Outlook, Volume 2018 Issue 2 (Nov. 2018) at https://www.oecd-ilibrary.org/economics/oecd-economic-outlook-volume-2018-issue-2_eco_outlook-v2018-2-en; Minneapolis Fed Comments on Board of Governors' Proposal about Large Banks (Nov. 19, 2018) at <https://www.minneapolisfed.org/news-and-events/bank-updates/minneapolis-fed-comments-on-board-of-governors-proposal-about-large-banks> ("This proposal to weaken regulations on banks is particularly alarming. ... What is most alarming is that this is not a future generation forgetting mistakes of their parents or grandparents. It is the same generation that made the terrible mistakes in the first place that is already forgetting and now is following the same path again.")

²⁸ See, e.g., Presidential Executive Order on Core Principles for Regulating the United States Financial System (Feb. 3, 2017).

²⁹ See, e.g., Financial Stability Board, COVID-19 Pandemic: Financial Stability Impact and Policy Responses (Nov. 17, 2020).

³⁰ See, e.g., Financial Stability Board, Holistic Review of the March Market Turmoil (Nov. 17, 2020), at p. 2.

³¹ See, e.g., Cristina Arellano, Yan Bai & Gabriel Mihalache, Deadly Debt Crises: COVID-19 in Emerging Markets, Federal Reserve Bank of Minneapolis Staff Report No. 603 (May 2020).

³² See, e.g., Financial Stability Board, The Implications of Climate Change for Financial Stability (Nov. 23, 2020), Financial Stability Board, FSB Roadmap for Addressing Climate-Related Financial Risks (Jul. 7, 2021).

³³ See, e.g., Financial Stability Board, Reforming Major Interest Rate Benchmarks: 2020 Progress Report (Nov. 20, 2020); Financial Stability Board, FSB Statement to Support Preparations for LIBOR Cessation (Nov. 22, 2021); Financial Stability Board, Progress Report on LIBOR and Other Benchmarks Transition Issues (Dec. 16, 2022).

³⁴ See, e.g., Financial Stability Board, Global Monitoring Report on Non-Bank Financial Intermediation (Dec. 20, 2022).

austerity measures were introduced in response in a number of countries (for example, in Greece). Growing levels of inequality in many countries, combined with increased anxiety among electorates led to populist politics and increased skepticism about technocratic elites.³⁵ The international financial regulatory system is the sort of technocratic system that populist politics (whether from the right or from the left) doubts. International financial institutions like the IMF and World Bank and networks of regulators like the Basel Committee and IOSCO are challenged by these developments. At the same time, there is no alternative institutional structure for the resolution of transnational crises than the post-World War II institutions such as the IMF, World Bank, OECD, G7 and G20. During 2022 the Russian invasion of Ukraine added to the challenges facing these international institutions.³⁶

Until recently it was taken for granted that participants in international or transnational financial transactions were very wealthy individuals, large corporate entities and financial firms. But the remittance market illustrates that even people who are not very wealthy may engage on a regular basis in transnational financial transactions.³⁷ International financial institutions and domestic banking regulators and politicians have focused on the remittance market in which migrant workers rely on remittance services, which may be informal services or part of the formal financial system, to send money home to their families. The remittance market is affected by economic downturns: during 2009, remittances from the US to Mexico decreased.³⁸ On the other hand, remittances to Bangladesh, Pakistan and the Philippines

³⁵ See, e.g., Joseph Nye, *Will the Liberal Order Survive?*, 96 FOREIGN AFFAIRS 10, 14 (2017) ("The 2016 presidential election was marked by populist reactions to globalization and trade agreements in both major parties, and the liberal international order is a project of just the sort of cosmopolitan elites whom populists see as the enemy.")

³⁶ See, e.g., James McBride, Anshu Siripurapu, and Noah Berman, *What does the G20 Do?* Council on Foreign Relations Backgrounder (Dec. 15, 2022) ("Geopolitical tensions, heightened by the Russian invasion of Ukraine but also spurred by strategic competition between China and the United States, have increasingly threatened cooperation. In the United States, bipartisan legislative efforts have aimed to deny Russia standing in the World Trade Organization (WTO) and other international institutions. Russia's participation in the G20 has grown contentious, with some Western countries seeking to exclude Moscow, though members including China and Brazil have opposed that idea.")

³⁷ On remittances generally see, e.g., World Bank, *Migration and Remittances, Migration and Development Brief 29* (Apr. 2018) at <https://www.knomad.org/publication/migration-and-development-brief-29>.

³⁸ See, e.g., Ronald Buchanan, *US-based Mexicans send less money home*, Financial Times (Jan. 5, 2010).

grew.³⁹ By 2017 remittance levels were higher than ever, amounting to \$466 billion.⁴⁰ Although the amounts involved in individual remittance transactions may be small, the market as a whole has been significant. The World Bank predicted in early 2020 that the pandemic would have a negative impact on the remittance market,⁴¹ but in January 2021 the Mexican Central Bank announced that Mexicans working in the US sent record amounts home during 2020.⁴² By November 2021 the World Bank noted that the remittance market had proved to be resilient during 2020 and was projected to increase during 2021, especially in Latin America and the Caribbean.⁴³ Levels of remittances continued to grow in 2022, although inflation, the war in Ukraine and risks of recession are among the risks that affect remittances.⁴⁴

Remittance systems raise issues for regulators concerned about money laundering. The Financial Action Task Force (FATF) has identified alternative (i.e. informal or unregulated) remittance systems as possible vehicles for money laundering.⁴⁵ But even institutions regulated as banks may find that moneylaundering regulation results in their being

³⁹ See, e.g., Migration and Remittances Team, Development Prospects Group, World Bank, Migration and Development Brief 11 (Nov. 3, 2009).

⁴⁰ Migration and Remittances, supra note 37, at 3 (“After two consecutive years of decline, remittance flows to low- and middle-income countries (LMICs) increased by an estimated 8.5 percent in 2017, to reach \$466 billion, a new record.”)

⁴¹ See, e.g., World Bank, World Bank Predicts Sharpest Decline of Remittances in Recent History, Press Release (Apr. 22, 2020); World Bank, Migration and Remittances, Migration and Development Brief 33 (Oct. 2020).

⁴² Anthony Harrup, Mexicans in U.S. Sent Record Remittances Despite Covid-19 Pandemic, Wall Street Journal (Jan. 8, 2021).

⁴³ World Bank, Migration and Remittances, Recovery: Covid-19 Crisis Through a Migration Lens, Migration and Development Brief 35 at 6 (Nov. 2021) (“Remittances now stand more than threefold above official development assistance and, excluding China, more than 50 percent higher than foreign direct investment. This underscores the importance of remittance flows in smoothing consumption in recipient countries during periods of economic hardship.”)

⁴⁴ See, e.g., Migration and Remittances Team, Remittances Brave Global Headwinds, Migration and Development Brief 37, at vii (Nov. 2022) (“Growth in remittances is expected to moderate to 2 percent in 2023, as GDP growth in high-income countries continues to slow. Downside risks remain substantial, including a further deterioration of the war in Ukraine, volatile oil prices and currency exchange rates, and a deeper-than-expected downturn in major high-income countries.”).

⁴⁵ See, e.g., Financial Action Task Force, FATF Recommendations 2012 (updated Mar. 2022) at <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>.

excluded from financial transactions: regulators have worried that concerns about the rules leads banks to engage in derisking, which may have an impact on access to financial services for individuals and even for banks.⁴⁶ The World Bank and IMF have focused on risk assessments for remittance corridors to identify situations where the risks of money laundering and terrorist financing are lower, and where simplified customer due diligence measures are appropriate.⁴⁷

Some commentators have critiqued the transnational focus on money laundering and argued that the development of the FATF was designed to serve the interests of the US in controlling money-laundering and to present money-laundering as an issue of international concern to promote the need for an international solution.⁴⁸ Whatever the origins of money-laundering control (AML) it has become a concern for financial regulators around the world, and a concern to prevent money laundering tends to make policy-makers prohibit remittances through unregulated channels, even if such channels are cheaper for customers than regulated channels. The remittance example illustrates that there may be a number of policy issues implicated by a particular financial market or type of transaction. Concerns about security and the prevention of organized crime may conflict with concerns to provide affordable financial services to people who need those services. The G7, G20 and the UN SDGs (Sustainable Development Goals) have all identified reducing the cost of remittances as a policy objective.⁴⁹

The costs of making overseas remittances through formal channels decreased in recent years, partly in response to moves to increase transparency with respect to remittance prices, and partly because of increased competition in the remittance market, including the ability to make payments by mobile phone. But innovation and competition in the payments market is more evident in some parts of the world than in others. Although Brazil and Mexico have taken steps to encourage open banking, which allows the sharing of data by financial institutions with non-financial institutions and can encourage competition in the payments market, many countries in Latin America and the Caribbean have not transitioned to digital

⁴⁶ See, e.g., FATF Guidance, Correspondent Banking Services (Oct. 2016); FATF, Mitigating the Unintended Consequences of the FATF Standards (Oct. 27, 2021).

⁴⁷ World Bank & IMF, A Draft Framework for Money Laundering/Terrorist Financing: Risk Assessment for Remittance Corridors (Sep. 2021).

⁴⁸ See, e.g., William Vlcek, *Securitizing Money to Counter Terrorist Finance: Some Unintended Consequences for Developing Economies*, 16 *International Studies Perspectives* 406 (2015) .

⁴⁹ See, e.g., World Bank, Remittance Prices Worldwide, Issue 43 (Sep. 2022).

payments to the extent that countries in other parts of the world have, and there is a relatively low level of cashless payments.⁵⁰

In the US, the Consumer Financial Protection Bureau introduced rules relating to remittances to protect consumers (a Remittance Transfer Rule). The rules require disclosures of the costs of remittances (carried out as electronic funds transfers) and allow consumers to cancel remittances. In October 2018 the Bureau of Consumer Financial Protection published a Report on the rules which noted that the use of mobile phones to make payments changed the market and made it difficult to assess the effects of the Remittance Rule.⁵¹ The Report stated: “The Bureau expects that the assessment findings made in this report and the public comments received in response to the RFI⁵² will help inform the Bureau’s future policy decisions concerning remittance transfers, including whether to commence a rulemaking proceeding to make the Remittance Rule more effective in protecting consumers, less burdensome to industry, or both.”⁵³ The Remittance Transfer Rule was amended in 2020.⁵⁴ The CFPB has taken enforcement action with respect to violations of the rule,⁵⁵ and is considering adopting new rules to allow customers to assess the true cost of remittances.⁵⁶

The costs of sending money from one country to another are affected by regulation in the sending and receiving countries, and also by the characteristics of the payment systems involved. Digital remittances (which require a transaction account) are cheaper to make than

⁵⁰ See, e.g., Viviana Alfonso, Alexandre Tombini & Fabrizio Tampolli, Retail Payments in Latin America and the Caribbean: Present and Future, BIS Quarterly Review (Dec. 2020) at https://www.bis.org/publ/qtrpdf/r_qt2012f.pdf.

⁵¹ Bureau of Consumer Financial Protection, Remittance Rule Assessment Report (Oct. 2018) at p 4.

⁵² This is a reference to a Request for Information Regarding Remittance Rule Assessment, 82 Fed. Reg. 15009 (Mar. 24, 2017).

⁵³ Remittance Rule Assessment Report at p 9.

⁵⁴ Bureau of Consumer Financial Protection, Remittance Transfers Under the Electronic Fund Transfer Act (Regulation E), 85 Fed. Reg. 34870 (Jun. 5, 2020)

⁵⁵ CFPB Orders Servicio UniTeller to Refund Fees and Pay Penalty for Failing to Follow Remittance Rules (Dec, 22, 2022).

⁵⁶ Andrew Ackerman, *CFPB Weighs Tougher Rules for Overseas Money Transfers*, Wall St. Journal (Jan. 16, 2023).

cash remittances, although historically remittances have involved cash payments,⁵⁷ and digital payments are complex for those who are not technologically competent or who lack relevant documentation to establish accounts (e.g. undocumented workers).⁵⁸ Remittances may have an impact on the conditions in the domestic financial markets in the countries where the recipients of remittances live. Remittance recipients may be more attractive to local banks as borrowers because of their receipts of funds and this may encourage the development of credit markets. On the other hand remittance recipients may need less credit if they are receiving funds from remittances. Diaspora bonds may be a way of raising funds from wealthy expatriates.⁵⁹ Cross-border transactions have implications for local conditions in domestic financial systems: domestic financial markets are increasingly related to each other.

In addition to involving issues relating to money-laundering, remittances may also run up against sanctions measures, where countries try to pressurize other countries, organizations or individuals to change their behaviors. After the Taliban took control of Afghanistan in the summer of 2021 the US took action to permit remittances to Afghanistan as an exception to sanctions measures.⁶⁰

Remittances illustrate a distinction between formal and informal financial activity.⁶¹ Remittances may be sent through formal channels such as wire transfers through regulated

⁵⁷ See, e.g., Oya Ardic, Hemant Bajjal, Patrizia Baudino, Nana Yaa Boakye-Adjei, Jonathan Fishman & Richard Audu Maikai, *The Journey So Far: Making Cross-border Remittances Work for Financial Inclusion*, Financial Stability Institute, FSI Insights on policy implementation No 43, at 9 (Jun. 2022).

⁵⁸ *Id.*

⁵⁹ See, e.g., World Bank, Migration and Development Brief 13 (Nov. 2010) at 12-13; Witney Schneidman, Admassu Tadesse & Abyssinia Lissanu, Diaspora Bonds: an Innovative Source of Financing? (May 27, 2022) at <https://www.brookings.edu/blog/africa-in-focus/2022/05/27/diaspora-bonds-an-innovative-source-of-financing/>.

⁶⁰ Office of Foreign Assets Control (OFAC), Counter Terrorism General License 16 - Authorizing Noncommercial, Personal Remittances to Afghanistan (Dec. 10, 2021).

⁶¹ For example: “Mobile money transfers have the potential to revolutionize access to remittance services and broader financial services for the poor. There is a compelling reason for applying mobile technology to cross-border remittance services: the bulk of poor cross-border migrants tend to travel short distances, mostly to neighboring countries just across the border,..and a large number of them stay within the calling range of domestic mobile phones. Such migrants typically cannot have bank accounts in the host country, and in any case banks do not want to serve them. These migrants rely on friends (or strangers) going home or hawaladars to send money home.” Migration and Development Brief 13, note [59](#) above, at 11.

financial institutions, or they may be sent through informal transfer mechanisms, such as hawala. The FATF evaluated “hawala and other similar service providers” or “HOSSPs” and noted that there were a number of these informal value transfer systems, often associated with particular geographic regions or ethnic communities. People used these informal systems to move money for a range of reasons including culture and lack of access to or distrust of banks but also to evade currency controls, taxes and sanctions.⁶²

Concerns about money laundering and terrorist financing in particular, tend to push financial activity into formal regulated channels, requiring money transmitters to be regulated. Regulation involves compliance costs which tend to be borne by consumers of regulated services. Increasing the costs of providing remittance services in order to control money laundering by organized criminals harms the interests of non-criminal remitters of money. “Money service businesses” are subject to money laundering regulation in many jurisdictions, as are banks and other types of financial firm.⁶³ This idea that services “for the transmission of money or value” should be regulated catches informal value transmission systems. In 2010 the FATF focused its attention on New Payment Methods (NPMs) which include mobile phone payments, internet payments and prepaid cards, noting that these NPMs might be useful in moving customers from unregulated payment systems into systems which, with digital payments records, would be easier for regulators to monitor and identify suspicious transactions. In order for this to work effectively, countries should adopt mechanisms for the verification of the identity of users.⁶⁴

Within domestic legal systems the regulation of money-laundering (anti-money laundering or AML law) can involve multiple legal instruments (statutes and regulations) and be administered by many different regulators. In the US, the Department of the Treasury, the Financial Crimes Enforcement Network (FinCEN), federal and state financial regulators

⁶² See FATF, *The Role of Hawala and Other Similar Service Providers in Money Laundering and Terrorist Financing* (Oct. 2013). Cf. Kingsley Kobo, *How Economic Sanctions Drove Money Transfers in West Africa Underground*, Quartz Africa (Nov. 8, 2021).

⁶³ See, generally, e.g., <https://www.fincen.gov/am-i-msb>.

⁶⁴ FATF, *Money Laundering Using New Payment Methods* (Oct. 2010) (“the World Bank has recommended to jurisdictions intending to promote financial inclusion (e.g., through mobile payment service providers) that if the jurisdiction’s “national identification infrastructure and other private databases lack coverage, integrity, or are not easily and cost-effectively accessible to financial institutions for verification purposes, the state should address these deficiencies”. Where customer data cannot be reliably verified, it may be appropriate to apply alternative risk mitigation measures (e.g., imposing low value limits in order to qualify as a “low risk” product and be allowed to apply simplified CDD measures..).

including the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC) are all involved in the regulation of money laundering. Interestingly, although the federal government went through a recent period of emphasizing deregulation, including in the context of financial services, AML was not a sphere of deregulation.⁶⁵

New financial technologies, or Fintech, have become an increasingly visible component of the financial system, raising questions about how financial regulation should respond. With respect to AML regulation Fintech might help to get around regulation (e.g. privacy wallets for cryptocurrencies which ensure anonymity) or might facilitate compliance and supervision (e.g. financial technologies which are oriented to compliance and enforcement (Regtech and Suptech)).⁶⁶ Central bank digital currencies (CBDCs) could allow governmental monitoring of the details of people's spending, facilitating tax collection.⁶⁷

The Covid-19 pandemic had implications for AML. In a report in May 2020, the FATF argued that government responses to the pandemic, including social assistance, tax relief and travel restrictions could "provide new opportunities for criminals and terrorists to generate and launder illicit proceeds."⁶⁸ Also in May 2020 the European Union (EU) Commission⁶⁹ published an Action Plan for a comprehensive EU AML policy, building on the EU's series of AML directives, and which also noted that the pandemic had increased the illicit money problem.⁷⁰ The EU Action plan was also a response to a number of enforcement failures with

⁶⁵ See, e.g., FinCEN, Customer Identification Programs, Anti-Money Laundering Programs, and Beneficial Ownership Requirements for Banks Lacking a Federal Functional Regulator, 85 Fed. Reg. 57129 (Sep. 15, 2020).

⁶⁶ See, e.g., Financial Stability Board, The Use of Supervisory and Regulatory Technology by Authorities and Regulated Institutions: Market Developments and Financial Stability Implications (Oct. 9, 2020).

⁶⁷ See, e.g., Kristin Tate, the Digital Dollar Is Coming on the Back of the FTX Collapse, The Hill (Jan. 4, 2023).

⁶⁸ FATF, COVID-19-related Money Laundering and Terrorist Financing: Risks and Policy Responses (May 2020) at 5.

⁶⁹ The EU Commission is organized much like a domestic government might be organized with heads of departments responsible for different policy areas.

⁷⁰ EU Commission Communication, Action Plan for a Comprehensive Union Policy on Preventing Money Laundering And Terrorist Financing, C(2020) 2800 final (May 7, 2020) at 1 ("The recent increase in criminal activities in the context of the COVID-19 pandemic¹ is a reminder that criminals will exploit all possible avenues to pursue their illicit activities to the detriment of society. The EU needs to be equally

respect to EU AML measures.⁷¹ In some cases the AML issues seemed to be the result of an enthusiasm about business without the required focus on AML risks. The EU Commission identified issues with respect to financial groups, for example where different parts of the group were subject to the supervision of different regulators. The Commission also noted that in some cases there was a climate of trust between the regulated firms and the regulator that impeded proper enforcement of the rules.⁷² In July 2021 the Commission introduced a package of four legislative proposals, three regulations and a directive, to implement the Action plan, including a proposal for a new EU level AML Authority (AMLA).⁷³

Within legal systems, ensuring that national or regional rules are applied appropriately everywhere can be a challenge. The EU Commission stated in its AML Action Plan that the EU had suffered “financial, economic and reputational damage” as a result of failures to apply AML rules appropriately, and proposed the development of a single rule-book for the EU and EU-level enforcement of those rules.⁷⁴ The US has identified High Intensity Financial Crime Areas where money laundering is a particular concern. South Florida is one of these areas.⁷⁵ In addition US FinCEN (Financial Crimes Enforcement Network) has issued real estate Geographic Targeting Orders requiring title insurance companies to identify individuals behind shell companies acquiring real estate without bank or external financing for \$300,000 or more in specific locations, again including South Florida (Miami-Dade, Broward and Palm Beach counties) (the order also applies to properties in Baltimore with a purchase price of \$50,000 or more).⁷⁶

Federal states and the EU, which functions in some respects like a federal state but is a regional international organization, encounter difficulties with respect to the enforcement of regulations, including AML regulation, but have legal mechanisms they can employ to address

determined in ensuring that they do not benefit from the proceeds of these crimes.”)

⁷¹ See, e.g., EU Commission, Report Assessing Recent Alleged Money-laundering Cases Involving EU Credit Institutions, COM(2019) 373 final (Jul. 24, 2019).

⁷² E.g. id.at 8-9.

⁷³ See Anti-money Laundering and Countering the Financing of Terrorism Legislative Package (Jul. 20, 2021)

⁷⁴ AML Action Plan, supra note [70](#), at 8.

⁷⁵ See <https://www.fincen.gov/hifca-regional-map> .

⁷⁶ See FinCEN, Geographic Targeting Order (Apr. 29, 2022).

these difficulties. At the international level, across legal systems, the FATF addresses a lack of enforcement of AML standards by publishing lists of countries with weak regimes.⁷⁷

3.0 FINANCIAL REGULATION, TRUST, AND CONFIDENCE IN THE FINANCIAL MARKETS

Countries regulate domestic financial activity to protect investors, depositors, and other categories of consumer in order to preserve the domestic financial markets. The essential functions of financial markets are relatively simple: they enable businesses and governments to raise money, and investors to obtain a return on capital they do not need for current consumption. Both of these functions are crucial to the functioning of capitalist economies. Businesses need to ensure supplies of capital in order to grow, and investors need to be able to provide for their future needs. The functions are also linked, as, ultimately, the money that businesses use comes from investors. If investors do not feel safe in committing their money to the businesses which need the money, they will refuse to invest, perhaps hiding the money under their mattresses. Moreover, if financial firms fail their failures may be transmitted to other financial firms through the payments system.⁷⁸ Such failures harm confidence. Thus, governments are convinced of the need to act to maintain investor/depositor confidence in the financial markets. The global financial crisis in 2007-8 was an illustration of what happens when market participants lose confidence in the financial markets. In this period of turmoil, some of the regulatory mechanisms which had been designed to maintain confidence turned out to be ineffective.⁷⁹ In the period after the onset of the crisis domestic financial regulators

⁷⁷ See, e.g., FinCEN, Financial Action Task Force Identifies Jurisdictions with Anti-Money Laundering and Combating the Financing of Terrorism and Counter-Proliferation Deficiencies (Oct. 31, 2022).

⁷⁸ In 2003, Anne Krueger (then First Deputy Managing Director of the International Monetary Fund) said that “At the domestic level, governments must take steps to ensure a sound banking system. That means addressing issues such as non-performing loans, capital adequacy ratios and effective regulation. It means ensuring there is proper competition within the banking sector. And it means ensuring that there are incentives in place so that financial institutions develop the appropriate skills needed to assess and manage credit risks and returns.” Anne Krueger, *Financing the Future: Why a Thriving Capital Market Matters*, Speech at the National Economic Outlook Conference, Kuala Lumpur, Malaysia, Dec. 9, 2003, available at <http://www.imf.org/external/np/speeches/2003/120903.htm>. Anne Krueger was the World Bank Chief Economist from 1982 to 1986, and the first Deputy Managing Director of the International Monetary Fund from September 1, 2001, to September 1, 2007. She then became a Professor at Johns Hopkins’ School of Advanced International Studies and a Senior Fellow of the Center for International Development at Stanford University.

⁷⁹ Deposit insurance schemes are an example of this. Deposit insurance schemes are supposed to prevent bank runs by persuading depositors that their money is safe. But depositors’ fears that they might have to wait for their money during the global financial crisis prompted legislators to rethink deposit insurance schemes. See Sebastian Schich, *Financial Turbulence: Some Lessons Regarding Deposit*

and legislators worked to improve existing regulation and develop new regulatory mechanisms to address financial stability. During the Covid-19 pandemic financial regulators have continued to focus on issues relating to financial stability. We will come back to this later.

In September 2002, **William J. McDonough**, then President and Chief Executive Officer of the Federal Reserve Bank of New York said:

Governments have long recognized that banking and other financial institutions, because of the nature of the functions they perform, must be subject to at least some form of regulation and official oversight. Governments have a broad mandate here. Their job is to ensure that markets operate in a fair, transparent, and efficient manner, and that participants comply with the rules of the game. Governments must not rely on outdated notions as to what constitutes risk and effective risk management. Official supervision must evolve in line with the way financial institutions manage their activities, which is increasingly across business lines rather than across legal entities.⁸⁰

Think about what this statement suggests about the appropriate role of regulators. The reference to “at least some form of regulation and official oversight” (emphasis added) seems to suggest a limited role for regulators. Do you think this is what McDonough really means? Is it realistic to think that markets can “operate in a fair, transparent, and efficient manner”? Who should decide what “effective risk management” requires - governments, financial firms, or investors/ depositors? Do these questions become more or less complex when we think of how domestic financial markets are linked to other domestic financial markets? If you were a US banking regulator would you trust US banks and/or foreign banks to decide on their own risk management principles? Would you trust financial trade associations (groups of banks and other financial institutions) to develop such principles? Would it make a difference which foreign countries the banks were based in?

At this point we are thinking about institutional regulation: the regulation of firms involved in the financial markets. Other types of rule regulate specific transactions - for example disclosure rules and rules specifying requirements for particular regulated products

Insurance, Financial Market Trends No. 94, 55 (Volume 2008/1).

⁸⁰ William J. McDonough, *Issues in Corporate Governance*, The William Taylor Memorial Lecture, Washington, D.C. (Sep. 29, 2002) McDonough was at one point the chair of the Basle Committee on Banking Supervision, and he was Chairman of the Public Company Accounting Oversight Board from 2003-2005 (PCAOB). The PCAOB is the body set up under the Sarbanes-Oxley Act of 2002 to deal with post-Enron issues).

or even requirements of regulatory approval of certain financial products.⁸¹

In thinking about how much and what sort of regulation is necessary for financial activity (domestic and transnational) it makes sense to identify some of the crises which have influenced the development of financial regulation. Here the focus is on developments this century.

At the end of 2001 (not long before McDonough's speech) Enron restated its financials for the prior four years, so that earnings from 1997 to 2000 declined by \$591 million, and debt for 2000 increased by \$658 million. Enron subsequently went into bankruptcy.⁸² The collapse of Enron and scandals involving companies including Tyco, Worldcom and Parmalat prompted regulators and legislators to act to protect investor confidence. The scandals and collapses raised a number of different questions about the regulation of financial markets involving: constraints on US corporate officers and directors, ensuring that financial disclosures accurately reflect the financial condition of issuers of securities (e.g. accounting for securitization, principles-based versus rules-based accounting regulation, regulating auditors, certification of company accounts), how to make sure that financial analysts do not mislead investors as to the value of securities, and the role of credit rating agencies.⁸³

In 2004 **Alan Greenspan**⁸⁴ discussed the importance of trust in financial markets: Recent transgressions in financial markets have underscored the fact that one can hardly overstate the importance of reputation in a market economy. To be sure, a market economy requires a structure of formal rules—for example, a law of contracts, bankruptcy statutes, a code of shareholder rights. But rules cannot substitute for character. In virtually all transactions, whether with customers or with colleagues, we rely on the word of those with whom we do business. If we could not do so, goods and services could not be exchanged efficiently. The trillions of dollars of assets that are priced and traded daily in our financial markets before legal confirmation illustrate the

⁸¹ See, e.g., Saule T. Omarova, *License to Deal: Mandatory Approval of Complex Financial Products*, 90 WASH. U. L. REV. 63, 66 (2012) (arguing for “pre-market government licensing of complex financial instruments—including derivatives, asset-backed securities, and other structured products..”)

⁸² Paul M. Healy, Krishna G. Palepu, *The Fall of Enron*, 17(2) J. OF ECON.PERSPECTIVES, 3, 4 (2003).

⁸³ Credit rating agencies such as Standard & Poors and Moodys are businesses which assign ratings to firms and to the securities they issue which reflect the risks that the firms will default (the credit risk). But credit rating agencies are paid by the firms they rate, which suggests severe conflicts of interest, and a need for regulation of credit rating agencies.

⁸⁴ Alan Greenspan was Chairman of the US Federal Reserve from 1987 to 2006.

critical role of trust. Even when followed to the letter, rules guide only a few of the day-to-day decisions required of business and financial managers. The rest are governed by whatever personal code of values that managers bring to the table.... Over the past half century, the American public has embraced the protections of the myriad federal agencies that have largely substituted government financial guarantees and implied certifications of integrity for business reputation. As a consequence, the market value of trust so prominent in the nineteenth century seemed unnecessary and by the 1990s appeared to have faded to a fraction of its earlier level. Presumably, we are better protected and, accordingly, better off as a consequence of these governmental protections. But corporate scandals of recent years have clearly shown that the plethora of laws of the past century have not eliminated the less-savory side of human behavior.

We should not be surprised then to see a re-emergence of the market value placed on trust and personal reputation in business practice. After the revelations of corporate malfeasance, the market punished the stock prices of those corporations whose behaviors had cast doubt on the reliability of their reputations. Recent allegations on Wall Street of breaches of trust or even legality, if true, could begin to undermine the very basis on which the world's greatest financial markets thrive.⁸⁵

In 2002 market participants were also concerned about the issue of investor confidence, and one trade association wrote:

Our industry, too, deserves a portion of the blame for the market's performance. The collapse of Enron, and then WorldComm, led to concerns about the independence and integrity of the analysts who evaluate whether companies are good investments. We have also faced questions about the underwriting process, and whether allocations of initial public offerings were used to attract business for firms.

All of these developments - the sharp drop in the market's performance, the revelations of corporate fraud, and the doubts about Wall Street's role in the crisis - have led many investors to question the wisdom of putting their hard-earned savings into stocks and bonds.

... investors' attitudes toward the securities industry and their brokers are at their lowest levels since we began our survey in 1995. Investors told us they are most concerned about losing money in their stock investments and about dishonesty within the marketplace. They told us that we, the industry, should be more honest and trustworthy and be more willing to punish the wrongdoers.

... It's vitally important that we address investor concerns and restore trust in the

⁸⁵ <http://www.federalreserve.gov/boarddocs/speeches/2004/20040416/default.htm>

financial markets...⁸⁶

Regulators worry about events and actions that may harm investor confidence. But market participants and some policy makers also worry about the costs and possible negative consequences of regulation, and regulators also express concerns about excessive regulation.⁸⁷ This issue of whether regulation was too burdensome arose between the US and the EU in the context of the US' Sarbanes-Oxley Act of 2002,⁸⁸ which included a number of provisions which adversely affected foreign issuers of securities which had issued their securities in the US.

In the 20 years since Enron there have been other crises and scandals in financial markets in the US and globally, including dramatic business collapses, manipulation of benchmarks on which financial markets rely, money laundering and sanctions non-compliance, a global financial crisis and sovereign debt crises in Argentina and the EU.

Some regulation is necessary to address market failures, but too much regulation imposes costs on financial firms. The firms will be able to pass some of these costs on to their customers but high levels of regulatory costs may discourage customers from transacting with financial firms. Regulation may make innovation difficult or impossible. At the same time, innovative financial products and services may be risky for individual financial services customers.

Scandals tend to produce new rules as politicians and regulators want to appear to be taking the problems seriously. And new rules introduced in a rush may not always be the best

⁸⁶ Allen B. Morgan, Jr., SIA Chairman, *Building Investor Confidence*, Speech to the Securities Industry Association Annual Conference (Nov. 7, 2002). The SIA was a trade association for securities firms which merged with the Bond Market Association, another financial industry trade association, to become SIFMA.

⁸⁷ See, e.g., Charlie McCreevy, European Commissioner for Internal Market and Services, *Towards a Better Regulated European Capital Market*, London Stock Exchange Christmas Lunch, London, 16 December 2005 ("I want to make life easier for our companies. When I finish at the Commission, there is just one question I will ask myself: have I helped to create a better, simpler and lighter regulatory framework for doing business in the EU that works? And have I blocked some of the more extravagant ideas that business might otherwise have been burdened with? That is my personal benchmark. Europe has to strive to be the best in the world, and nothing less. Strive to have a better regulatory framework than our competitors – business driven, prudentially sound, and sensible – with responsible levels of investor protection. We should aim to be the model for the emerging capital markets – and be open to innovative ways to cooperate with China, India, Brazil. And of course the United States...")

⁸⁸ Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745, July 30, 2002. Cf. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521 (2005).

rules to address the problems. Sometimes new rules are not really what is needed (although extra enforcement efforts may be desirable).

There are other issues relating to who should make the rules. What is the appropriate role of corporates, financial firms, trade associations, regulators (state or federal), or legislatures in financial regulation? Does business driven regulation mean that businesses should make the rules?

The global financial crisis illustrated that a lack of effective regulation can impose costs on citizens, just as regulation may impose costs.⁸⁹ Bailouts may be expensive and need to be paid for from tax revenues or by reducing government expenditures. Reducing the risk of bailouts was a major preoccupation of policy-makers after the onset of the global financial crisis.

Do you think that different jurisdictions should try to compete with each other in terms of regulation? Is this sort of competition desirable?

The global financial crisis illustrated the interconnection of the financial markets in different parts of the world. **Már Gudmundsson** said in a speech in September 2008:⁹⁰

The current global financial crisis has now lasted more than a year, with no immediate end in sight. The crisis was triggered by increasing defaults on subprime mortgages and the turn of the housing cycle in the United States. Subsequently, the credit ratings of structured products, wholly or partly based on these mortgages, were significantly downgraded, raising uncertainty about the valuation of such products.

It was at this point that the banks at the centre of the financial system were hit much more speedily than most had envisaged before the crisis. Thus the drying-up of the market for asset-backed commercial paper created pressure on banks' funding liquidity. The reason was that the banks needed, for legal or reputational reasons, to provide their special purpose vehicles with liquidity or to bring them back onto their balance sheets. Thus, the banks needed to make more use of their own funding liquidity at the same time as their future liquidity needs were becoming both bigger and more uncertain. On top of this, they were becoming more uncertain about the creditworthiness of other banks, as they did not know where the exposure to the toxic subprime and structured product stuff was, or which banks might face problems because they would be forced into a distressed sale of assets due to a lack of funding liquidity. The result was a generalised hoarding of funding liquidity,

⁸⁹ See, e.g., Gautam Makunda, The Social and Political Costs of the Financial Crisis, 10 Years Later (Sep. 25, 2018) at <https://hbr.org/2018/09/the-social-and-political-costs-of-the-financial-crisis-10-years-later>.

⁹⁰ See <http://www.bis.org/speeches/sp081119.htm>. At the time he was Deputy Head of the Monetary and Economic Department of the BIS (Bank for International Settlements) and he was Governor of the Central Bank of Iceland from 2009 to 2019.

which might have been rational from the standpoint of individual banks but was disastrous for the system as a whole.

This hoarding of funding liquidity made the crisis come to the fore in the drying-up of market liquidity in interbank money markets in the United States and in Europe on 9 August last year. This in turn prompted central banks in these regions to inject massive amounts of liquidity in order to stop money market interest rates from rising far above targeted levels.

We now know that this was only the beginning. What at first seemed mostly to be a US problem is now increasingly a global problem. What at first seemed to be valuation problems in specific segments of financial markets have turned into a broader-based downturn in asset prices. What at first seemed to be a liquidity problem has turned into major losses and writedowns of bank capital.

We are currently in a phase of this crisis where significant parts of the financial system in advanced economies are being forced to reduce their assets relative to capital, that is, to reduce what is called leverage. The reason is that the current level of leverage of many financial institutions implies a higher level of risk than they can manage in this environment of higher funding costs, increased volatility of most financial prices and more uncertainty. The deleveraging can take place through the raising of additional capital, which is currently becoming more difficult, or the disposal of assets and use of the proceeds to repay debt. However, a deleveraging of the whole financial sector, as distinct from individual institutions in normal market conditions, is a painful process involving asset price deflation and a lack of market liquidity.

The impairment of the wholesale money market along with higher funding costs and shorter available maturities has made many business models untenable. Those relying on short-term funding in wholesale money markets have been particularly vulnerable. This was the undoing of Northern Rock and contributed to the downfall of investment banks. One result of the decline of wholesale funding has been a significantly higher degree of competition for deposits, particularly in Europe.

The metamorphosis of the crisis from its initial stages to now is easier to understand when we realise that it had deeper causes than the faults in US subprime loan origination and the associated securitisation process. The crisis was preceded by a period of low real interest rates and easy access to credit, which fuelled risk-taking and debt accumulation. In the United States, it was the case both for households and for the financial sector itself. However, although the increased indebtedness of the US household sector was plain for everybody to see, the increased leverage of the financial sector was somewhat hidden. One reason was that the leverage was partly accumulating in what is now being called the shadow banking system. Another reason was that the focus on risk metrics like value-at-risk and the use of short time series as inputs allowed the low recent volatility of asset prices to mask the increase in leverage.

In the United States, easy credit conditions were made even more so by global current account imbalances and the willingness of foreign governments to finance the US current account deficit. Easy monetary policy in the aftermath of the bursting of the tech stock bubble in 2001 might also have contributed at the margin, although easy credit preceded it.

Last but not least, financial innovation contributed to debt accumulation. In particular, the originate-to-distribute model made it possible to originate loans - especially mortgages - to households, securitise them in large quantities, slice and dice them into differently rated tranches, and then sell them all over the world to both risk-averse and risk-seeking investors. The effect was that loan origination was less constrained by the balance sheet capacity of banks.

One result of this setup was that risk was apparently spread away from the institutions that are critical for the overall functioning and stability of the financial system, which should be good from the standpoint of financial stability. However, as it turned out, the distribution was less than met the eye, as the asset-backed securities were often held by special purpose vehicles closely associated with the banks originating them. Some commentators have for this reason called the arrangement "originate and pretend to distribute". Furthermore, as the value of structured products was potentially unstable and would become very uncertain at the first sign of stress and illiquidity in financial markets, what was distributed was not only risk, but also uncertainty and fear.

The upshot of all of this was the underpricing of risk. This underpricing was widely recognised in the central banking community, and by others, and was expected to result in significant repricing, which would in all probability be associated with lower asset values and a downturn in the credit cycle. What nobody knew, of course, was the timing of this repricing; nor did anyone anticipate the speed and ferocity of the change or the degree to which it would, in the first round, affect the core of the financial system.

The "shadow banking system" Gudmundsson refers to involves non-bank institutions which behave like banks, borrowing short (issuing commercial paper, which is short term debt) and lending long. These non-bank entities were not regulated in the same way that banks are, and have not been part of deposit insurance systems, nor have they had access to lender of last resort facilities available to banks, although AIG, which was a shadow bank, was bailed out by the US Government in 2008.

The **Congressional Oversight Panel** criticized the AIG bailout:

At its peak, American International Group (AIG) was one of the largest and most successful companies in the world, boasting a AAA credit rating, over \$1 trillion in assets, and 76 million customers in more than 130 countries. Yet the sophistication of AIG's operations was not matched by an equally sophisticated risk-management structure. This poor management structure, combined with a lack of regulatory

oversight, led AIG to accumulate staggering amounts of risk, especially in its Financial Products subsidiary, AIG Financial Products (AIGFP). Among its other operations, AIGFP sold credit default swaps (CDSs), instruments that would pay off if certain financial securities, particularly those made up of subprime mortgages, defaulted. So long as the mortgage market remained sound and AIG's credit rating remained stellar, these instruments did not threaten the company's financial stability.

The financial crisis, however, fundamentally changed the equation on Wall Street. As subprime mortgages began to default, the complex securities based on those loans threatened to topple both AIG and other long-established institutions. During the summer of 2008, AIG faced increasing demands from their CDS customers for cash security . known as collateral calls totaling tens of billions of dollars. These costs put AIG's credit rating under pressure, which in turn led to even greater collateral calls, creating even greater pressure on AIG's credit.

By early September, the problems at AIG had reached a crisis point. A sinkhole had opened up beneath the firm, and it lacked the liquidity to meet collateral demands from its customers. In only a matter of months AIG's worldwide empire had collapsed, brought down by the company's insatiable appetite for risk and blindness to its own liabilities.

AIG sought more capital in a desperate attempt to avoid bankruptcy. When the company could not arrange its own funding, Federal Reserve Bank of New York President Timothy Geithner, who is now Secretary of the Treasury, told AIG that the government would attempt to orchestrate a privately funded solution in coordination with JPMorgan Chase and Goldman Sachs. A day later, on September 16, 2008, FRBNY abandoned its effort at a private solution and rescued AIG with an \$85 billion, taxpayer-backed Revolving Credit Facility (RCF). These funds would later be supplemented by \$49.1 billion from Treasury under the Troubled Asset Relief Program (TARP), as well as additional funds from the Federal Reserve, with \$133.3 billion outstanding in total. The total government assistance reached \$182 billion....

The government failed to exhaust all options before committing \$85 billion in taxpayer funds. In previous rescue efforts, the federal government had placed a high priority on avoiding direct taxpayer liability for the rescue of private businesses. For example, in 1998, the Federal Reserve pressed private parties to prevent the collapse of Long-Term Capital Management, but no government money was used. In the spring of 2008, the Federal Reserve arranged for the sale of Bear Stearns to JPMorgan Chase. Although the sale was backed by \$28.2 billion of federal loans, much of the risk was borne by private parties.

With AIG, the Federal Reserve and Treasury broke new ground. They put U.S. taxpayers on the line for the full cost and the full risk of rescuing a failing company. During the Panel's meetings, the Federal Reserve and Treasury repeatedly stated that

they faced a “binary choice”: either allow AIG to fail or rescue the entire institution, including payment in full to all of its business partners. The government argues that AIG.s failure would have resulted in chaos, so that a wholesale rescue was the only viable choice. The Panel rejects this all-or-nothing reasoning. The government had additional options at its disposal leading into the crisis, although those options narrowed sharply in the final hours before it committed \$85 billion in taxpayer dollars.

For example, the federal government could have acted earlier and more aggressively to secure a private rescue of AIG. Government officials, fully aware that both Lehman Brothers and AIG were on the verge of collapse, prioritized crafting a rescue for Lehman while they left AIG to attempt to arrange its own funding. By the time the Federal Reserve Bank reversed that approach, leaving Lehman to collapse into bankruptcy without help and concluding that AIG posed a greater threat to financial stability, time to explore other options was short. The government then put the efforts to organize a private AIG rescue in the hands of only two banks, JPMorgan Chase and Goldman Sachs, institutions that had severe conflicts of interest as they would have been among the largest beneficiaries of a taxpayer rescue.

When that effort failed, the Federal Reserve decided not to press major lenders to participate in a private deal or to propose a rescue that combined public and private funds. As Secretary Geithner later explained to the Panel it would have been irresponsible and inappropriate in his view for a central banker to press private parties to participate in deals to which the parties were not otherwise attracted. Nor did the government offer to extend credit to AIG only on the condition that AIG negotiate discounts with its financial counterparties. Secretary Geithner later testified that he believed that payment in full to all AIG counterparties was necessary to stop a panic. In short, the government chose not to exercise its substantial negotiating leverage to protect taxpayers or to maintain basic market discipline.

There is no doubt that orchestrating a private rescue in whole or in part would have been a difficult – perhaps impossible – task, and the effort might have met great resistance from other financial institutions that would have been called on to participate. But if the effort had succeeded, the impact on market confidence would have been extraordinary, and the savings to taxpayers would have been immense. Asking for shared sacrifice among AIG.s counterparties might also have provoked substantial opposition from Wall Street. Nonetheless, more aggressive efforts to protect taxpayers and to maintain market discipline, even if such efforts had failed, might have increased the government.s credibility and persuaded the public that the extraordinary actions that followed were undertaken to protect them.

The rescue of AIG distorted the marketplace by transforming highly risky derivative bets into fully guaranteed payment obligations. In the ordinary course of business, the costs of AIG.s inability to meet its derivative obligations would have been borne entirely by AIG.s shareholders and creditors under the well-established rules of bankruptcy. But

rather than sharing the pain among AIG's creditors, an outcome that would have maintained the market discipline associated with credit risks. The government instead shifted those costs in full onto taxpayers out of a belief that demanding sacrifice from creditors would have destabilized the markets. The result was that the government backed up the entire derivatives market, as if these trades deserved the same taxpayer backstop as savings deposits and checking accounts.

One consequence of this approach was that every counterparty received exactly the same deal: a complete rescue at taxpayer expense. Among the beneficiaries of this rescue were parties whom taxpayers might have been willing to support, such as pension funds for retired workers and individual insurance policy holders. But the across-the-board rescue also benefitted far less sympathetic players, such as sophisticated investors who had profited handsomely from playing a risky game and who had no reason to expect that they would be paid in full in the event of AIG's failure. Other beneficiaries included foreign banks that were dependent on contracts with AIG to maintain required regulatory capital reserves. Some of those same banks were also counterparties to other AIG CDSs.

Throughout its rescue of AIG, the government failed to address perceived conflicts of interest. People from the same small group of law firms, investment banks, and regulators appeared in the AIG saga in many roles, sometimes representing conflicting interests. The lawyers who represented banks trying to put together a rescue package for AIG became the lawyers to the Federal Reserve, shifting sides within a matter of minutes. Those same banks appeared first as advisors, then potential rescuers, then as counterparties to several different kinds of agreements with AIG, and ultimately as the direct and indirect beneficiaries of the government rescue. The composition of this tightly intertwined group meant that everyone involved in AIG's rescue had the perspective of either a banker or a banking regulator. These entanglements created the perception that the government was quietly helping banking insiders at the expense of accountability and transparency....

The government's actions in rescuing AIG continue to have a poisonous effect on the marketplace. By providing a complete rescue that called for no shared sacrifice among AIG's creditors, the Federal Reserve and Treasury fundamentally changed the relationship between the government and the country's most sophisticated financial players. Today, AIG enjoys a five-level improvement in its credit rating based solely on its access to government funding on generous terms. Even more significantly, markets have interpreted the government's willingness to rescue AIG as a sign of a broader implicit guarantee of "too big to fail" firms. That is, the AIG rescue demonstrated that Treasury and the Federal Reserve would commit taxpayers to pay any price and bear any burden to prevent the collapse of America's largest financial institutions, and to assure repayment to the creditors doing business with them. So long as this remains

the case, the worst effects of AIG.s rescue on the marketplace will linger...

Through a series of actions, including the rescue of AIG, the government succeeded in averting a financial collapse, and nothing in this report takes away from that accomplishment. But this victory came at an enormous cost. Billions of taxpayer dollars were put at risk, a marketplace was forever changed, and the confidence of the American people was badly shaken.⁹¹

The US made a profit from the AIG bailout,⁹² although it should be recognized that the calculation here reflects only part of the relevant financial costs.⁹³

4.0 INSTITUTIONS OF TRANSNATIONAL FINANCIAL REGULATION

Rules of financial regulation, and the rules of private law which help to constitute cross-border transactions, are artefacts of domestic legal systems. However, activity which crosses territorial boundaries raises questions about what law applies, and how law applies to those transactions. Domestic regulators, legislatures and courts are actors in transnational financial law because of cross-border transactions and the cross-border characteristics of many financial firms.

Parties to transnational transactions can choose which rules of contract law apply to their transactions, subject to the risk that in a particular jurisdiction (with which the transaction is connected in some way) some rules of contract law or non-contract law will be treated as being mandatory and not able to be contracted around (for example, fiduciary duties, rules of securities regulation, and anti-trust law). Cross-border transactions raise issues of choice of law and jurisdiction, and domestic courts are involved in applying the relevant rules. Some cross-border transactions include arbitration provisions. Parties to transnational transactions can avoid the application of certain legal rules by avoiding connections with certain jurisdictions.

Financial regulators based in different jurisdictions increasingly work together to regulate transnational financial activity, through Memoranda of Understanding (MOUs), through transnational standard-setting organizations, and in the context of supervision and enforcement.

⁹¹ Congressional Oversight Panel, *The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy*, 7-10 (Jun. 10, 2010).

⁹² Department of the Treasury, *Citizens' Report: Office of Financial Stability—Troubled Asset Relief Program*, Fiscal Year 2013.

⁹³ See, e.g., James Kwak, *The Profitable Bailout? Inside the Real Costs of the Saving AIG and Wall St.*, *The Atlantic* (Sep. 12, 2012).

At the supranational level there are international organizations which have an interest in financial markets and financial regulation. Different organizations have different mandates and structures. Some inter-governmental organizations, such as the Basel Committee on Banking Supervision, IOSCO (International Organisation of Securities Commissions), and the IAIS (International Association of Insurance Supervisors) are essentially collaborative, technocratic organizations with the power to develop non-binding recommendations, principles and standards.

In contrast to intergovernmental/inter-regulator organizations, the European Union has supranational institutions which function like a legislature, creating rules which are binding on its Member States and on people and businesses within those Member States. Traditionally the EU legislated for financial regulation using directives which require implementation in the Member States and thus function as instructions to the Member States to introduce rules which give effect to the provisions of the directives. More recently the EU has moved to using more regulations.⁹⁴ Regulations take effect directly within the legal systems of the Member States without any need for, or possibility of, implementing action by the Member States (like a federal statute). And the EU has also developed a number of EU level agencies with responsibilities for supervising financial market activity: the European Systemic Risk Board,⁹⁵ and a set of sectoral supervisory authorities: the European Banking Authority (EBA),⁹⁶ the European Securities and Markets Authority (ESMA),⁹⁷ and the European Insurance and Occupational Pensions Authority (EIOPA).⁹⁸ These regulators were established in response to the global financial crisis, evolving from earlier EU institutions with more limited powers. And whereas much of the work of the agencies has involved working with the various national financial regulators, over time these bodies have acquired more direct regulatory responsibility, for example for benchmarks and credit ratings. This development is both an illustration of the EU's tendency to deepen over time, taking on more policy areas with more detailed centralized control, and a response to international regulatory challenges. In 2011,

⁹⁴ See, e.g., Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ No. L 302/ 1 (Nov. 17, 2009) at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0001:0031:EN:PDF> .

⁹⁵ See <https://www.esrb.europa.eu/home/html/index.en.html>.

⁹⁶ See <http://www.eba.europa.eu/> .

⁹⁷ See <http://www.esma.europa.eu/> .

⁹⁸ See <http://eiopa.europa.eu/> .

Michel Barnier, who was at the time a Commissioner whose portfolio involved working on the development of a single internal market within the EU, stated:

The crisis highlighted only too clearly the limits and sometimes the failings of our supervision system in Europe. The accumulation of excessive risk was not detected. Surveillance and supervision were not effective in time. When transnational financial institutions faced problems, the coordination between national authorities was far from optimal, and this even though these institutions are more and more numerous. Europe is learning the lessons from the crisis and that is why today, it is giving itself a new apparatus of surveillance and supervision. To detect problems early and to act in time – in a coordinated and efficient way. This new structure are the control tower and the radar screens that the financial sector needs... The European Systemic Risk Board will monitor the entire financial sector, to identify potential problems which could contribute to a crisis in the It will work in close cooperation with the new European Supervisory Authorities. These will not replace national authorities and our objective is not to transfer the control of financial institutions to the EU. Our aim is to create a network of authorities, where the national authorities are responsible for the daily surveillance, and the European authorities – using the expertise of the national authorities and working hand in hand with them – are responsible for coordination, monitoring and if need be arbitration between national authorities, and will contribute to the harmonisation of technical rules applicable to financial institutions.

With this new framework of financial supervision in Europe in place, we are putting into effect in practical terms the lessons learnt from the crisis. This framework is at the heart of the ongoing financial reforms. It is the foundation on which all other reforms are based – for example those for credit rating agencies, hedge funds, derivatives, stress tests etc. Together, these measures will enhance consumer protection. And they will contribute to ensuring the taxpayer is not again the first in line to bear the costs of a crisis.

This move forward also demonstrates that Europe is leading the way and upholding its international commitments. These new authorities will work with others across the world to ensure better global supervision.⁹⁹

In response to the European sovereign debt crisis the Eurozone (the EU countries which have adopted the euro as their currency)¹⁰⁰ agreed on a European Banking Union¹⁰¹

⁹⁹ EU Commission, a Turning Point for the European Financial Sector, MEMO/11/1 (Jan. 1, 2011).

¹⁰⁰ See, e.g., https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area_en. Denmark has an opt-out with respect to the euro; Bulgaria, the Czech Republic, Hungary, Poland, Romania and Sweden are not yet part of the euro area, but the other EU member States are in the

with a single supervisory mechanism for its banks,¹⁰² administered by the European Central Bank (ECB). The Eurozone has a Single Resolution Mechanism for banks in the European Banking Union, administered by the Single Resolution Board.¹⁰³ Although a European Deposit Insurance Scheme¹⁰⁴ was part of the Banking Union plan, the European Banking Union does not yet include such a scheme. Deposit Insurance in the EU is decentralized, administered by the Member States, subject to some harmonization.¹⁰⁵

The IMF is a treaty-based international organization which was founded in 1944 to govern the international monetary system to assure exchange rate stability and encourage IMF members to do away with exchange restrictions.¹⁰⁶ The IMF lends money to its member countries when they have needs for funding they are not able to meet in the financial markets. The financial crisis increased demand for funds from the IMF: for example, Iceland benefitted from the IMF's ability to engage in crisis lending.¹⁰⁷ As part of its lending programs, the IMF examines the economies of the countries to which it lends, including their bank regulatory

Eurozone. These are Austria, Belgium, Croatia, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

¹⁰¹ In late 2018 the EU Parliament and Council reached provisional agreement on changes to the rules for the European Banking Union. See EU Commission Press Release, Completing the Banking Union: Commission Welcomes Political Agreement to Further Reduce Risks in the EU Banking Sector (Dec. 4, 2018).

¹⁰² See, e.g., <https://www.bankingsupervision.europa.eu/home/html/index.en.html>.

¹⁰³ See <https://srb.europa.eu/en/content/single-resolution-mechanism-srm>.

¹⁰⁴ See, e.g., Commission Communication on completing the Banking Union, COM (2017) 592 final (Oct. 11, 2017) at 5-6 (“a single European Deposit Insurance Scheme (EDIS) remains one of the missing pieces. All depositors within Banking Union should enjoy the same level of protection. In this way, the European Deposit Insurance Scheme would underpin stability in the banking sector by providing strong and uniform insurance coverage for all such depositors, independent of their geographical location in the Banking Union.”)

¹⁰⁵ See Directive 2014/49/EU on Deposit Guarantee Schemes, O.J. L173/149 (Jun. 12, 2014).

¹⁰⁶ You can find the Articles of Agreement of the International Monetary Fund at <http://www.imf.org/external/pubs/ft/aa/index.htm>.

¹⁰⁷ See, e.g., IMF, IMF Completes First Review Under Stand-By Arrangement with Iceland, Extends Arrangement, and Approves US\$167.5 Million Disbursement, Press Release No. 09/375 (Oct. 28, 2009) at <http://www.imf.org/external/np/sec/pr/2009/pr09375.htm>; IMF, Iceland: Financial System Stability Assessment—Update, IMF Country Report No. 08/368 (Dec. 2008).

systems.¹⁰⁸ The IMF's interest in monitoring the financial soundness of its members, especially of its borrowers, gives it an interest in regulation as a mechanism for promoting financial stability. The IMF has been criticized with respect to the requirements it imposes on borrowing countries. For example, commentators have argued that requiring privatization can be harmful: requiring privatization of the water industry tends to lead to charges for the provision of clean water which means that poor people do not have access to clean water.¹⁰⁹ The IMF reacted to criticisms of such policies (IMF conditionality) and began to emphasize transparency as an accountability mechanism.¹¹⁰ Some critics argue that the IMF has not really reformed and that it still engages in problematic conditionality.¹¹¹

Ten years before the global financial crisis, the Asian financial crisis¹¹² led to the

¹⁰⁸ Consider the comments of Poul Thomsen, the IMF's mission chief for Iceland: "Iceland allowed a very oversized banking system to develop—a banking system that significantly outstripped the authorities' ability to act as a lender of last resort when the system ran into trouble. Only a few years ago, Iceland had a banking system that was the normal size. But after the privatization of the banking sector was completed in 2003, the banks increased their assets from being worth slightly more than 100 percent of GDP to being worth close to 1,000 percent of GDP. When confidence problems intensified this fall, Iceland was one of the first victims because the market realized that the banking system was far too big relative to the size of the economy. As investors started to pull out, it quickly spilled over into trouble for the Icelandic króna. Within a week the three banks collapsed, the króna's value dropped by more than 70 percent, and the stock market lost more than 80 percent of its value. For a small economy that is totally dependent on imports, this was a crisis of huge proportions." Camilla Andersen, *Iceland Gets Help to Recover From Historic Crisis*, IMF Survey Online (Dec. 2, 2008) available at <http://www.imf.org/external/pubs/ft/survey/so/2008/int11908a.htm>.

¹⁰⁹ Cf. Thomas Stubbs & Alexander Kentikelenis, *International Financial Institutions and Human Rights: Implications for Public Health*, *Public Health Reviews* (2017) 38:27.

¹¹⁰ See, e.g., IMF, *Transparency is Key to Accountability* (Jan. 11, 2010) at <http://www.imf.org/external/np/exr/cs/news/2010/cso110.htm>, IMF, *Transparency at the IMF* (Sep. 16, 2022) at <https://www.imf.org/en/About/Factsheets/Sheets/2016/07/27/15/35/Transparency-at-the-IMF>.

¹¹¹ See, e.g., Alexander E. Kentikelenis, Thomas H. Stubbs, & Lawrence P. King, *IMF Conditionality and Development Policy Space 1985-2014*, 23 *Review of International Political Economy* 543 (2016). For some discussion of changing approaches to conditionality over time, see, e.g., Jung Yeon Kim & Kwang Yeon Lee, *Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs*, IEO Background Paper, BP/21-01/04 (Jun. 30, 2021).

¹¹² See, e.g., IMF, *Recovery from the Asian Crisis and the Role of the IMF* (Jun. 2000) at <http://www.imf.org/external/np/exr/ib/2000/062300.htm> ("The crises that began in Thailand with a series of speculative attacks on the baht unfolded after several decades of outstanding economic performance in Asia. Although the circumstances varied among the countries concerned, the difficulties stemmed primarily from a combination of macroeconomic imbalances (even though government budgets were broadly in balance and inflation rates were modest), external developments, and weakness in financial and corporate systems. The external imbalances were a reflection both of strong private capital inflows and of high domestic private investment rates, and were exacerbated, prior to the crisis, by appreciation of

development of the Financial Stability Forum (FSF), which was established in 1999. The FSF was designed to bring together representatives of national central banks, supervisory authorities and treasury departments, international financial institutions (e.g. the IMF and the World Bank), international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank. In 2009 the FSF was reborn as the Financial Stability Board:¹¹³

In April 2009 the **G20** issued a **Declaration on Strengthening the International Financial System** which stated:

We, the Leaders of the G20, have taken, and will continue to take, action to strengthen regulation and supervision in line with the commitments we made in Washington to reform the regulation of the financial sector. Our principles are strengthening transparency and accountability in financial markets and reinforcing international cooperation.... In particular, we have agreed the following major reforms.

We have agreed that the Financial Stability Forum should be expanded, given a broadened mandate to promote financial stability, and re-established with a stronger institutional basis and enhanced capacity as the Financial Stability Board (FSB).

The FSB will:

- assess vulnerabilities affecting the financial system, identify and oversee action needed to address them;
- promote co-ordination and information exchange among authorities responsible for financial stability;
- monitor and advise on market developments and their implications for regulatory policy;
- advise on and monitor best practice in meeting regulatory standards;
- undertake joint strategic reviews of the policy development work of the international Standard Setting Bodies to ensure their work is timely, coordinated, focused on priorities, and addressing gaps;
- set guidelines for, and support the establishment, functioning of, and participation in, supervisory colleges, including through ongoing identification of the most systemically important cross-border firms;
- support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- collaborate with the IMF to conduct Early Warning Exercises to identify and report to the IMFC and the G20 Finance Ministers and Central Bank Governors on the build up

the U.S. dollar to which the currencies of the countries concerned were formally or informally pegged.”)

¹¹³ See <http://www.financialstabilityboard.org/> .

of macroeconomic and financial risks and the actions needed to address them.

Members of the FSB commit to pursue the maintenance of financial stability, enhance the openness and transparency of the financial sector, and implement international financial standards (including the 12 key International Standards and Codes), and agree to undergo periodic peer reviews, using among other evidence IMF / World Bank public Financial Sector Assessment Program reports. The FSB will elaborate and report on these commitments and the evaluation process.

We welcome the FSB's and IMF's commitment to intensify their collaboration, each complementing the other's role and mandate.¹¹⁴

The G20 also agreed to strengthen international co-operation and prudential regulation, to ensure systemically important institutions are subject to regulation, "to ensure compensation structures are consistent with firms' long-term goals and prudent risk taking," to deal with tax havens and territories which do not comply with money laundering controls, to improve accounting standards, and to regulate credit rating agencies more effectively.

The Financial Stability Board works with the G20, regularly updating the G20 on progress in improving financial regulation.¹¹⁵ The FSB works with standard-setting bodies to develop principles and standards of financial regulation,¹¹⁶ and also engages in peer review to evaluate implementation of international standards in specific jurisdictions,¹¹⁷ or more generally.¹¹⁸

The World Bank does not have a specific focus on financial regulation, but it is generally interested in issues relating to development and poverty reduction, and these interests have implications for transnational finance. For example the World Bank has an interest in reducing corruption,¹¹⁹ and one issue relating to corruption involves the proceeds of

¹¹⁴ See <http://www.g20.utoronto.ca/2009/2009ifi.pdf> .

¹¹⁵ See, e.g., FSB Reports to G20 Leaders on Progress in Financial Regulatory Reforms (Nov. 28, 2018).

¹¹⁶ See, e.g., Financial Stability Board, Crypto-assets: Report to the G20 on the Work of the FSB and Standard-setting Bodies (Jul. 16, 2018).

¹¹⁷ See, e.g., Financial Stability Board, Peer Review of Singapore (Feb. 26, 2018).

¹¹⁸ See, e.g., Financial Stability Board, Thematic Review on Corporate Governance (Apr. 28, 2017).

¹¹⁹ See, e.g., Combating Corruption at <http://www.worldbank.org/en/topic/governance/brief/anti-corruption> ("Much of the world's costliest forms of corruption could not happen without institutions in wealthy nations: the private sector firms that give large bribes, the financial institutions that accept corrupt proceeds, and the lawyers and accountants who

corruption being located in foreign jurisdictions. Encouraging financial inclusion is also related to poverty reduction, and the World Bank, with other actors, has focused on Fintech as a component of promoting financial inclusion.¹²⁰ The World Bank has also been more generally interested in financial law and corporate governance as aspects of governance seen as crucial to economic development.¹²¹ A 2008 working paper stated:

The process of globalization and financial development has been prone to crises. Over the long run, financial development is expected to support economic growth and poverty reduction. But, along the way, even relatively mature financial systems are vulnerable to systemic banking crises, cycles of booms and busts, and financial volatility. This appears to be partly intrinsic and partly due to policy mistakes. It arises as banks expand and capital markets generate new financial products. This entails new, unfamiliar, risks for financial intermediaries and regulators. Furthermore, as countries become more open to capital flows, crises are more easily transmitted across borders. The positive long-run relationship between financial development and growth coexists with a negative short-run relationship through financial fragility...

The most direct channel linking the developed world to the financial crisis emanating from the developed world in 2008 is through exposure to assets that are at the heart of the crisis, notably (though not only) the sub-prime mortgages. However, the more important channels for most developing countries will probably be indirect, notably through trade (via declining demand for developing- country exports or declining export process, including commodities), investment (as external finance contracts) and remittances (also stemming from the recession in the developed world).¹²²

Other UN agencies have been involved in the negotiation of treaties which have an impact on financial transactions. For example, UNCITRAL, the United Nations Model Commission on International Trade Law, has worked on insolvency, including a Model Law on

facilitate corrupt transactions. Data on international financial flows shows that money is moving from poor to wealthy countries in ways that fundamentally undermine development.”)

¹²⁰ See, e.g., IMF & World Bank, The Bali Fintech Agenda: Chapeau Paper (Sep. 19, 2018).

¹²¹ See, e.g., Asli Demirgüç-Kunt & Ross Levine, Finance, Financial Sector Policies, and Long-run Growth, World Bank Policy Research Working Paper No. 4469 (Nov. 2008) available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/01/07/000158349_20080107115116/Rendered/PDF/wps4469.pdf.

¹²² The World Bank, Development Research Group, Lessons from World Bank Research on Financial Crises, 3-4, Policy Research Working Paper 4779 (Nov. 2008).

Cross-Border Insolvency,¹²³ and in other trade related areas, including a Convention on the Assignment of Receivables in International Trade.¹²⁴

Non-UN international organizations may also be involved in developing harmonized standards relevant to financial transactions. For example, Unidroit, the International Institute for the Unification of Private Law, has developed a Convention on Substantive Rules for Intermediated Securities (securities held not directly by investors but indirectly through an intermediary such as a broker) (the Geneva Securities Convention).¹²⁵ The OECD focuses on a range of issues relating to financial markets from general financial markets issues¹²⁶ to corporate governance¹²⁷ and investor education.¹²⁸

These interactions between domestic and supranational institutions can be seen as forming a system of multi-level governance or regulatory networks for financial market activity. Here is an excerpt from a paper discussing some of the issues that arise in multi-level systems:¹²⁹

Over time, supranational standard-setters have begun to formalise their standard-setting processes, developing their practices for consulting on proposed standards, and even establishing consultation policies.¹³⁰ However, the different organizations approach consultation and the reporting of the results of consultation differently,¹³¹ and

¹²³ See https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency. See also, e.g., <https://globalinsolvency.com/>.

¹²⁴ See <https://uncitral.un.org/en/texts/securityinterests/conventions/receivables>.

¹²⁵ See <https://www.unidroit.org/capital-markets#GenevaSecuritiesConvention>

¹²⁶ See <http://www.oecd.org/finance/>.

¹²⁷ See <http://www.oecd.org/corporate/>.

¹²⁸ See <http://www.oecd.org/daf/fin/financial-education/>.

¹²⁹ Caroline Bradley, Financial Trade Associations and Multilevel Regulation. A version of this paper was published in Ramses Wessel, Andreas Follesdal & Jan Wouters eds., *Multilevel Regulation and the EU: The Interplay between Global, European and National Normative Processes* (2008) (footnote numbering adjusted for this document).

¹³⁰ See, e.g., IOSCO, Executive Committee, *IOSCO Consultation Policy And Procedure*, (Apr. 2005) available at http://www.iosco.org/librar_y/pubdocs/pdf/IOSCOPD197.pdf. Cf. R. D. Kelemen & Eric C. Sibbitt, *The Globalization of American Law*, 58 INT'L ORG. 103 (2004)

¹³¹ See generally, e.g., C. Bradley, *Private International Law-Making for the Financial Markets*, 29 FORDHAM INT'L L. J. 127, 140-154 (2005).

there is, so far, no harmonised supranational administrative law.¹³² Consultation processes which exclude groups which are affected by harmonised rules because of a lack of transparency,¹³³ or because the issues are framed in ways which make the views of affected groups seem irrelevant, lack legitimacy. Consumers and the organisations which represent their interests are more likely than financial firms to be excluded from effective participation in supranational standard-setting due to the combined effects of opaque processes, framing, and lack of resources. Some harmonised rules are set out in binding legal instruments, others are only hortatory. Even the EU's binding harmonisation measures sometimes leave to the Member States some discretion about how to implement the directives within their domestic legal systems.¹³⁴ Non-binding standards developed by bodies such as IOSCO may be implemented differently by different states, or may not be implemented at all.¹³⁵ However, even formally hortatory standards derive greater force, and become harder for domestic legislators and regulators to ignore, because international financial institutions (IFIs) such as the IMF encourage governments to adopt these standards.¹³⁶ Financial regulation involves complex issues of regulatory jurisdiction, in which jurisdiction is allocated horizontally between authorities in different territorial areas,¹³⁷ and vertically between authorities at different hierarchical levels within states, and at the

¹³² See, e.g., B. Kingsbury, N. Krisch, and R. B. Stewart, *The Emergence of Global Administrative Law*, 68 LAW AND CONTEMPORARY PROBLEMS 15, 16 (2005) (noting "an accountability deficit in the growing exercise of transnational regulatory power.")

¹³³ Cf. EU Commission, Green Paper: European Transparency Initiative, COM (2006) 194, May 3, 2006.

¹³⁴ Firms have suggested that the UK is too prone to "gold-plate" its rules: going further than is required by the directives. Cf. Financial Services Authority (hereafter "FSA"), *Better Regulation Action Plan*, London: FSA, December 2005, at p. 6 ("Our basic approach is to 'copy out' the text in our Handbook, adding interpretive guidance where that will be helpful. This avoids placing unintended additional obligations on firms. We will not gold-plate EU requirements. We will only add additional requirements when these are justified in their own right.")

¹³⁵ See, e.g., D. E. Alford, *Core Principles for Effective Banking Supervision: an Enforceable International Financial Standard?*, 28 B. C. INT'L & COMP. L. REV. 237, 286 (2005) ("because the agreements are not legally enforceable, nations can vary in their own interpretation and implementation of the standards.")

¹³⁶ See, e.g., *idem* at pp. 286-289.

¹³⁷ In some states, such as the US, jurisdiction is also splintered among different functional regulators. See, e.g., H. M. Schooner and M. Taylor, *United Kingdom and United States Responses To the Regulatory Challenges of Modern Financial Markets*, 38 Tex. Int'l L. J. 317 (2003)

supranational (regional or global) levels.¹³⁸ Within a domestic legal system the source for a rule of financial regulation may be sub-national, national, or supranational. Rules for the allocation of regulatory jurisdiction are established in statutes and treaties, but there can be uncertainty about the proper interpretation of the rules.¹³⁹

Standards which are formally harmonised at the supranational level usually need to be implemented within domestic regulatory systems. Implementation is sometimes multilayered and indirect. For example, the Basle Committee has developed capital adequacy standards for banks involved in international banking.¹⁴⁰ Within the EU, capital adequacy requirements are an aspect of harmonised regulation of credit institutions, and the EU's capital adequacy rules are being amended to reflect the new Basle standards.¹⁴¹ Competent authorities within the Member States are responsible for adjusting domestic capital adequacy requirements to reflect the new Basle standards as reflected in EU implementing measures.¹⁴²

Where domestic legislators and regulators have discretion about how they carry out implementation, there are usually multiple points for influencing the regulatory process. Many different actors have a stake in the outcomes of these multi-level or multi-stage regulatory processes, from financial firms and their advisors to corporate and individual consumers of financial services.¹⁴³ But some stakeholders are in a better position to

¹³⁸ The complex web of regulation includes a significant component of privately generated standards and codes and contracts which may have quasi-regulatory effects. See, e.g., Bradley, *loc. cit.* note [131](#) at pp. 158-179.

¹³⁹ Cf. S. Issacharoff and C. M. Sharkey, *Backdoor Federalization*, 53 *UCLA L. Rev.*, 2006, p. 1353 at p. 1366 ("preemption battles have been largely confined to the realm of statutory interpretation.")

¹⁴⁰ BIS, Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version*, Basel: BIS, June 2006.

¹⁴¹ See 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, O.J. No. L177/1, June. 30, 2006. The Committee of European Banking Supervisors (hereafter CEBS) has sought comments on details of the implementation of the new rules. See, e.g., CEBS, *Consultation Paper on the Guidelines for a Common Approach to the Recognition of External Credit Assessment Institutions (ECAIS)*, CP07, London: CEBS, June 29, 2005.

¹⁴² See, e.g., FSA, *Strengthening Capital Standards*, CP 05/03, London: FSA, January 2005.

¹⁴³ The decision-makers in the supranational bodies also have a stake in the regulatory process, as do legislators and regulators. Cf. Braithwaite & Drahos, *Global Business Regulation*, Cambridge: Cambridge University Press, 2000, at 23 ("Each regulatory domain has a distinct range of actors contending for victory at different sites.")

influence regulatory outcomes because of superior financial and other resources. Financial trade associations (“FTAs”) and their members now take advantage of opportunities to influence regulatory policy within multi-level systems. In particular, FTAs use two rhetorical strategies that tend to promote the interests of their members and which work against the interests of consumers. The first of these strategies is “market protection rhetoric.” In relation to rule-making at the domestic or supranational level, FTAs often invoke arguments that particular proposals will interfere with the proper functioning of the financial markets. Market protection rhetoric is based in claims of expertise and usually implies that those invoking it are in a unique position to understand the market. Market protection rhetoric includes arguments for self-regulation based on expertise.

The FTAs’ other routine strategy relies on “harmonisation rhetoric,” which is invoked in the context of domestic regulatory action.¹⁴⁴ Harmonisation rhetoric involves an argument that the rules in one domestic jurisdiction should not be stricter than those in another. The argument appears in the context of implementation of supranational standards or rules (for example, arguments against gold-plating when implementing EU directives)¹⁴⁵ and also arises to oppose rules proposed by domestic regulators that lack a supranational source. Harmonisation rhetoric can be seen as a subset of market protection rhetoric because those who invoke it would argue that more onerous rules in one jurisdiction limit the ability of firms established there to compete with firms established elsewhere. Harmonisation rhetoric may also include arguments for self-regulation, on the basis that self-regulatory standards and codes may be able to operate more effectively across territorial boundaries than state-based regulation.¹⁴⁶ Although the characterization of financial regulation as a system of multi-level

¹⁴⁴ Harmonisation rhetoric is only necessary in the context of the development of supranational rules and standards in order to limit the discretion of the implementing authorities.

¹⁴⁵ See, e.g., S. Schaefer and E. Young, *Burdened by Brussels or the UK? Improving the Implementation of EU Directives*, London: Foreign Policy Centre, August 2006, at pp 10-11 (“Rules agreed at the EU level are vital for the proper functioning of the single market. But they can also hamper competitiveness and productivity if they add a differently sized burden in individual member states because they have been implemented in different ways. Gold-plating, as defined by an ongoing audit by HM Treasury, is part of a larger category of over-implementation which also includes double-banking or regulatory creep.”)

¹⁴⁶ Cf. N. S. Poser, *The Stock Exchanges of the United States and Europe: Automation, Globalization and Consolidation*, 22 U. Penn. J. Int’l Econ. L. 497, 538 (2001) (“These are not rules promulgated by a government agency, but by contractual arrangements among the participants. This suggests that self-regulation has the ability to finesse the problems of national sovereignty and differing legal systems that stand in the way of developing and enforcing common governmental regulatory standards.”)

governance is useful in some ways, and links to multi-level governance in other fields, the idea of multi-level governance does not fully capture the ways in which transnational financial regulation is developing.¹⁴⁷

... it is useful to characterize transnational financial regulation as a series of intersections between different regulatory spheres rather than as a multi-layered regime for four sets of reason. First, whereas constitutional or treaty-based systems explicitly or implicitly allocate the jurisdiction to make rules to different levels of the system, most transnational financial regulation involves the establishment of agreed, but formally non-binding, standards, rather than an allocation of jurisdiction to make rules. The relationships between the supranational bodies and nation states are qualitatively different from those between the states and their component entities. Second, characterizing the regulatory system as a system of layers may tend to generate normative conclusions about where jurisdiction to regulate financial activity should be exercised.¹⁴⁸ Thinking about regulatory spheres might be less likely to generate such a result. Third, the terminology of layers or levels tends to imply that the relevant issues involve vertical relationships, whereas thinking in terms of regulatory spheres invites us to think in terms of more complex, and more descriptively realistic, categories of relationship. Finally, any implication that transnational standard-setting is at the top of a regulatory hierarchy is problematic when transnational standard-setting is not subject to administrative law norms or mechanisms for judicial review, and where transnational standard-setters themselves set the principles by which they develop their standards. The intersections I explore in this paper are those between governmental and non-governmental or private spheres; between the spheres of expertise and of politics; and between the domestic and foreign or international spheres....

Financial regulation has both governmental and non-governmental components. In the administrative state, regulators seek comments on regulatory proposals. Financial regulatory systems include self-regulatory organizations (SROs) as well as governmental regulators, and accommodate privately generated standards and codes. SROs are involved both in the generation of rules and in the enforcement of regulation. Courts interpret and apply standard form contracts generated by non-governmental bodies in ways that sometimes seem to be the equivalent of recognizing the law-

¹⁴⁷ What follows is from Caroline Bradley, *Intersections and Layers in Financial Regulation* (April 2009 draft).

¹⁴⁸ Discussions of pre-emption and subsidiarity tend to assume that there is an appropriate location for jurisdiction with respect to a particular issue. But jurisdiction involves choices which are inherently political.

making effect of actions of private actors.¹⁴⁹

Private regulation of financial activity precedes governmental control:¹⁵⁰ exchanges have traditionally controlled the conduct of their members and were incorporated into governmental regulatory systems in order to make governmental regulation more palatable to market participants. A recent and voluminous literature on regulation has advocated a decentring of regulation and a move away from command and control forms of regulation. The financial crisis has for some policy-makers raised issues about the appropriate balance between self-regulation and governmental regulation. The term "self-regulation" has been used in different ways in different contexts,¹⁵¹ and comparing and contrasting self-regulation and governmental regulation, and defining the relationships between them, are complex tasks. The official terminology that legislators and other governmental and inter-governmental actors use to describe a regulatory system is not always a reliable descriptor of the system, and may even be designed to allow different communities to interpret the balance between governmental and non-governmental authorities differently. For example, as part of its work on the development of transnational standards for securities regulation, IOSCO has focused on the role of credit rating agencies (CRAs) in analyzing the credit risk of issuers of securities. Although IOSCO has presented the work it has done with respect to developing principles and fundamentals for the regulation of CRAs as encouraging self-regulation, CRAs were only part of the story. The initial consultation document on fundamentals for CRA Codes of Conduct noted that it had been developed with input from CRAs.¹⁵² But IOSCO is an organization of securities commissions; in seeking to develop rules for CRAs, IOSCO sought input from two other inter-governmental regulator organizations, the Basel Committee of Banking Supervisors, and the International Association of Insurance Supervisors.¹⁵³ The system developed for the

¹⁴⁹ For example, courts have recognized and given effect to standard form contracts and practices in the distressed debt market. See, e.g., *Bear Stearns Bank PLC v Forum Global Equity Ltd.* [2007] EWHC 1576 (Comm) at <http://www.bailii.org/ew/cases/EWHC/Comm/2007/1576.html>.

¹⁵⁰ See, e.g., Paul Mahoney, *The Exchange as Regulator*, 83 VA. L REV. 1453, 1457 (1997).

¹⁵¹ See Caroline Bradley, *Reconfiguring the Self in Self-Regulation* (Draft: October 5, 2008) available at <http://blenderlaw.umlaw.net/wp-content/uploads/2008/10/bradleyselfart008.pdf> (examining the concept of the self in self regulation).

¹⁵² IOSCO, Code Of Conduct Fundamentals For Credit Rating Agencies, Consultation Report from the Technical Committee Chairmen Task Force on CRAs (Oct. 2004) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD173.pdf>.

¹⁵³ *Id.*

“self-regulation” of CRAs involved standards developed through a mixed governmental and non-governmental process, to be implemented by CRAs but subject to the supervision of some domestic regulators.

The term "self-regulation" is inherently slippery and imprecise, combining two apparently conflicting ideas. It is a term which may disguise a regulatory structure in which there is more governmental control than market participants might think desirable, and more independence from governmental control than the public and, in particular retail consumers of financial services, might want. Statutory constraints on SROs limit self-regulation, allow governments to distance themselves from regulatory failures, and restructure the competitive landscape of markets.

Some non-governmental groups, such as exchanges and trade associations, exercise regulatory or quasi -regulatory authority. In addition, firms and their trade associations lobby to influence the development of regulation by governmental regulatory agencies. Financial firms and the trade associations which represent them have for some time used two inter-linked rhetorical strategies to influence the development of transnational financial regulation, which I have called harmonization rhetoric and market protection rhetoric.¹⁵⁴ Market protection rhetoric involves claims that governmental regulation should not interfere too much with market activity, and governments have been receptive to such arguments, for example when they have adopted Better Regulation agendas.¹⁵⁵ On the other hand, the transnational financial market crisis has created pressure for more governmental regulation.

In some areas, such as the regulation of money laundering and controls imposed on alleged terrorists, financial regulation is used as a tool of criminal or security law. Here, we see a different relationship between the government and non-governmental entities, as financial firms are enrolled as gatekeepers and monitors in relation to the activities of their customers. Participating in law enforcement is part of the price of the financial firm’s license to do business.

In many ways, therefore, governmental authorities and non-governmental participants in the financial markets negotiate their respective roles in the control of financial activity. And the results of such negotiations vary in different places and at different times, and even with respect to different types of activity....

Formal financial regulation is constructed in two modes: the political and the technocratic. Legislatures may focus on financial regulation as part of a program of

¹⁵⁴ See, e.g., Caroline Bradley, *Financial Trade Associations and Multilevel Regulation*, in Ramses Wessel, Andreas Follesdal & Jan Wouters eds., *MULTILEVEL REGULATION AND THE EU: THE INTERPLAY BETWEEN GLOBAL, EUROPEAN AND NATIONAL NORMATIVE PROCESSES* (2008).

¹⁵⁵ See, e.g., Financial Services Authority, *Better Regulation Action Plan*, London: FSA, December 2005.

restructuring and updating regulation more generally, or they may legislate with respect to the financial markets as a result of scandals and crises. However, much of the time rules of financial regulation are developed by means of administrative rule-making, a technocratic process where the power to make detailed rules is delegated to bodies with expertise in particular areas. Administrative agencies are not immune to politics, as they are subject to political control: legislatures set the constraints within which they operate, and politicians appoint the people who run the agencies. The funding arrangements for agencies may be designed to give them more or less freedom from political control.¹⁵⁶

Many areas of financial regulation involve combinations of issues which are technical (and of little obvious interest to consumers) and issues which are directly relevant to consumers. Before the financial crisis it was not obvious that consumers of financial services generally should care too much about the details of capital adequacy regulation of financial institutions. But as the crisis has unfolded it has become clear that individual consumers' ability to borrow money and the value of their retirement funds were connected in fundamental ways to issues of confidence in financial institutions and the markets. Crises clearly complicate regulatory policy-making by politicizing realms which in other times belong to technocrats and those they regulate, but, even in ordinary times, a more effective, and more legitimate, regime for financial regulation might recognize the inherently political (as well as technical) characteristics of financial regulation.

At the supranational level, whether standard-setters emphasize the technical aspects of their activities or the possible impact on a range of stakeholders beyond financial firms may have a significant impact on whether stakeholders other than financial firms decide to become involved in debating appropriate standards and rules. If financial firms and their trade associations, using market protection rhetoric, successfully induce standard-setters to view their work as involving only technical standards, consumers are less likely to comment on any proposed rules and standards and, as a result, their interests are less likely to be taken into account. Domestic regulators' ability to adopt this perspective is affected by their ability (or lack of ability) to ignore the political implications of their actions. But supranational standard setters such as IOSCO and the Basel Committee are inherently more insulated from the political sphere than are most domestic financial regulators. And, to the extent that standards decisions taken at the supranational level in technocratic rather than political fora are treated as pre-empting the ability of national (and sub-national) authorities to develop rules which deviate from the supranational standards, consumer-voter-taxpayers' interests are prejudiced....

¹⁵⁶ For example, whereas the OCC can fund its own operations from its revenues without depending on Congressional appropriations, the SEC depends on them.

Financial regulation involves complex issues of the division of functions between different authorities. Jurisdiction to prescribe and enforce regulations is allocated horizontally between authorities in different territorial areas, and vertically between authorities at different hierarchical levels within states, and at the supranational (regional or global) levels. Within a domestic legal system the source for a rule of financial regulation may be sub-national, national, or supranational.

Financial activity and transactions are visibly transnational at the wholesale and even at the retail level. The development of the remittance market illustrates that even people who are not very wealthy may engage on a regular basis in transnational financial transactions. But although financial activity is often transnational, the rules of financial regulation, and the rules of private law which help to constitute cross-border transactions, are artefacts of domestic legal systems. Thus domestic regulators, legislatures and courts are actors in transnational financial law because of cross-border transactions. From the perspective of enforcement of financial regulation, financial regulators based in different jurisdictions increasingly work together through Memoranda of Understanding (MOUs), through transnational standard-setting organizations, and in the context of supervision and enforcement. Financial firms and their trade associations often argue for harmonization of regulation in order to reduce disparities in regulation and the concomitant compliance costs or competitive inequalities.¹⁵⁷

The rate and volume of harmonization of financial regulation continue to increase thanks to multiple initiatives and to the recent financial crisis. Major international efforts include the work of IOSCO, the Basle Committee on Banking Supervision, and the IAIS to develop harmonized principles of financial regulation and the EU's effort to achieve a single market in financial services.¹⁵⁸ Although the EU's rules often leave very little discretion as to implementation to EU Member States, as a practical matter, as states act to implement supranational standards at the domestic level, they usually have a significant amount of discretion to adapt the standards to local conditions. Often supranational standards are drafted as very general (or "high-level") principles leaving significant scope for the exercise of discretion in implementation. Where such discretion exists, financial firms and their trade associations have double opportunities

¹⁵⁷ See, e.g., Italian Banking Association, response to CEBS' draft of high-level principles on Remuneration Policies (Apr.6, 2009) ("any initiative at EU level should preferably take into account progress at the international level. Indeed the Banking Industry operates in a global environment and as such there is a need for a coordinated response from regulators. Any initiatives which only impact banks headquartered in Europe could put those firms at a competitive disadvantage.")

¹⁵⁸ See, e.g., EU Commission, *Financial Services: Implementing the Framework for Financial Markets: Action Plan*, COM (1999) 232, May 11, 1999.

for lobbying to affect the rules which are adopted: they can lobby at the supranational level when the standards are agreed and again at the national level when the standards are transformed into domestic law. Financial firms and trade associations are in a better position than other stakeholders to influence regulatory outcomes because they have superior financial and other resources.

Within a federal or federal-type system, the foundational documents will set principles for the allocation of jurisdiction to make rules about various matters. Although the interpretation of these documents by courts and legislators may be fluid and involve political assessments and may change over time, there is an underlying set of agreements about the allocation of jurisdiction. The transnational system for the regulation of financial activity does not (yet) involve such foundational documents or even agreements. Governmental authorities in different jurisdictions work together in groups with varying memberships to establish standards which have a greater coercive impact on some states than on others. Whereas IOSCO has 109 ordinary members, the Basle Committee has 20.¹⁵⁹ But while the standards developed by IOSCO and the Basel Committee are formally not binding, the IMF encourages states to implement the standards (including states which are not able to participate directly in developing the standards) through its Standards and Codes initiative.

The processes for developing supranational standards of financial regulation are not inclusive, and tend to privilege the wealthiest countries. Although the Basel Committee's recent expansion of its membership shows some sensitivity to this issue, it is still a very select group. Supranational standard setters have responded to critiques of their legitimacy by developing more formal processes, by consulting on proposed standards, and even by establishing consultation policies.¹⁶⁰ However, despite these developments, there are still some very visible differences between consultations carried out by supranational bodies and those carried out by domestic regulators (or even by EU institutions).¹⁶¹ Although the supranational standard setters may voluntarily undertake to comply with what they understand to be best practices with respect to consultation, their actions are not subject to any kind of judicial review at the

¹⁵⁹ The Basel Committee expanded its membership in March 2009 including Australia, Brazil, China, India, Korea, Mexico and Russia. Basel Committee, Expansion of Membership Announced by the Basel Committee (Mar. 13, 2009) available at <http://www.bis.org/press/p090313.htm> .

¹⁶⁰ See, e.g., IOSCO, Executive Committee, *IOSCO Consultation Policy And Procedure*, IOSCO: Madrid, April 2005.

¹⁶¹ The EU still has a noticeable democratic deficit but its processes for consultation are formalized, and subject to judicial review (although individuals may find it difficult to establish standing to challenge EU acts in the CFI).

supranational level.¹⁶²

Consultation at the supranational level may be more or less meaningful. The Basel Committee has published documents which are described as consultation documents but which do not explicitly invite comments.¹⁶³ The documents may not even provide a name or an address of a person who is willing to receive comments. When the Basel Committee publishes final versions of documents based on prior consultative documents it may not acknowledge comments or explain why the final version of the document deviates from the consultation version.¹⁶⁴

Defects in the processes for developing supranational standards matter because financial trade associations seek to invoke harmonization rhetoric at the national level when states are implementing supranational standards, arguing that domestic regulators should not impose more restrictive rules than those provided for in the standards or by other domestic regulators which are implementing them. In the EU, for example, financial firms have argued that the UK authorities should not “gold-plate” measures which implement EU directives.¹⁶⁵ Financial firms and their trade associations use harmonization rhetoric to suggest to domestic regulators that they should regard themselves as pre-empted by supranational standards, or even by foreign rules on the basis that imposing stricter standards on firms they regulate will put those firms at an unfair competitive disadvantage in the transnational markets....

This paper has outlined three different sets of spheres in financial regulation which intersect with each other in complex and often opaque ways in the development of domestic financial regulation. Domestic regulation is already affected by the transnational interactions of governmental and non-governmental actors in fora with limited accountability to consumer-voters. And financial firms and their trade associations have been able to argue quite effectively that governmental authorities, in

¹⁶² For example, even where people are designated as terrorists for the purposes of sanctions, including restriction of access to bank accounts, they may not have any right to challenge the designation at the supranational level. See, e.g., Simon Chesterman, *The Spy Who Came in from the Cold War: Intelligence and International Law*, 27 MICH. J. INT'L L. 1071 (2006).

¹⁶³ See, e.g., Basel Committee on Banking Supervision, Consultative Document, Supervisory Guidance for Assessing Banks' Financial Instrument Fair Value Practices (Nov. 2008) available at <http://www.bis.org/publ/bcbs145.pdf> .

¹⁶⁴ See, e.g., Basel Committee on Banking Supervision, Supervisory Guidance for Assessing Banks' Financial Instrument Fair Value Practices (Apr. 2009) available at <http://www.bis.org/publ/bcbs153.pdf> .

¹⁶⁵ See, e.g., FSA, *supra* note [155](#). The terminology of gold-plating combines market protection and harmonization rhetoric.

exercising regulatory authority domestically, should not impose more onerous rules than those which apply in other jurisdictions. The importance of and the intersections between these different spheres are not readily apparent to many of those who are affected by the rules and standards they develop.

As governments emphasize the development of standards of financial regulation at the supranational level, and particularly if those standards are more specific than they have been, and if the IMF exerts greater pressure on countries to implement standards, it becomes increasingly important to develop a supranational administrative law, rather than relying on self-regulation by the standard-setters.

In the period since I wrote these two pieces there were developments in transnational standard-setting prompted by the financial crisis, the EU developed its system of financial regulation, and at the same time political developments began to raise questions about the multilateral system for trade and regulation. In December 2018, **Christine Lagarde**, who, at that time was the Managing Director of the IMF (she is currently President of the European Central Bank), gave a speech advocating reimagined international co-operation:

Let us look at some of the turning points over the last 75 years. Think first of the creation of the Bretton Woods system itself. The principal architects, John Maynard Keynes of the UK and Harry Dexter White of the US, were deeply influenced by the period between the great wars. They witnessed a moment in history when flawed domestic policies poisoned international relationships, which themselves were built on troubled foundations. The result was protectionism and competitive currency devaluations. Imploding world trade deepened the Great Depression, and caused massive economic, financial, and social upheaval. Ultimately, these pressures gave rise to nationalist and populist movements and, eventually, catastrophe. Emerging from the Second World War, the US and some 40 other countries gathered in Bretton Woods, New Hampshire and decided to create the International Monetary Fund and the World Bank. They charged the Fund with three critical missions: promoting international monetary cooperation, supporting the expansion of trade and economic growth, and discouraging policies that would harm prosperity. It was revolutionary. It was visionary And it worked.

From the very beginning, the IMF helped countries address major new challenges through collaboration. Complementing the Marshall Plan, we helped Europe rebuild from the rubble of war. Our loans gave countries breathing space to stabilize their economies in difficult times and implement policies to promote growth. It is a mission that we continue to this day — as you may have seen recently in countries as diverse as Argentina, Egypt, and Ukraine.

The genius of this collaborative system was that it was designed to adapt and change. In the early 1970s that change arrived . In his landmark speech, “The Challenge of

Peace,” President Nixon suspended the US dollar’s convertibility into gold. The decision shocked the world and forced a year-long negotiation that led to the modern floating exchange rate structure. At the time, some thought that this particular change would mean the end of the IMF. But all our members, including the US, knew that the goals of stability and prosperity extended well beyond fixed exchange rates. They recognized the benefits of a global financial firefighter that could help countries in times of need. They built on what worked, changed what did not, and adapted.

In response to the oil crisis of 1973, the IMF created new tools to help countries facing an energy emergency in line with the Fund’s role to help smooth shocks and prevent harmful spillovers. As a debt crisis hit Latin America in the 1980s, the IMF, with creative ideas and support from our members, we took on a new challenge: helping nations in the former Soviet bloc transform themselves from centrally planned to free market economies. In the 1990s, the Fund assisted countries in overcoming, first, the Mexican peso crisis, and then the Asian financial crisis.

Throughout all of these challenges we continued to help countries around the world with their economic fundamentals — their fiscal, monetary, and exchange rate policies — and with steps to build stronger economic institutions. These efforts enabled better policies that opened markets, boosted trade, created jobs, and unleashed economic potential.

Then came 2008 and the global financial crisis. The ensuing great recession reminded us that international cooperation is essential, not optional. As the French Finance Minister, I was part of that international response. G20 nations and the Federal Reserve took extraordinary steps to save the system. The IMF deployed its own firepower, committing over \$500 billion to help secure the global economy. In the decade since, we supported economic programs in over 90 countries and adapted our lending instruments, including zero-interest loans to help low-income countries.

But the global economy needed more than liquidity and stimulus. We worked with our membership to craft stronger financial sector regulations so that, together, we could prevent the next crisis.

We learned from the past, got creative, and changed for the better.

None of this would have been possible without the United States . This country challenged the international economic order when it needed challenging. It forged compromise when compromise was necessary. Why?

Because a stronger and more stable world paid dividends for the US. It enabled the US to enjoy some of the longest runs of sustained economic growth the modern world has ever known. Since that meeting at Bretton Woods nearly 75 years ago, real US GDP increased by a factor of eight. The average American’s real income has quadrupled. This success did not come at the expense of other nations. On the contrary. This country’s collaborative leadership paved the way not only for decades of opportunity here in America, but also for growth that spread across the world.

Today, the landscape has shifted again. Part of this change is driven by geopolitics and the shift in some economic power from west to east. Part of it by the rise of non-state actors, including multi-national companies. And part of it is driven by technology and the rapid acceleration of everything in our lives. As I am sure the curators of this library are well aware, 90 percent of the world's data was created just over the last two years. As a daughter of two classics professors, I know my parents would find this fact very hard to believe. But the truth is all things — from information, to money, to disease — travel more quickly in our modern world.

These transformations can bring enormous opportunities, but also unprecedented risks. Why? Because more than ever before, what happens in one nation can impact all nations. Think about it: From weapons of mass destruction, to cyber-security, to the interconnected financial system, many of our current challenges do not recognize borders. So, when support for international cooperation falters, we must remember the lesson the United States and her allies taught the world over the last 75 years: Solidarity is self-interest. That principle endures in our changing world. Our challenge now is to adapt and reform once more.

II. The Next Chapter: How to Reimagine International Cooperation

I believe that this next year, 2019, can be another turning point in our journey — a moment when the world delivers a new burst of creativity in solving our shared challenges.

We can draw inspiration from our surroundings. Inscribed on the walls above us are the words of the poet Edward Young, “They build too low, those who build beneath the stars.”

Imagine what the world might look like if we fail to build and adapt: We could live in an Age of Anger:

By 2040, inequality could surpass the levels of the Gilded Age. Strong tech monopolies and weak governments with ineffective domestic policies could make it impossible for start-ups and entrepreneurs to succeed. Health breakthroughs could allow the richest to live past 120, while millions of others suffer from extreme poverty and disease. Social media would bombard the “left-behind” population, underscoring the disparity between their reality and the possibility of a better life. The aspiration gap fuels resentment and anger. Trust between nations breaks down. The world would be more interconnected digitally, but less connected in every other way. International cooperation for mutual benefit would be a concept studied in libraries like this one, but rarely practiced on the world stage, due to the supremacy of national interests and a singular focus on domestic policies. To borrow from Dr. Kissinger in his book *World Order*, we might be, “facing a period in which forces beyond the restraints of any order determine the future.”

That is a very dystopian scenario, isn't it? But I do not believe it is our destiny. Neither

does Dr. Kissinger, by the way. We have overcome existential threats before and can do so again. Think of the world if we make 2019 the start of a different kind of “AI” — an Age of Ingenuity. This would be a future fueled by creativity and cooperation: By 2040, we would see flourishing economies predominantly running on renewable energy. Women would be fully empowered in the workforce, proving to be an economic and social game-changer. New pension systems and health care portability would reflect the changing nature of work in the digital economy. Corporations would embrace social responsibility as part of their business models. Technological wizardry could save lives and create millions of jobs. We would see an end to mass migration. Trade would expand across the world and peaceful co-existence between nations would prevail.

a. Keys to the Age of Ingenuity

First, trade. I have been saying for some time now that we need to “fix the system.” More recently I have been urging countries to “de-escalate” trade tensions. It was encouraging to see progress on this front at the G20 over the weekend. Now we must continue the de-escalation, while at the same time improving the trading system for the future. This would include eliminating distortionary subsidies, whichever form and color they take. It would also mean protecting intellectual property rights without stifling innovation and getting rid of rents . New trade agreements could unleash the potential of e-commerce and trade in services. I should stress that better macroeconomic policies would reduce the external imbalances — including trade surpluses and deficits — that have been the backdrop for rising trade tensions. All of this is critical because trade lifts productivity and accelerates innovation.

My second issue where we need more cooperation: international taxation . Companies now have a world-wide presence, but governments have not figured out a world-wide answer on tax. Right now, too many tax dollars are left on the table thanks to tax optimization and the bad kind of creativity. So countries need to work closely together to collect what is owed and avoid a tax race to the bottom. They can close the loopholes that lead to what is called base erosion and profit shifting. The IMF is working with our partners, so our members can share best practices and devise regulations for a digital economy in which many companies have no single established base of operations. Why the need for this revenue? Because all countries should be investing in their future. Public and private funding working together can strengthen infrastructure, improve education, and prepare all of us to adjust to the technological transformation on our doorstep.

My third issue: our climate. From the recent major hurricanes in the Caribbean to the wildfires in California, the dangerous effects of climate change are becoming more tangible by the day. A new US government study shows that the economic impact from climate change could significantly reduce America’s GDP in the coming decades. The collaborative agreement reached in Paris in 2015 is the best toolbox we have to start

fixing this planetary challenge and move towards a zero-carbon economy. It also reflects the ideas that I have highlighted tonight — creativity, visionary thinking, and a global commitment to the common good that serves self-interest. This is a matter of survival for our children and grandchildren.

Now each of these issues — trade, tax, climate — is worthy of its own Kissinger Lecture. But there is one issue that I believe is the bedrock for progress nearly everywhere else. That is why the fourth and final area I want to discuss is good governance, free from the shackles of corruption. The simple fact is that without confidence in our institutions, none of the change we seek will be possible. So, let me focus on this briefly.

b. Fighting Corruption, Promoting Good Governance

Why is corruption so corrosive? Because when people start believing the economy no longer works for them, they start disconnecting from society. Corruption saps economic vitality and siphons off desperately needed resources. The money diverted from education or health care perpetuates inequality and limits the possibility of a better life. The annual cost of bribery alone is over 1.5 trillion dollars — roughly two percent of global GDP.

Millennials feel the problem acutely. A recent survey of global youth revealed that young people identify corruption — not jobs, not lack of education — as the most pressing concern in their own countries.

There is wisdom in this insight — because corruption is a root cause of many of the economic injustices young men and women feel every day.

That is why the IMF, with the support of all our membership, is scrutinizing anew the impact of corruption on a country's macroeconomic health. So far, we have worked with over 110 countries on improving their efforts to tackle money laundering and terrorist financing.

And this is only a small part of the wider work needed to promote good governance. Investing in institutions is indispensable, as is persistence to verify that institutions actually deliver.

Here is the fundamental point: Corruption is a cancer that does not recognize borders. Think of how fintech is changing the economic game. New innovations — including cryptocurrency — can be used by cyber-criminals to funnel illicit financial flows and fund illegal activities worldwide. This is not one nation's problem or within one nation's power to resolve. It can only be fixed through cross-border collaboration.

But it is something fixable. The same innovations that create cross-border challenges can also be used to help us fight back. Through biometrics, blockchain, and more we can find creative ways to build a better, safer system for the long-term. Governments can and must work with the world's best engineers to build stronger cyber security systems that protect people's bank accounts and their well-being. This is a common

good we must choose to support.¹⁶⁶

5.0 RISK AND FINANCIAL MARKETS

Financial instruments may be used to hedge business risks. For example, firms which have income in one currency and liabilities in another currency may enter into contracts to swap their obligation to pay into the currency of their income (this is a currency swap). People may buy options to acquire securities in the future (giving them rights to buy the securities at a particular price at a particular time in the future, or futures, which require them to buy or sell the security at a fixed price at a particular time in the future. These are examples of transactions in derivatives. Derivatives may be used for hedging or speculation, and derivatives transactions are regulated,¹⁶⁷ although some derivatives transactions may be subject to more regulation than others. Before the financial crisis regulators and market participants tended to characterize swap transactions as individually negotiated contracts rather than exchange traded derivative products and as a result they were subject to less regulation.¹⁶⁸ This has changed since the global financial crisis. The Dodd-Frank Act introduced a new system for regulating swaps, including requirements that certain swaps be cleared through clearing agencies, and the CFTC and SEC have developed rules for these new markets.¹⁶⁹

In a derivatives transaction involving two parties there may be two speculators or two hedgers (each party may take a different view of the risks, or may have different characteristics which mean that they need to hedge against different eventualities) or one speculator and one hedger. In a currency swap, for example, X may have obligations to make payments denominated in US\$ (X may have borrowed money in a US\$ loan which may have offered the most favorable interest rates at the time X borrowed the money) but have most of its income in euros. In these circumstances X might be worried about the risk that US\$ will increase in value compared to euros and want to enter into a swap transaction to hedge this

¹⁶⁶ Christine Lagarde, Age of Ingenuity: Reimagining 21st Century International Cooperation, Eighth Henry A. Kissinger Lecture, Washington D.C. (Dec. 4, 2018).

¹⁶⁷ In the US, the Commodities Futures Trading Commission (CFTC) regulates derivatives activities under the Commodity Exchange Act of 1970 and the Commodities Futures Modernization Act of 2000CFTC . See generally <http://www.cftc.gov> . The CFTC and the Securities Exchange Commission share the regulation of security futures products (futures on individual securities).

¹⁶⁸ Banks which enter into swap contracts need to have regulatory capital in respect of risks associated with these contracts.

¹⁶⁹ See, e.g., <https://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm>

risk. The cost of entering into the swap plus the US\$ interest on the loan might be less than the cost of taking out a euro denominated loan. The other party to this swap could be a firm with assets in US\$ and liabilities in euros (the reverse of X's position) and might want to hedge the risk that euros would increase in value compared to US\$. But the other party could also be a speculator. The protection buyer under a credit default swap may be an entity that is exposed to credit risk with respect to a particular reference entity (such as a bank that has lent money to the reference entity) but it may not in fact have any such exposure and may merely be speculating on the creditworthiness of the reference entity. The credit default swap market developed in the years leading up to the global financial crisis but the size of the market was much less significant by 2018.¹⁷⁰

The derivatives markets illustrate the tendency of the financial markets to become increasingly complex over time. Financial firms are developing new financial products and transactions all the time and regulators are often concerned that the firms which are involved in these products and transactions may not fully understand how the products/transactions work and the risks which they involve. Credit derivatives transactions are supposed to transfer credit risk. Credit risk is the risk that a party to a financial transaction (such as a loan) will not be able to meet its obligations under the transaction. This would cause a loss to the other party or parties to the transaction. In the spring of 2005, the BIS warned that if the parties to credit derivatives transactions did not understand the risks associated with those transactions, the transactions might threaten financial stability.¹⁷¹ Credit derivatives can have the effect of transferring risk away from regulated entities such as banks to less regulated entities. Regulators were concerned about how to deal with newer and complex financial products such as credit derivatives in assessing risk before the crisis. For example, at the end of 2005 the UK's Pension Protection Fund, which is responsible for pricing the risk that defined benefit pension funds in the UK are underfunded, and which imposes levies which are used to compensate pension fund members who incur losses as a result of underfunding, suggested that it would not give pension funds credit for using credit default swaps for the 2006/7 levy. The Fund did give pension funds credit for guarantees, security over cash, real property and

¹⁷⁰ See, e.g., Iñaki Aldasoro & Torsten Ehlers, *The Credit Default Swap Market: What a Difference a Decade Makes*, BIS Quarterly Review 1 (Jun. 2018) at 2 (“Outstanding notional amounts of credit default swap (CDS) contracts fell markedly, from \$61.2 trillion at end-2007 to \$9.4 trillion 10 years later. During the Great Financial Crisis (GFC) and its aftermath this was driven by compression, whereas in recent years it appears to have been driven by the rise of central clearing.”)

¹⁷¹ See, e.g., Basle Committee on Banking Supervision, *The Joint Forum, Credit Risk Transfer*, (March 2005) available at <http://www.bis.org/publ/joint13.pdf>.

securities and letters of credit.¹⁷² The Fund stated :

The Board has also considered the inclusion of credit default swaps, but has decided not to recognise these for the 2006/7 levy year. These may be included in future levy years, if standardised documentation and procedures can be developed to reflect the specific and more complex mechanics of their operation, and if there is evidence that such products may be practically used by pension schemes. The Board will also consider the inclusion of credit insurance policies for future levy years, should evidence demonstrate that such products would become widely used.¹⁷³

The International Swaps and Derivatives Association (ISDA) challenged the assertion that there were not standard forms for credit default swaps:

Standard-form documentation very much does exist for a wide range of credit derivatives, including credit default swaps (CDS). The consultation document incorrectly asserts .. that this is not the case. The credit derivatives market has been in existence for over 10 years, while ISDA plays a well established and widely supported role in developing and maintaining documentation for all major forms of 'over-the-counter' derivatives. Much of the well publicised growth in credit derivatives can be directly attributed to the development of standard-form documentation.

This example illustrates an agency responding cautiously to arguments that it should acknowledge the risk minimization effects of credit default swaps, and being subject to pushback from a financial trade association which is dedicated to promoting derivatives. With respect to the development of rules of financial regulation there are debates which include financial firms, trade associations and regulators. In response to scandals and crises legislatures focus on financial regulation, and in those periods concerns about addressing the risks are more evident than concerns about over-regulation. The example also illustrates that, as well as lobbying about regulation, financial trade associations are active in developing standard form documentation for transactions.

ISDA describes itself as a global trade association, and it comments on regulatory proposals from different authorities around the world that would affect derivatives transactions. This ISDA comment is therefore an illustration of how matters that may seem to be purely or largely domestic (the funding of UK-based pension funds) have transnational implications. International financial market activities have implications for domestic policy choices.

¹⁷² Pension Protection Fund, Guidance in Relation to Contingent Assets (Dec. 2009).

¹⁷³ Pension Protection Fund, THE PENSION PROTECTION LEVY CONSULTATION DOCUMENT, para. 2.3.27 (Dec. 2005).

Participants in the derivatives markets (like participants in other financial markets) may be concerned about being subjected to different regulatory requirements in the different national markets in which they operate. The CFTC and the EU agreed to co-operate in relation to the regulation of derivatives.¹⁷⁴

In May 2008 the CFTC issued a concept release on the regulation of event contracts: Since 2005, the Commission's staff has received a substantial number of requests for guidance on the propriety of offering and trading financial agreements that may primarily function as information aggregation vehicles. These event contracts generally take the form of financial agreements linked to eventualities or measures that neither derive from, nor correlate with, market prices or broad economic or commercial measures. Event contracts have been based on a wide variety of interests including the results of presidential elections, the accomplishment of certain scientific advances, world population levels, the adoption of particular pieces of legislation, the outcome of corporate product sales, the declaration of war and the length of celebrity marriages. In response to the various requests for guidance, and to promote regulatory certainty, the Commission has commenced a comprehensive review of the Act's applicability to event contracts and markets.¹⁷⁵

In 2012 the CFTC prohibited the North American Derivatives Exchange (Nadex) from listing or making available for clearing or trading a set of self-certified political event derivatives contracts on the basis that they involved gaming and were contrary to the public interest.¹⁷⁶ CFTC Regulations prohibit event contracts referencing "terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law, or that involves, relates to, or references an activity that is similar to any of those activities and that the CFTC determines by rule or regulation to be contrary to the public interest."¹⁷⁷ During 2022 Kalshi proposed two new political event contracts based on whether Republicans or Democrats

¹⁷⁴ See, e.g., CESR-CFTC Common Work Program to Facilitate Transatlantic Derivatives Business (Jun. 2005); CFTC, CESR Press Release, CESR Chairman Visits US CFTC Chairman and Attends Global Markets Roundtable, (Dec. 14, 2005).

¹⁷⁵ CFTC, Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 Fed. Reg. 25669 (May 7, 2008).

¹⁷⁶ CFTC, North American Derivatives Exchange (Apr. 2, 2012) at <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

¹⁷⁷ 17 CFR §40.11.

would control the House and the Senate after the elections in November.¹⁷⁸ Commissioner Pham dissented from the CFTC's decision to impose a 90 day stay on the basis that the contracts were not within the specific language of the rule,¹⁷⁹ and noting that another entity, PredictIt, was offering similar unregistered event contracts relating to the November elections,¹⁸⁰ although the CFTC took action to withdraw the No-Action letter on which PredictIt's contracts were based.¹⁸¹

Do you think that the distinction between hedging and speculation (or gaming) should be significant for financial regulation? Should regulation discourage speculation? Should regulation discourage speculation generally, or only by people who cannot properly evaluate the risks? How can we tell whether people can evaluate the risks of speculation?

During the Covid-19 pandemic, although there were some significant declines and periods of volatility,¹⁸² stock market prices ultimately rose. The pandemic created economic challenges for some businesses. Some businesses, such as those involved in information and communications technology, did very well during the pandemic, whereas businesses involved in tourism and hospitality suffered.¹⁸³ Financial markets were supported by

¹⁷⁸ See, e.g., Declan Harty, Washington Weighs Plan to Let Americans Wager on Elections, Politico (Sep. 5, 2022).

¹⁷⁹ Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts (Aug. 26, 2022) ("An event contract is only prohibited under Rule 40.11(a)(1) if it is based upon the underlying activity of terrorism, assassination, war, or gaming, or an activity that is unlawful under any State or Federal law.")

¹⁸⁰ *Id.* ("We must apply our rules fairly. Congress has mandated that the CFTC promote responsible innovation and fair competition...The Commission is already allowing an unregistered event contract market, PredictIt, to continue to operate its political control markets through the November 2022 election cycle and until Feb. 15, 2023... But the Commission has not taken any action on Kalshi's contracts, even though Kalshi submitted their request for voluntary approval over a month ago, and have been discussing it with the CFTC for almost a year." (Footnotes omitted))

¹⁸¹ See, e.g., John Holden, Opinion: Why Loss Of PredictIt Will Not Be A Positive For Society, Legals Sports Report (Dec. 27, 2022), Jacob Stern, PredictIt Already Won, The Atlantic (Nov. 14, 2022).

¹⁸² See, e.g., Financial Stability Board, Holistic Review of the March Market Turmoil (Nov. 17, 2020) at <https://www.fsb.org/wp-content/uploads/P171120-2.pdf>.

¹⁸³ See, e.g., Kibrom Abay, Kibrom Tafere & Andinet Woldemichael, Winners and Losers from COVID-19 : Global Evidence from Google Search. Policy Research Working Paper;No. 9268. World Bank, Washington, DC)(2020) <https://openknowledge.worldbank.org/handle/10986/33852>

governments.¹⁸⁴ In a low interest environment, stock markets benefited from the search for yield.¹⁸⁵ And new investors began to participate in financial markets. But the participation of some of these new investors raised concerns about their ability to evaluate the risks of their financial activity. In December 2020 the State of Massachusetts brought proceedings against Robinhood, an online trading platform, arguing that it had encouraged investors to use its platform through gamification without regard for the best interests of those investors, in violation of state law.¹⁸⁶ Massachusetts sought to revoke Robinhood's licence to do business in the state. The complaint stated that the median age of Robinhood customers was 31 and most customers who were trading options through the platform said they had limited or no investment experience. The complaint stated that one customer with no investment experience was allowed to make more than 12,700 trades in a 6 month period. But in March 2022 a judge held that a rule that was relied on in the case against Robinhood was invalid.¹⁸⁷ In December 2020 the Securities and Exchange Commission (SEC) charged Robinhood with failing to disclose that trading firms paid Robinhood for routing customer orders to them.¹⁸⁸ In September 2021 the SEC published a request for comments on broker-dealer and investment adviser digital engagement practices, including the use of game-like features.¹⁸⁹ A study

¹⁸⁴ Holistic Review, *supra* note [182](#), at p 2 (“The policy response was speedy, sizeable and sweeping. The unprecedented policy actions by central banks alleviated market stress through different channels: asset purchases; liquidity operations, including for US dollars; and backstop facilities designed to provide targeted liquidity to specific financial entities (e.g. MMFs and primary dealers). Regulatory and supervisory measures as well as fiscal policies complemented these central bank interventions. Securities regulators also took measures to support market functioning. The policy measures succeeded in alleviating market strains to date, with announcement effects appearing to be particularly important in restoring confidence and shaping the expectations of market participants.”)

¹⁸⁵ See, e.g., Search for Yield Sustains Buoyant Markets, BIS Quarterly Bulletin (Dec. 2020) at https://www.bis.org/publ/qtrpdf/r_qt2012a.pdf.

¹⁸⁶ See, e.g., <https://robinhood.com/us/en/support/articles/massachusetts-state-and-robinhood/>.

¹⁸⁷ See, e.g., Nate Raymond, in Win for Robinhood, Judge Declares Massachusetts Investment Advice Rule Invalid, Reuters (Mar. 30, 2022).

¹⁸⁸ SEC Charges Robinhood Financial With Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution (Dec. 17, 2020) (with link to SEC Order) at <https://www.sec.gov/news/press-release/2020-321>.

¹⁸⁹ SEC, Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology To Develop and Provide Investment Advice, 86 Fed. Reg. 49067 (Sep. 1, 2021). *Cf.* Philipp Chapkovski, Mariana Khapko & Marius Zoican, Does Gamified Trading Stimulate Risk Taking? (November 25, 2021). Swedish House of

published by the Ontario Securities Commission found that participants who were awarded points for buying and selling stocks made more trades, as did participants who were shown lists of top traded stocks.¹⁹⁰

Different countries may regulate different types of financial activity in different ways. So, firms which are regulated in one country and which want to carry on business in another country may find it difficult to gain access to the second country's financial markets,¹⁹¹ or may be subjected to different rules in the second country. Either type of rule (access restriction or requirement to follow two sets of rules) may function as a barrier to entry into the second country's market. The GATS (General Agreement on Trade in Services) aims at progressive liberalization of trade in services, including financial services among parties to the agreement.¹⁹² The USMCA (US-Mexico-Canada Agreement, replacing NAFTA) also contains a Chapter on Financial Services (Chapter 17).¹⁹³ Within systems for free trade in services, there is always the question whether a particular national rule is a prohibited interference with free trade, or is a legitimate means of ensuring consumer protection.

Paragraph 2 of the GATS Annex on Financial Services states:

2. *Domestic Regulation*

(a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.

(b) Nothing in the Agreement shall be construed to require a Member to disclose information relating to the affairs and accounts of individual customers or any

Finance Research Paper No. 21-25, Available at SSRN: <https://ssrn.com/abstract=3971868> or <http://dx.doi.org/10.2139/ssrn.3971868>. See also SEC Press Release, SEC Launches Game Show-Themed Public Service Campaign (Jun. 1, 2022).

¹⁹⁰ OSC Staff Notice 11-796 Digital Engagement Practices in Retail Investing: Gamification and Other Behavioural Techniques 9NOV. 17, 2022).

¹⁹¹ This second country is commonly referred to as the "host" country.

¹⁹² See, e.g., GATS, at http://www.wto.org/english/docs_e/legal_e/26-gats.pdf

¹⁹³ See <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between>.

confidential or proprietary information in the possession of public entities.

Do you think it is likely to be easy to balance the need for investor/depositor protection with the requirement to avoid barriers to free trade?

This issue of distinguishing between legitimate and illegitimate host country rules (rules which should be accepted as necessary in the interest of the public interest versus rules which are not really justified and which have the effect of creating unnecessary barriers between markets) has also been an issue within the EU. The EU seeks to integrate financial markets by removing barriers and by agreeing on harmonized rules on financial services, but the process of harmonizing the rules has been a slow one. Harmonization of regulation is difficult even where the countries involved are at similar levels of economic development, and have similar cultural environments. Where culture and history diverge, harmonization is even more problematic.¹⁹⁴

The promotion of free trade in financial services is one reason for promoting harmonization of financial regulation. Another is the desire of governments and regulators in developed countries to protect their financial markets from various types of threat from other countries. If countries generally had similar levels of investor protection, then they would not need to worry about protection of their own residents who decided to invest abroad (although they might be concerned about the loss of funds from their own investment sector). Harmonization of regulation is an alternative to extraterritorial application of rules. Regulatory harmonization also limits the ability of firms to escape regulation by moving their activities into another jurisdiction (regulatory arbitrage).

Crises in developing markets during the 1990s led to general concern about the “International Financial Architecture”,¹⁹⁵ and to the setting up of the Financial Stability Institute, and the Financial Stability Forum (now the Financial Stability Board). Some scholars

¹⁹⁴ See, e.g., V Sundararajan & Luca Errico, *Islamic Financial Institutions and Products in the Global Financial System: Key Issues in Risk Management and Challenges Ahead*, IMF Working Paper WP/02/192, (Nov. 2002) (describing problems of applying Western risk management principles to Islamic financial products and services).

¹⁹⁵ See, e.g., *Introduction to Reports on the International Financial Architecture - Reports of Working Groups* (Oct. 1998) (“The international financial crisis that began in Asia and has now spread to other continents lends urgency to efforts to strengthen the architecture of the international financial system. The importance of these efforts was first given prominence in 1995 at the Halifax summit of heads of state and government of G-7 countries, and progress since has benefited from the involvement of finance ministries and central banks from both developed and emerging market economies... In their discussions, Ministers and Governors stressed the importance of strengthening the international financial system through action in three key areas: enhancing transparency and accountability; strengthening domestic financial systems; and managing international financial crises.”)

have argued that differences in legal origins correlate with the level of development of a country's securities markets,¹⁹⁶ and that countries with strong securities markets tend to have high levels of economic growth.¹⁹⁷ Thus it has been argued that increasing standards of regulation in less developed economies not only protects developed economies by reducing the likelihood of crises which might infect the developed economies, but also benefits less developed economies more directly. It is worth noting that some commentators have challenged the idea that changing legal rules necessarily promotes economic development.¹⁹⁸ And some critics of harmonization have argued that legal harmonization has risks:

I am also concerned that the effort to homogenize capital rules across the world may do serious damage to certain markets in which U.S. banks – particularly national banks – have been world leaders, such as credit cards and securitizations. We have to exercise great caution that we do not, in the name of achieving international uniformity, needlessly disrupt settled banking practices and established, well-functioning markets.¹⁹⁹

Some commentators argue that rather than emphasizing harmonization of law and regulation we should allow different countries to compete with each other in the laws and regulations they apply, because such legal and regulatory competition will produce the most efficient regulatory outcomes. But the global financial crisis resulted in a push for greater harmonization of financial regulation rather than for more competition in standards of financial regulation. And, as well as developing more standards of international financial regulation, the standards bodies have also focused their efforts on ensuring implementation of the standards. The Basel Committee has worked on improving capital requirements for international banks, and introduced a Regulatory Consistency Assessment Program, which

¹⁹⁶ See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998) (arguing that common law jurisdictions provided stronger protections to investors than civil law jurisdictions, thus encouraging the development of securities markets). There are also critiques of the law and finance literature. See, e.g., Ruth V. Aguilera & Cynthia A. Williams, "Law and Finance": Inaccurate, Incomplete, and Important, 2009 BYU L. Rev. 1413 (2009).

¹⁹⁷ See, e.g., Bharat N. Anand & Alexander Galetovic, *Investment Banking and Security Market Development*, IMF Working Paper, WP/01/90, July 2001.

¹⁹⁸ See, e.g., Gordon Smith, Taking Legal Origins Theory Seriously, Jotwell (Jan. 7, 2011) at <http://corp.jotwell.com/taking-legal-origins-theory-seriously/>.

¹⁹⁹ John D. Hawke, Jr., (then) Comptroller of the Currency, *Basel II: A Brave New World for Financial Institutions?*, speech to the American Academy in Berlin (Dec. 15, 2003).

includes peer reviews, to ensure implementation of the new standards.²⁰⁰ IOSCO has also focused on issues of implementation, for example studying how its members have dealt with IOSCO Objectives and Principles of Securities Regulation relating to systemic risk.²⁰¹

The idea of using peer reviews to ensure implementation of international standards was developed by the G20 and implemented by the Financial Stability Board (as well as by the Basel Committee and IOSCO). The Financial Stability Board published the **FSB Framework for Strengthening Adherence to International Standards** in 2010:²⁰²

The FSB is committed to strengthening adherence to international financial standards. Financial markets are global in scope and, therefore, consistent implementation of international standards is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability.

The FSB, working through the Standing Committee on Standards Implementation, will foster a race to the top, wherein encouragement from peers motivates all countries and jurisdictions to raise their level of adherence to international financial standards.

Encouragement will come in three forms.

First, FSB member jurisdictions will lead by example. FSB member jurisdictions have committed to implementing international financial standards and disclosing their level of adherence.

Second, FSB member jurisdictions will undergo periodic peer reviews to evaluate their adherence to international standards in the regulatory and supervisory area. Such evaluations will provide members with feedback from peers on the implementation and effectiveness of standards and policies. Moreover they will encourage non-FSB member jurisdictions to undergo similar evaluations.

Third, the FSB will establish a toolbox of measures to encourage adherence to international cooperation and information exchange standards by all countries and jurisdictions. Application of these measures will be based on transparent procedures to evaluate the degree of adherence of jurisdictions to the relevant standards.

...FSB members' adherence to international standards is essential to reinforce the credibility of the FSB's efforts to strengthen adherence by all countries and jurisdictions.

²⁰⁰ See <http://www.bis.org/bcbs/implementation.htm>. See also Basel Committee on Banking Supervision, Regulatory Consistency Assessment Programme (RCAP) - Handbook for Jurisdictional Assessments (Mar. 12, 2018).

²⁰¹ IOSCO, Thematic Review of the Implementation of Principles 6 and 7 of the IOSCO Objectives and Principles of Securities Regulation: Final Report (Sep. 2013) at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD424.pdf>.

²⁰² At http://www.financialstabilityboard.org/publications/r_100109a.pdf.

To lead by example, FSB member jurisdictions have committed to: implementing international financial standards; undergoing an assessment under the IMF-World Bank Financial Sector Assessment Program (FSAP) every five years; disclosing their degree of adherence of international standards, notably by publishing the detailed assessments prepared by the IMF and World Bank as a basis for the Reports on the Observance of Standards and Codes (ROSCs); and undergoing periodic peer reviews using, among other evidence, reports prepared as part of the FSAP.

All 24 FSB member jurisdictions have participated or are in the process of participating in the FSAP ... An initial FSAP was completed in 20 member jurisdictions (five of which also completed an FSAP Update) and is currently under way in a further three jurisdictions, while an FSAP was not completed in the case of one member jurisdiction. ... FSB member jurisdictions have committed to undergoing periodic peer reviews focused on the implementation and effectiveness of international financial standards and of policies agreed within the FSB. The peer reviews will build on, and avoid duplicating, existing assessment mechanisms, such as FSAPs and ROSCs. The added value of FSB peer reviews will come in significant part from the cross-sector, cross-functional, system-wide perspective brought by its members. Dialogue with peers will be a key benefit of the reviews.

FSB member jurisdictions have agreed to undergo both thematic and country peer reviews. Thematic peer reviews will focus on the implementation across the FSB membership of policies or standards agreed within the FSB, with particular attention to consistency in cross-country implementation and the effectiveness of the policy or standard in achieving the intended results. Country peer reviews will focus on the implementation and effectiveness of financial sector standards and policies agreed within the FSB in achieving the desired outcomes in a specific member jurisdiction, notably through systematic and timely follow up to relevant recommendations arising from an FSAP or ROSC.

FSB peer reviews will be based on reports drafted by small teams composed of experts from FSB member jurisdictions and international bodies, supported by the FSB Secretariat. The substantive review by peers will take place in the Standing Committee on Standards Implementation. The final responsibility for approving FSB peer reviews lies with the Plenary, as the decision-making body of the FSB. In keeping with the FSB's commitment to lead by example, peer review reports will be published, along with any commentary provided by the reviewed jurisdictions for inclusion. Following publication of the report, jurisdictions' implementation of agreed actions will be monitored by the FSB and, if implementation lags, peer pressure may be applied. Guidelines for the conduct of FSB peer reviews are set out in a Handbook for FSB Peer Reviews that will be revised and expanded as experience is gained.

Thematic and country reviews will move forward in parallel. The first thematic review is

on actions taken by firms and national authorities to implement the FSB Principles and Implementation Standards for Sound Compensation Practices. This review will be completed by March 2010. The FSB aims to complete two more thematic reviews and three country reviews in 2010.

...The FSB is finalising procedures to encourage the adherence of all countries and jurisdictions to international financial standards, including by identifying non-cooperative jurisdictions and assisting them to improve their adherence. This initiative responds to a call by G20 Leaders at the April 2009 London Summit and complements initiatives by the Global Forum and OECD to promote adherence to international standards in the tax area, and by FATF for standards concerning anti-money laundering and combating the financing of terrorism.

Of particular concern to the FSB is the adherence of jurisdictions to international cooperation and information exchange standards in the financial regulatory and supervisory area. The three key standards in the regulatory and supervisory area are: the BCBS Core Principles for Effective Banking Supervision; the IAIS Insurance Core Principles; and the IOSCO Objectives and Principles of Securities Regulation.... The initial focus of the FSB is on jurisdictions that could pose a risk to financial stability because of their importance in the financial system and their weak adherence to the relevant standards. Over time, the FSB will reassess this focus and may adjust it to other potential areas of concern or groups of jurisdictions.

The FSB is prioritising a pool of jurisdictions to engage in dialogue in order to further evaluate their adherence to the relevant standards and possible ways to improve adherence. Prioritisation will take place according to available information on jurisdictions; importance in the financial system and on their compliance with the relevant standards.

In order to measure financial importance, a combination of the following economic and financial indicators will be considered to rank jurisdictions:

Domestic financial assets, both in absolute terms and relative to national GDP.

External financial assets and liabilities of a jurisdiction as measured by creditor-side data, specifically the BIS international banking statistics and the IMF Coordinated Portfolio Investment Survey.

Gross capital flows, both in absolute terms and relative to national GDP.

Market share in selected global market segments. Five market segments will be considered: cross-border interbank assets, pension fund assets, hedge fund assets (based on both the location of the manager and the legal domicile of the fund), over-the-counter derivatives markets, and insurance premiums.

The adherence of jurisdictions to the relevant standards will be evaluated using information on compliance from ROSCs prepared by the IMF and World Bank, and Multilateral Memoranda of Understanding (MMoU). A jurisdiction that is either

“compliant” or “largely compliant” in all, or all except one, of the relevant international cooperation and information exchange principles ... will not require further evaluation. In the case of principles in the securities regulation area, signature of the IOSCO MMoU Concerning Consultation and Cooperation and the Exchange of Information will be considered as sufficient evidence of compliance.

All FSB member jurisdictions will be held to the same standard, and be subject to the same evaluation process, as will be applied to non-member jurisdictions. The FSB will actively engage in external outreach and communications to ensure that the process and potential outcomes of this dialogue to promote and strengthen adherence to international standards are fully explained and understood.

The FSB’s dialogue with jurisdictions will evaluate areas of weakness, consider cooperation with international assessment processes, examine where further information is needed, identify priorities for reform, and recommend actions to address weaknesses. To support the efforts of low-capacity jurisdictions to achieve adherence with international standards, capacity-building mechanisms will be made available to provide technical assistance. A toolbox of potential measures to promote adherence is being finalised. The toolbox will be a balance of positive and negative measures, and will include the option of publishing by the end of 2010 the names of non-cooperative jurisdictions in the event that other measures to promote adherence to international cooperation and information exchange standards are not achieving sufficient progress.

Above (at page [56](#)) I asked whether regulation should aim to discourage speculation. How we might think about this question might depend on our perspective or the reason for asking the question. We might be concerned with the issue whether the actions of speculators damage the markets, or other actors in those markets. For example, European states were concerned during the EU sovereign debt crisis about the impact of speculative trading on their sovereign debt. We might be concerned to limit the costs of bailouts by restricting the activities of insured institutions (e.g. the “Volcker Rule”).²⁰³ Or we might be interested in the question of what legal protections should be available to investors who engage in speculative or excessively speculative behavior.

²⁰³ See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 FR 5535 (Jan. 31, 2014). See also Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds 85 FR 46422 (Jul. 31, 2020) (“modifying and clarifying” requirements).