

THE LEGAL RESPONSE TO THE NEXT FINANCIAL CRISIS

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Financial crises are now cross-border affairs, and yet many feel that international law does little to either constrain or enable the response to them.

I disagree, and in this essay, I identify the ways that law and regulation will affect the response to the next crisis. The law will be domestic, rather than international – and in that sense the critics are onto something. It is regulation, as opposed to treaty or even statute, that will form much of the underpinnings of the international response.

The next crisis response will be facilitated by a track record of international coordination designed to minimize the impact of shocks to the financial system. And the precedents created by the response to the last crisis, such as the lending to one another by central banks, will make the response to the next crisis more predictable.

None of this means that law and tradition will supplant politics and discretion when the next crisis comes. In crisis response, as opposed to crisis preparation, international law and domestic administrative law have shown their limits; the difficulties of either regime to grapple with so-called cross-border resolution authority – the power to quickly fail and recapitalize large, interconnected financial institutions – exemplifies this.

But that does not mean that crisis response is orthogonal to the project of international financial regulation. Financial crises are one of the rule of law's greatest tests. Understanding and assessing how international financial regulation - a unique creature of international governance - will respond to catastrophe helps us to take its measure.

I. INTRODUCTION

Classical international law focused on peace and security, and not on the economic well-being of states. The more modern version certainly has its share of treaties designed to promote economic prosperity – the all-inclusive World Trade Organization is the canonical example, while the

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welter of bilateral and regional investment protection regimes are the growth agents. Both seek to take matters that used to be left to diplomats and delegate the resolution of them to adjudication. They exemplify the turn to legalization in international economic law.

But there is no financial crisis response treaty. And many believe that there could not be one, or that if there was one, that it would be ignored in a crunch. International relations scholars argue that in a crisis, all bets for legal compliance are off, as nations either abandon their treaty obligations or cooperate in a way that can only be understood to be a matter of pure politics.¹

Domestic students of regulation are also unconvinced that the response to a cross-border financial crisis is fit to be subjected to the rule of law. As a matter of foreign relations, Eric Posner and Adrian Vermeule believe that the discretion required to respond to crises requires a relatively untrammelled executive branch.² Scholars in this camp predict that it will be impossible to rule out bailouts of banks during the next financial crisis, despite legal efforts to do precisely that.³ They argue that trying to institutionalize an agency, or a council of agencies, to protect America's "financial stability" and coordinate international efforts to assure the same on a global level, would constitute the exercise of unfettered discretion, rather than constrained administrative action.⁴

¹ John J. Mearsheimer, *A Realist Reply*, 20 INTL SECURITY 82, 82 (1995) ("Realists ... believe that institutions cannot get states to stop behaving as short-term power maximizers [I]nstitutional outcomes invariably reflect the balance of power. Institutions, realists maintain, do not have significant independent effects on state behavior."); HANS J. MORGENTHAU, *POLITICS AMONG NATIONS: THE STRUGGLE FOR POWER AND PEACE* 4-15 (Knopf 1973) (describing the tenets of realism).

² Eric A. Posner & Adrian Vermeule, *Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of 2008*, 76 U. CHI. L. REV. 1613, 1681 (2010) (arguing that "[t]he pattern of a strong executive with primacy during financial crises was established [during Roosevelt's New Deal response to the Great Depression], and it has lasted to this day. It is the normal mode of crisis governance in the administrative state").

³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. H.R. 4173, 111th Cong. (2010) (establishing as goals "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts"). But as Peter Conti-Brown has put it, "Dodd-Frank seeks to end government bailouts--forever. But this promise is implausible objectively, inaccurate subjectively, and, regardless, is undesirable as a matter of policy." Peter Conti-Brown, *Elective Shareholder Liability*, 64 STAN. L. REV. 409, 412 (2012).

⁴ Allen, Hilary J., *Putting the 'Financial Stability' in Financial Stability Oversight Council* (January 8, 2015). Suffolk University Law School Research Paper No. 14-31. Available at SSRN: <http://ssrn.com/abstract=2485949> or <http://dx.doi.org/10.2139/ssrn.2485949>.

Moreover, efforts to legally respond to crises have not enjoyed much popularity, or clear success. The European Union responded to the financial crisis by trying to create strong continental level financial supervisors, but this has created controversy among member states unhappy with this sort of federalization.⁵ Moreover, although analogies between financial and fiscal crises are by definition strained, European institutions have fumbled their way through subsequent banking-related crises in Cyprus⁶ and Greece.⁷

All of this raises the question of how these institutions will respond to the next global crisis. Is there any hope for legal constraint in what will surely be an international effort requiring coordination between domestic regulators and politicians in a tense, fast-moving situation?

No one should doubt the importance of discretion and political relationships between powerful economies in a crisis. Much of the governing done during the next financial crisis will be functions of actors making political decisions that will either be within their legal discretion or that, at least, will not be challenged by those so worried about the threat to the economy as to be cowed from standing up for procedural regularity.

Underneath the exercise of discretion however, there lies an increasingly robust set of legal and regulatory relationships that take some crisis response options off the table, while creating frameworks for others. In this essay, I will show how these relationships have evolved. This permits some musing on a legal question that may not, ultimately, be too meaningful; specifically, whether this policy coordination is law, defined in any way you wish. In my view, you could call it law, law-ish, governance, soft law, or

⁵ Wearden, Graeme (16 March 2013). "The Cyprus bail-out: Unfair, short-sighted and self-defeating". *The Economist*, <http://www.economist.com/blogs/schumpeter/2013/03/cyprus-bail-out>.

⁶ See, e.g., Clyde Stoltenberg et. al., *The Past Decade of Regulatory Change in the U.S. and EU Capital Market Regimes: An Evolution from National Interests Toward International Harmonization with Emerging G-20 Leadership*, 29 BERKELEY J. INT'L L. 577, 644 (2011) (suggesting that financial reform raised "the specter of long-held underlying fears of EU Member States that the central European body will infringe on their carefully guarded national sovereignty"). For a nice overview of European fiscal reform, see Derek Takehara, Comment, *Financial Reform in the European Union: Establishing the Common Technical Rulebook*, 26 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 531, 533 (2013) ("The regulatory overhaul in the European Union provides an illustrative case study of post-crisis financial reform.").

⁷ As Anna Gelpern has put it, "firm commitments against fiscal transfers, such as Europe's infamous "no-bailout" clause. Such blunt commitment devices are tested in crisis. At this writing, EU treaties have been creatively interpreted to permit bilateral and regional bailout facilities for Greece, Portugal, and Ireland." Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888, 918 (2012)

whatever you like, but given that it involves regulators regulating, and rules being issued through an administrative procedure, there is little point in deeming it not-law or ignoring it, even while there should be no doubt that it is not the same thing as binding international law.

Governments will attempt to forestall the next crisis by regulating their financial entities in the same way, and by reviewing one another's work to ensure this consistency – this is the most recognizably law-like aspect of the response to the financial crisis, and it should be emphasized that it is part of the process that precedes the actual shock. When the next crisis occurs, independent central banks will stand ready to lend to one another, while finance ministers and heads of states have created institutions that can facilitate cooperative responses to macroeconomic shocks. Although I differ, methodologically, from political science's constructivists and sociology's contextualists, I, like them, “foreground the role of institutions” as Victoria Nourse and Greg Shaffer have put it, in my account of what matters in financial regulation.⁸ The prominence of reinvigorated institutions like the G20 and arrangements like central bank swap lines, along with (maybe) cooperation and coordination in the resolution of large, cross-border financial institutions, will comprise much of the institutional response to the next crisis.

There are gaps in this structure – a multinational financial institution will collapse in the future, and yet countries and their regulators may well not agree how they will handle the corresponding race for the assets of the firm.⁹ Moreover, power in this system is distributed extremely unevenly. Nonetheless, as a model of global governance, it can only be deemed an accomplishment, as it has created process and institutions over what was formerly pure discretion, and, at worst, panic.

I. THE FINANCIAL REGULATORY ARCHITECTURE SO FAR

Much of what has happened in cooperative cross-border financial regulation is a matter not of crisis response, but rather of crisis prevention. The next financial crisis will benefit from an elaborate global architecture that, in my view, is increasingly procedurally regularized, designed to deal with the prospect of financial crisis and contagion. The *response* this architecture will have to the next financial crisis lies almost entirely in its *preparation* for it; it is designed to “harden the target.” Done right, the

⁸ Victoria Nourse, Gregory Shaffer, *Varieties of New Legal Realism: Can A New World Order Prompt A New Legal Theory?* 95 CORNELL L. REV. 61, 81 (2009).

⁹ Simon Johnson, *The Myth of Resolution Authority*, N.Y. TIMES, March 31, 2011, <http://economix.blogs.nytimes.com/2011/03/31/the-myth-of-resolution-authority/>

cooperative preparations of regulators will make financial institutions resilient to shocks, and, by creating a common regulatory approach, will make it easier for any domestic regulator of a cross-border multinational financial institution to understand it.

This crisis preparation endeavor covers much of what financial regulators have done with regard to their international counterparts, and I find it to be an exceedingly powerful example of the possibilities of international cooperation. The remainder of this section sketches out how I think this architecture works.

Much of what has happened in international financial regulation began as an effort to solve problems of coordination that appeared to be intractable under formal international law – hence the advent of the network-of-regulators form during the 1970s, although its antecedents in financial oversight reach earlier.¹⁰ Today, the networked institutions of international financial regulation continue to promulgate a dizzying array of standards, best practices, principles, and rules. But intertwined with these substantive efforts to coordinate the global regulation of finance has been a developing agenda making improvements in the procedures followed in international financial regulation. After becoming established as the principal mechanism for coordinating global financial regulation, reform of international financial regulation focused on imposing procedural regularity and political oversight on a process that did not used to feature either.

This evolution, both procedural and substantive, make for a compelling story about a global regulatory enterprise with few peers. The old efforts to deal with the cross-border externalities of finance, which were limited in their ambitions and range, have been cast aside. In their place, a new order is emerging. That order is hierarchical, procedurally regular, and politically supervised. Elsewhere, I have traced the emergence of a legal-ish system of oversight of the global financial system, which looks to be one of the principal accomplishments of international governance of the modern era.¹¹ It is one that has developed through regulation, rather than through more

¹⁰ The Basel Committee on Banking Supervision was founded in 1974, as was a precursor to what is now know as the International Organization of Securities Commissions (IOSCO). See IOSCO, Membership and Committees Lists, IOSCO.ORG, http://www.iosco.org/lists/display_members.cfm?memID=1&orderBy=None; see also About IOSCO, <http://www.iosco.org/IOSCO.ORG>, <http://www.iosco.org/about/>. See Basel Comm. on Banking Supervision, Chairmen of the Basel Committee, <http://www.bis.org/bcbs/> (identifying the chairs and founding date of the Basel Committee Membership, <http://www.bis.org/bcbs/membership.htm>).

¹¹ David Zaring, *Finding Legal Principle in Global Financial Regulation*, 52 VA. J. INT'L L. 683 (2012).

traditional mechanisms of public international law.¹² Specifically, it has developed through regulatory cooperation. But while that term – regulatory cooperation – suggests a negotiated sort of informality that might be easily dismissed by lawyers as insufficiently law-like, the way the cooperation has evolved suggests something quite different.

Political supervision, increasingly regularized output, and bureaucratic order are, after all, familiar phenomena to students of the modern state. They are the fundamentals of administrative law. International financial regulation is looking increasingly like an administrative agency stretched into a global multilateral context.

This “agencification” of international financial regulation offers a regulatory alternative to traditional public international law. It creates a two-step process for legal obligation. The international context of financial regulation, where the policy is made, is the first step of the process. It creates no binding obligations – those obligations come, if at all, after the international process has ended, and financial regulators have returned to their countries to go through the processes that make domestic administrative rules binding law, the second step.

But this hardly makes the international part of international financial regulation superfluous. In fact, the first step in international financial regulation is the particularly interesting one. It is the source of the principles of international financial regulation. It is growing and developing in its own right. And it has added hierarchy, structure, and distributional consequence since the financial crisis.

Post-crisis financial regulation has resulted in institutionalization along hierarchical lines, with a political overseer, a regulatory supervisor, and a group of task-specific but increasingly coordinated regulatory networks making the rules for banks, capital markets participants, insurers, and other financial intermediaries. What those regulators do, moreover, is both procedurally regular and increasingly explicable with resort to a few organizing principles that mimic the fundamental principles espoused by hard law international organizations.

The transformation of international financial regulation has not only been a matter of the imposition of procedural regularity, bureaucratization, and a degree of political oversight. It is also an increasingly tractable and definable enterprise, at least if the definition is done through a legal lens.

In conjunction with this post-crisis reform, there is an identifiable commitment to a variety of legal principles that undergird the particular regulatory decisions made in international financial regulation. At least six

¹² *Id.*

such principles can be identified in the organization and institutionalization of the post-crisis financial regulatory settlement; although many of these principles are rooted in the cooperation extant before the financial crisis, it is with the flurry of activity after the crisis that has brought them to the fore.

The legal principles include a commitment to *national treatment*, meaning that domestic and foreign financial intermediaries should be subject to roughly similar rules, and a *most favored nation* (MFN) principle identifiable through the consensus practices of the organizations. These principles are institutionalized through *rulemaking*, rather than adjudication – international financial regulation sets its standards in advance and without the assistance of a tribunal. Those standards are administered with adherence to a principle of *subsidiarity*, whereby each agency engaged in the global financial regulatory architecture is charged with implementing the rules and standards agreed to internationally in its own domestic jurisdiction without international direction. That subsidiarity is paired with a *peer review* process meant to check the implementation decisions of member agencies in lieu of a third-party dispute resolution such as that offered by the international tribunal. This, paired with the sort of threats that small, familiar communities can impose on one another – shunning, and ostracism in the manner of the informal order developed by ranchers in Shasta County, among other things – is all the enforcement contemplated by the system.¹³

All of this evinces an approach that prefers the commitment of the institutional form of the *network* over all others, a final, discernible legal principle that governs and characterizes international financial regulation. Networks are comprised of agencies, are not disciplined or authorized by treaties, and meet informally and regularly to handle the problems posed by globalization to their task-specific issue areas. But they are not creatures of formal public international law. Any effort to create a more formal treaty-based organization to ensure that financial regulation is done globally and consistently has so far been eschewed in favor of the increasingly elaborate network. Global financial regulation, while idiosyncratic, has become a form of the rule of law. The problem for lawyers – and this is a problem that has long characterized all sorts of international law – is that the rule of law embodied by global financial regulation has few of the formal characteristics of the rule of domestic law, ranging from promulgation to enforcement.

¹³ ROBERT ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1994) (discussing the way that Shasta County ranchers resolve disputes with one another without resorting to lawsuits).

II. THE NEXT FINANCIAL CRISIS

If we know anything about global financial crises, we have learned that they are ubiquitous. Since the end of the Cold War, financial crises with cross-border implications have broken out in Mexico,¹⁴ East Asia,¹⁵ the United States,¹⁶ and Europe.¹⁷ And, of course, over the same period, multinational banks have collapsed as well, many with knock-on effects, ranging from the spectacularly corrupt BCCI, which operated in 78 countries at the time of its 1992 collapse, to 2014's Banco Espírito Santo, a nominally Eurozone bank brought low by its Angolan credit practices.¹⁸

For policymakers, then, the approach to the next financial crisis will be an exercise in damage minimization rather than in absolute prevention. The damage minimization will be institutionalized in two ways.

First, the cross-border crisis response – the actions governments will take once it becomes apparent that the global economy is reeling – will be focused on relationships built by the regularized interaction of heads of state, central bankers, and finance ministers through the G-20. As I have argued elsewhere, the G-20 has provided the political oversight over the emerging system of financial regulation, and so the immediate response to the next crisis will be one built out of political agreement (or not).¹⁹

Second, the pre-crisis resilience of the financial system that will minimize the damages inflicted by the next crisis will be built by

¹⁴ Editorial, *Mexico's Self-inflicted Peso Crisis*, CHICAGO TRIB., December 24, 1994, http://articles.chicagotribune.com/1994-12-24/news/9412240014_1_chiapas-rebellion-zedillo-government-free-trade

¹⁵ Jonathan Fuerbringer, *How Asian Currencies Tumbled So Quickly*, N.Y. TIMES, Dec. 10, 1997, <http://partners.nytimes.com/library/review/archive/1210asia-currency.html>; Richard W. Stevenson & David E. Sanger *Asian Crisis Could Wreak Havoc on Balance of Trade*, N.Y. TIMES, Dec. 20, 1997, <http://partners.nytimes.com/library/financial/122097asia-us-trade.html>

¹⁶ Steven Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463 (2009).

¹⁷ Buchheit, Lee C. and Gulati, G. Mitu, *How to Restructure Greek Debt* (May 7, 2010). Available at SSRN: <http://ssrn.com/abstract=1603304> or <http://dx.doi.org/10.2139/ssrn.1603304>; Gelpern, Anna and Gulati, G. Mitu, *Sovereign Snake Oil* (December 30, 2010). Law and Contemporary Problems, Forthcoming; American University, WCL Research Paper No. 2011- 05. Available at SSRN: <http://ssrn.com/abstract=1732650>.

¹⁸ Frances Coppola, *Banco Espírito Santo: The Angolan Story*, FORBES, Aug. 9, 2014, <http://www.forbes.com/sites/francescoppola/2014/08/09/banco-espirito-santo-the-angolan-story/>.

¹⁹ David Zaring, *Legal Obligation in International Law and International Finance*, 47 CORNELL J. INT'L L. __ (forthcoming 2015).

institutionalization of regulatory cooperation, an institutionalization that I have discussed in part I. I posit that one can think of this as a form of international administration, a legal-ish structure meant to do the sort of work that public international law does: that is, create a structure that can facilitate international cooperation and minimize conflict and beggar-thy-neighbor policymaking.

A. *Discretion in Response: The G-20 and Central Banks*

The cross-border tools of crisis response and minimization feature diplomacy and central-bank-to-central-bank lending. Neither of these mechanisms of response are particularly constrained by law or the regulatory alternative to traditional international law that I have outlined in Part I of the paper, but they are increasingly institutionalized practices.

1. The G-20

During the last crisis, some of the crisis response was hashed out at G-20 summits, at which heads of state and finance ministers worked to create mechanisms that would support each other. At the 2009 London summit, for example, the G-20 pledged funds to the IMF and the regional development banks to support countries that needed access to funds, and also made the sorts of important-sounding statements meant to reassure markets that the leaders are, in fact, on the job.²⁰ These actions by the modern-day Concerts of Europe that the G-20, essentially, is, however, constitute examples of international cooperation untrammelled by either law or regulation.²¹ Treaties are not negotiated at the G-20, and the commitments tend to veer towards the immediate, rather than the lasting.

The G20 has “begun to take shape as a global ‘steering committee,’” and has also settled into a relatively predictable routine for developing and following up on its agenda.²² G20 meetings begin with an outline, rooted in the communique issued at the conclusion of the last meeting. Within the finance ministries, “sherpas” have guided the G20 agenda through a series of pre-meetings and, in the time-honored format of international summits, a

²⁰ G-20, London Summit Leaders Statement, https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf

²¹ David Zaring, *International Institutional Performance in Crisis*, 10 CHI. J. INT’L L. 475 (2010).

²² Andrew Cooper, *G-20: The Unspoken Issues*, <https://www.cigionline.org/publications/2010/6/g20-membership-and-process-unspoken-issues>.

good part of the agenda is all but completed by the time the heads of state meet. This means that an important part of what heads of state do is to put their imprimatur on the process and establish to their own and their observers' satisfaction that the meeting was worth having. The meeting concludes with a carefully negotiated and drafted communique, which sets the agenda for future meetings and reports on the progress made at the current meeting.

For example, the communique issued at the conclusion of the 2015 G20 meeting in Ankara, Turkey, included both marching orders and encouragement to regulators engaged in regulatory cooperation. The communique "welcome[d]" the work done by regulators on developing "rigorous and comprehensive quantitative impact assessments on a total-loss-absorbing-capacity standard (TLAC) for global systemically important banks" and "on criteria for identifying simple, transparent and comparable securitizations."²³ The communique "look[ed] forward" to

robust higher loss absorbency requirements for global systemically important insurers by the Antalya Summit, and completion of the previously agreed work on the extension of the contractual recognition of temporary stays on early termination rights for OTC derivatives contracts to include other instruments and firms, excessive variability in risk-weighted asset calculations for bank capital ratios and implementation of the G20 shadow banking roadmap.²⁴

This sort of chivvy along of the international regulatory process, by recording accomplishments and setting forth an agenda, then, is one of the functions of the G20, but also, its regular presiding over the process is also meant to create the sort of regular contact necessary to coordinate the political decisions necessary to address the next crisis.

Of course, the G20 is not without its problems. The prospect of economic governance by a minority of the world's nation states strikes some as unappealing, though the G20 includes most of largest economies and most populous countries on the planet. Europe is overrepresented while African, and other emerging, countries are underrepresented. Some suspect that a small number of the members wield significant power in decision-making, create even greater representation problems. Indeed, the very location of the G20 summits are selected by only eight of the members.

Moreover, the G20 has been active in financial crisis response, but so far, most of its members have not practiced close coordination when

²³ <https://g20.org/wp-content/uploads/2015/09/September-FMCBG-Communique.pdf> at paragraph 9.

²⁴ *Id.*

those crises arise. After both the 1997-98 Asian financial crisis and the 2007-08 financial crisis, the G20 met as its membership was crafting various individual responses to the problem, a dynamic that has been described as “together alone.”²⁵ In the wake of crises, moreover, the cooperation has begun actively, but has proven difficult to sustain as the crisis recedes.

2. Central Bank Swaps

By the same token, the efforts of finance ministers and central bankers to coordinate their response to financial crises are also examples of cooperation unconstrained by law. During the last financial crisis, central bankers smoothly extended loans and supplied plenty of particular stable currencies to one another. The transaction is known as a currency swap, and agreements in place to commit to a number of currency swaps in advance is known as a swap line. “Swap lines became mechanisms to outsource the Federal Reserve’s bedrock power--its lender of last resort role--to foreign central banks,” as Colleen Baker has observed.²⁶ The Fed’s extension of credit lines for currency swaps to its foreign counterparts during the last crisis was a massive and barely scrutinized crisis response program.²⁷ Today it has standing swap agreements with five other central banks.²⁸ During the last financial crisis, as the Council on Foreign Relations has reported, the Fed extended swap lines to Brazil, Mexico, South Korea, and Singapore,²⁹ on the basis that, as the Fed put it, “intensification of stresses in [these countries] could trigger unwelcome spillovers for both the U.S. economy and the international economy more generally.”³⁰

Controversial though they were, swap lines were policy tools deemed to

²⁵ Jorge Braga, *Peer Pressure to Meet G20 Commitments: A Promising Innovation?* (2010) <https://www.cigionline.org/publications/2010/6/peer-pressure-meet-g20-commitments-promising-innovation>.

²⁶ Colleen Baker, *The Federal Reserve’s Use of International Swap Lines*, 55 ARIZ. L. REV. 603, 607 (2013).

²⁷ As Baker observed, “Many economists have concluded that the Federal Reserve’s swap lines aided in stabilizing markets during the recent financial crisis. But the swap lines also played a critical role in the expansion of the Federal Reserve’s balance sheet and contribute to its expansion even today.” Colleen Baker, *The Federal Reserve’s Use of International Swap Lines*, 55 ARIZ. L. REV. 603, 608 (2013).

²⁸ https://www.newyorkfed.org/markets/liquidity_swap_archive.html.

²⁹ http://www.cfr.org/international-finance/central-bank-currency-swaps-since-financial-crisis/p36419#1/?cid=from_interactives_listing.

³⁰ <http://www.federalreserve.gov/monetarypolicy/files/FOMC20081029meeting.pdf> at 10.

fall well within the Fed's discretion as a central bank. Indeed, these macroeconomic efforts are thought to be one of the few things central banks can do to stave off a collapse. Central banks are supposed to flood the economy with correctly denominated liquidity, encouraging lending, and credit and stabilizing currencies. In many countries, the liquidity supplied has to be more reliable than government printed money; hence the extension of lines of credit from central banks with stable currencies, to central banks that presided over more volatile money.

In general, central banks have generally managed to act unconstrained by the normal vagaries of administrative law, and least for much of what they do in macroeconomic policy.³¹ Some worry that this leaves them with too much discretion to act as they wish when the global economy is threatened; to others, their decisions on whether and how to loan one another money, and to bailout either their entire financial sector, or particularly important firms within it, are ill-suited to the traditional disciplines of administrative law.

In my view, what matters is that this form of crisis response is different than cooperation with other regulators. It is transactional and discretionary, and because it has turned into an increasingly important crisis response tool, one can expect that it will evolve to include increasingly predictable customs. But it is different from an effort to oversee financial institutions; instead it very much is about making a loan to them.

B. Regulatory Cooperation

Both diplomacy and central bank lending will likely be important parts of the response to the next financial crisis. Nonetheless, it would be incorrect to say that international governance, at least defined capaciously as I am inclined to do, will play no role in responding to the next financial crisis.

First, the legal/regulatory institutionalization of crisis response has meant that the communication both at the level of banking regulators and at the higher political levels of the G20 has been regularized and routinized. Communication all the way from the bottom to the top of each country's organizational chart has now been engaged in an international effort to create standards meant to minimize the risks of a financial crisis.

Second, the constant coordination and international policymaking mechanisms used to set the terms of how regulators should approach the

³¹ David Zaring, *Law and Custom on the Federal Open Market Committee*, 77 L. & CONTEMP. PROBS. (forthcoming 2015).

supervision of domestic banks is the focus of that damage minimization effort. The signature achievement of financial regulators over the past 40 years has been the Capital Adequacy Accords concluded in Basel, Switzerland.³² The Basel Capital Accords require banks to hold a significant portion of their assets as either equity or very safe cash-like instruments. The Accord now includes alternatives such as the Net Stable Funding Ratio and the Liquidity Coverage Ratio, both designed to ensure that banks meet a host of different tests to be considered adequately capitalized, and therefore safe to do business.³³

The idea is that these capital requirements will prevent banks from collapsing in an over-leveraged heap the next time something bad happens, because the safe assets that they are regulatorily required to have on hand will protect them. Regulators and their political superiors are committed to this form of international coordination because financial regulation has a particular cross-border contagion problem. Because of the interconnected nature of the financial system, a disaster in one country can very easily be exported to another country. It means that regulators cannot assume their domestic banks are safe simply because they have met the domestic requirements of safety and soundness.

An international disruption of the payment system, as happened in 1974, can sweep across even tightly ringed fenced domestic financial institutions.³⁴ The problem of contagion has led to the institutionalization of lending and cooperation that will mark the response to the crises. And all of this is being done as a matter of regulation enforced domestically but agreed to internationally.

This way, the response to the next crisis will be inflected by this regulatory cooperation that differs from traditional international law. The prelude to that crisis – the strengthening of institutions and agencies through regulatory cooperation done through notice and comment, both domestically and internationally, and subject to political supervision and

³² <http://proxy.library.upenn.edu:2187/docview/249422679/fulltext?accountid=14707#>
Caruana, Jaime. 2003. "A Vision of Stability within the Basel Accord" *Financial Times*,
Oct 30, 21. <http://search.proquest.com/docview/249422679?accountid=14707>.

³³ For a discussion of these ratios, see Gregory J. Lyons et. al., *Basel Bank Resilience and Liquidity Proposals Confirm the Global Paradigm Shift Toward Increased Financial Regulatory Oversight*, 127 *BANKING L.J.* 226, 234 (2010).

³⁴ *Big Bank Closed By West Germany; Private Institution, Herstat Of Cologne, Ordered To Shut*, N.Y. TIMES, <http://query.nytimes.com/gst/abstract.html?res=950CE7DF153AEF34BC4F51DFB066838F669EDE>, *Failure of Herstatt Disturbs Banking*, N.Y. TIMES, June 10, 1974, <http://query.nytimes.com/gst/abstract.html?res=9907EEDD153EEF32A2575AC2A9609C946590D6CF>.

bureaucratic organization – is the very definition of administrative procedure. And the creation of regulatory mechanisms like finance ministry pre-meetings before political events has resulted in the institutionalization of these practices, making it easier for the next financial crisis summit to mean something.

These efforts have also become iterative. A constant process of peer review is the enforcement mechanism employed to ensure that regulatory harmonization becomes a reality. There are no courts in international financial regulation, but there are constant supervisory committees.

In this way, the legal contribution to the response to the next financial crisis is organizational and administrative, but no less real than international law made through the pomp and circumstance of a treaty signing.

C. Cross-Border Resolution: A Case Study

During the last financial crisis, the failure of cross-border financial institutions led to an often chaotic government response, one that likely made countries more likely to bail out banks, as the alternative – an organized, cross-border resolution – looked unavailable. Because banks that suspect they are covered by a government guarantee are likely to take more risks, because bailouts are politically unpopular, and because without an international process, domestic regulators may respond to crises by unproductively ring-fencing whatever assets of troubled banks they can find, there have ever since been efforts to create a better mechanism for dealing with failing banks. The progress has been slow, but what results there have been represents a doubling down on the promise of regulatory cooperation, either because nothing more can be achieved, or because there is consensus on it being the best way to pursue international financial regulation.

During the last crisis, the problems posed by a lack of cross-border resolution coordination was illustrated time and again. Fortis, a Belgian-Dutch financial conglomerate was taken over by the Belgian and Dutch only to find itself in chaotic post takeover litigation and proxy disputes.³⁵ Dexia, a French-Belgian bank, fared better when it received a relatively coordinated set of financing guarantees from French, Belgian, and Luxembourgian central banks, although even in that case, the banks found it

³⁵ For an account of the Fortis problems, see Matthew C. Turk, *Reframing International Financial Regulation After the Global Financial Crisis: Rational States and Interdependence, Not Regulatory Networks and Soft Law*, 36 MICH. J. INT'L L. 59, 99 (2014).

difficult to agree on how they should apportion their bailout.³⁶ Kaupthing, the Icelandic bank that had branched or created subsidiaries in 13 other jurisdictions was bailed out to the point of diplomatic incident.³⁷ Icelandic supervisors guaranteed to the deposits of Icelandic customers, but were unwilling to bail out those located abroad. Foreign regulators accordingly seized whatever assets of the bank they could find to satisfy their own citizen depositors.

The problem was replicated, although in a substantially magnified way, by the failure of Lehman Brothers, which, as the Basel committee's Cross-Border Bank Resolution Group put it, "consisted of 2985 legal entities operated in some 50 countries."³⁸ When the institution failed after the American government refused to bail it out, and the British refused to sanction an emergency purchase by a large multinational bank, various regulators and creditors raced to their courthouses to find assets of the firm that could be used to satisfy the obligations of the bank; the result was generally thought to be chaotic.³⁹

The G 20 accordingly urged, during their Summit on Financial Markets and the World Economy in 2008, and again at their London Summit in April 2009, that cross-border resolution regimes and bankruptcy laws be strengthened in a way to permit the orderly resolution of these kinds of complex institutions.⁴⁰

However, there has been no appetite for the creation of an international organization that could coordinate these cross-border schemes. Instead of the effort is once again regulatory, with the Basel Committee making a series of recommendations about how resolution regimes ought to be strengthened among its member regulators. These recommendations can tend to the anodyne: Basel has suggested that "national authorities should consider the development of procedures to facilitate the mutual recognition of crisis management and resolution proceedings and or measures."⁴¹ But

³⁶ Some Dexia statistics may be found in Note, *Bank Recapitalizations: A Comparative Perspective*, 50 HARV. J. ON LEGIS. 513, 526 (2013).

³⁷ For a discussion, see Birgir T. Petursson & Andrew P. Morriss, *Global Economies, Regulatory Failure, and Loose Money: Lessons for Regulating the Finance Sector from Iceland's Financial Crisis*, 63 ALA. L. REV. 691, 792 (2012).

³⁸ Report And Recommendation Of The Cross-Border Bank Resolution Group at 14 (March, 2010).

³⁹ A nice overview of the Lehman Brothers lessons may be found in Yesha Yadav, *The Specter of Sisyphus: Re-Making International Financial Regulation After the Global Financial Crisis*, 24 EMORY INT'L L. REV. 83, 108 (2010).

⁴⁰ For a discussion of the way the G20 has addressed cross border resolution, see Edward F. Greene & Joshua L. Boehm, *The Limits of "Name-and-Shame" in International Financial Regulation*, 97 CORNELL L. REV. 1083, 1090 (2012)

⁴¹ Report And Recommendation Of The Cross-Border Bank Resolution Group at 4

not every recommendation is a platitude; Basel has endorsed the power to stay the satisfaction of financial contracts upon resolution, for example.

Moreover, the approach has, if anything, suggested that banking supervisors are particularly comfortable with regulatory cooperation. For the cases of resolution of complex and interconnected cross-border financial intermediaries, the development of so-called “colleges of supervisors” has been urged. Under this scheme, supervisors would quote work closely with relevant home and host resolution authorities in order to understand how group structures and their individual components would be resolved in a crisis.”⁴² More generally, supervisors have been encouraged to simplify and shrink financial institutions that they suspect might be vulnerable in a crisis.

The FSB, which sits above the Basel Committee, has also endorsed the coordination and capacity building approach.⁴³ It has identified what it characterizes as the key attributes of effective resolution regimes, and encouraged its members to ensure that they have regulators with those powers. The FSB has encouraged regulators to develop so-called bail-in mechanisms which take debts owed by the banks and turn it into equity held by the creditors of those banks.⁴⁴ They also have encouraged every authority to obtain the power to temporarily stay early termination rights in financial contracts, and encouraged them to require financial institutions to follow common practices with their financial contracts, including using the forms created by the International Swaps and Derivatives Association.⁴⁵

These efforts may not suffice. Already the United States has adopted a relatively unique approach to bailing out financial institutions, the so-called “single point of entry” approach, which would recapitalize financial institutions at the holding company level.⁴⁶ Because European and other jurisdictions have not structured their financial institutions with the holding company approach, it is not clear how this could be internationalized. Rumored disagreements on how to handle supervision, and how to trust, say, the supervisor of the home country a multinational financial institution to take the lead on resolution seems on the cards. The FSB has encouraged its members to honor the decisions of lead supervisors in multinational

(March, 2010).

⁴² *Id.* at 5.

⁴³ Financial Stability Board, Consultative Document, Effective Resolution Regimes, http://www.financialstabilityboard.org/wp-content/uploads/c_140929.pdf?page_moved=1

⁴⁴ *Id.* at Rec. 1

⁴⁵ *Id.*

⁴⁶ Lubben, Stephen J., *Thoughts on Single Point of Entry* (February 7, 2014). Seton Hall Public Law Research Paper No. 2392450. Available at SSRN: <http://ssrn.com/abstract=2392450> or <http://dx.doi.org/10.2139/ssrn.2392450>

financial resolution contexts, but it is not clear that it is enough.

Moreover, although coordinated resolution requires courts in other countries to honor the steps taken by regulators leading the resolution, European courts have, so far, generally read the EU Directive requiring them to honor the decisions of regulators leading a resolution narrowly.⁴⁷ If coordinate has been limited within Europe, one can only imagine more conflict outside of it.

Cross-border resolution is the second principle way that the international regulatory architecture will respond to the next financial crisis, and although it requires coordination, the low key sort of coordination recommended by the international institutions that have developed since the last crisis suggests that it will truly be one of the challenges for financial regulation in the next crisis. If regulatory cooperation can work there, it can work anywhere in the world of finance.

III. CONCLUSION

Nobody ever thought that the response to a financial crisis would be easy; crises, by definition, challenge those who must respond to them. Crisis response is particularly difficult for institutions built on informal cooperation and the cross-border coordination of domestic regulation. One can see why the welter of agreements to coordinate the oversight of financial institutions generally stick to preparing for crises, trying to make the rules for crisis response. Nonetheless, these agreements have influenced the ways that crisis response will happen, both by creating the institutional vehicles through which discretion will be exercised in crisis response, and even by serving as the rickety vehicle for the takeover and recapitalization of failing financial institutions.

⁴⁷ <http://corpgov.law.harvard.edu/2015/09/06/england-and-germany-limit-bank-resolution-obligations/>