THE FINANCIAL STABILITY FORUM: A STEP IN THE RIGHT DIRECTION . . . NOT FAR ENOUGH

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1. INTRODUCTION

1.1. Background

After the Mexican Peso Crisis in 1994 and the Barings Crisis in 1995, economists and regulators examined the events that led to these crises in an attempt to prevent further systemic economic failures. The analysis of these past crises continued even as the Asian Crisis of the late 1990s was unfolding. In the wake of the Asian Crisis, reformers called for a New International Financial Architecture.

As national economies continue to grow increasingly interdependent, as advances in technology and communications make international transactions even more efficient and profitable, and as the global economy further ties the economic fates of our nations together, we become ever more susceptible to the systemic instability that reformers fear.

The primary concerns of those reformers are the lack of a single set of rules or standards, and the lack of a central body to oversee and enforce standards, in the international marketplace. Often re-
ferred to as the “control gap,” the multitude of varying financial regulations from market to market creates uncertainty among market players, which can quickly lead to panic from investors, and a massive withdrawal of funds from a market or a geographic region, sending shockwaves throughout the interconnected global economy.

1.2. The Current Approach

The current approach to international financial regulation is one in which bodies of international standards such as the Basle Committee on Banking Supervision (“Basle Committee”), the International Organization of Securities Commissions (“IOSCO”), and the International Association of Insurance Advisors (“IAIS”) create suggested voluntary minimum standards of practice. The adoption of these suggested standards is then left up to each nation’s central bank or regulating institutions. Further support for the current financial architecture is provided by the Group of Seven (“G7”), the Group of Ten (“G10”), the International Monetary Fund (“IMF”), and the World Bank, who provide monitoring, communication, and organizational functions.

1.3. Possible Solutions

While the call for reform of the current system is nearly unanimous, the potential plans for reform are quite varied, hence the “best way to fix the system” is still open for debate. Huw Evans describes reformers as falling into three basic camps along a spectrum: at one end are the market purists, who believe that attempts

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5 As has often been the case in recent financial crises, in the Mexican Peso Crisis a panic from foreign investors led to a complete cessation in new foreign investment and a massive withdrawal of foreign funds in Mexico, exacerbating and extending the crisis. See Scott & Wellons, supra note 1, at 1288.


8 Evans, supra note 6, at 110.
at international regulation have proven to be failures and that instead, everything should be left to the forces of the market; in the middle of the spectrum are the pragmatists,9 or the so-called 'gap-fillers,' who see the current architecture as successful, and who only want to continue to try to fill in the gaps between regulating standards and regulating bodies (the majority of reformers fall into this group); on the far end of the spectrum are the visionaries, who believe that it is both possible and desirable to set up a new world financial authority.10

Most reformers, and much of the academic and economic communities that are given a forum in which to voice their opinion, believe that it is impractical or impossible to create a single central authority to promulgate, regulate, and enforce standards for the international marketplace.11 The purpose of this Comment is to argue otherwise.

1.4. Comment Outline

In an attempt to understand the potential problems that are exposed by our global economy and the lack of a single set of overarching regulations to govern the international marketplace, this Comment will engage in brief case studies of four international financial crises that illustrate these potential dangers. This Comment will also present a possible solution to the problems posed by the evolving international financial marketplace, in the form of the recently established Financial Stability Forum.

Section 2 of this Comment will briefly introduce the Financial Stability Forum—its stated purpose, its goals, and its structure.

Section 3 of this Comment will examine four past international financial crises that may have been prevented or otherwise reduced in impact by the work of the Financial Stability Forum: the Bank of Commerce and Credit International ("BCCI") Banking Collapse of the early 1990s, the Barings Crisis of 1995, the Mexican Peso Crisis of 1994-1995, and the Asian Crisis of the late 1990s.

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9 See id. (describing further the pragmatists along his spectrum of reformers).
10 See id. (describing the theoretical goals and ideas of the visionary-minded reformers).
11 See, e.g., id. at 115-16.
Section 4 of this Comment will revisit the Financial Stability Forum, engaging in a more searching analysis of the Forum. The Forum represents a step forward in the thought process on international financial regulation. Rather than creating yet another international body in an attempt to review or propose regulation in a very specific subject area, the Financial Stability Forum is essentially a forum meant to bring together the vast array of existing bodies and regulatory groups so as to provide a vehicle of international communication and exchange regarding financial regulation.

In examining the Financial Stability Forum, this Comment will analyze its creation, its intended purpose, its membership policies and procedures, and the results of a few of the early reports and working groups commissioned by the Forum.

Section 4 will also argue that while the Financial Stability Forum is a step in the right direction, there are reasons to believe that the current structure of the Forum will in fact prevent the Forum from achieving the very goals it was commissioned to perform. Unless the key issues of expanded membership and widened participation are addressed, there is little doubt that the ability of the Financial Stability Forum to create a truly international financial architecture will be compromised.

In examining these potential pitfalls of the Financial Stability Forum, it will become evident that many of the reformers who claim that a single global financial authority is impossible or impractical are in fact the same parties who stand to lose the most in terms of current economic position and current relative power over the international financial architecture if a single global financial authority is achieved.

2. **Financial Stability Forum: A Brief Overview**

The Financial Stability Forum was created by the G7 in response to a perceived growing instability in the international marketplace. As technology and communications advances have brought national economies together in an increasingly intercon-
connected "global economy,"\textsuperscript{14} those national economies have become exposed to the risks of systemic instability. These national economies often have their economic fates tied to one another, such that a collapse or crisis in one nation can quickly spread to others throughout a geographic region, like dominoes.

The Financial Stability Forum was convened in April 1999, "to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance."\textsuperscript{15}

The group is made up of national authorities responsible for financial stability in significant international financial centers (treasuries, central banks, and supervisory agencies); sector-specific international groupings of regulators and supervisors engaged in developing standards and codes of good practice; international financial institutions charged with surveillance of domestic and international financial systems, and monitoring and fostering implementation of standards; and committees of central bank experts concerned with market infrastructure and functioning.\textsuperscript{16}

Currently, national membership in the Financial Stability Forum is limited to Australia, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, the United Kingdom, and the United States.\textsuperscript{17} The Forum is scheduled to meet twice per year, or "as often as needed to carry out its functions."\textsuperscript{18}

3. **Four International Financial Crises**

Perhaps the best way to understand the potential significance of a group like the Financial Stability Forum is to look at the dangers that it hopes to curb and prevent. In that vein, this section of the paper will briefly investigate four international financial crises that illustrate the growing interdependence, and subsequent grow-

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\textsuperscript{14} See generally, id. (describing the increasingly global marketplace and providing examples of its growing interdependence).


\textsuperscript{17} Id. at http://www.fsforum.org/About/Membership.html (last visited Jan. 11, 2002) [hereinafter Financial Stability Forum, Membership] (on file with author).

ing systemic risk, that accompany our increasingly "global econ-
omy."

3.1. The BCCI Banking Collapse

The failure of the BCCI in 1991 illustrates the difficulty of regu-
lating, monitoring, and enforcing basic minimum safety standards
in an international context where differing rules, lax oversight, and
biased (non)enforcement can create failures and systemic risk.

In the case of BCCI, the regulatory problems and resulting fail-
ure occurred in the international banking field. It is important to
note in this context that much of the difficulty in regulating the "in-
ternational financial architecture" stems from the variety of indus-
tries and financial instruments that currently make up the inter-
national market. Not only is it crucial to find a way to regulate
international banking, but there is also a need to regulate securities
firms and insurance firms as well. Furthermore, new types of fi-
nancial instruments are being introduced all the time, many of
which are hard to categorize for regulatory purposes. For exam-
ple, the markets for derivatives and swaps are relatively recent
fixtures in the international financial markets.

In regulating international banking activity, the main objective
of regulation is to avoid systemic risk. In our current interna-
tional system, it is generally left to the host country (the country

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19 A derivative security is a financial asset that represents a claim to another
underlying financial asset. For a more complete description and understanding of
derivative securities and the derivatives markets, see Stephen A. Ross et al.,

20 A swap contract is an agreement between two parties to exchange or swap
specified cash flows at specified intervals. For a better understanding of how
swap contracts may be used as hedging instruments, see id. at 729.

21 In the banking context, systemic risk involves a chain reaction of bank fail-
ures that usually occur for three reasons. First is the risk that a bank failure will
leave the failing bank unable to fulfill its debt requirements through net settle-
ment systems to other banks at the end of a trading day, which may in turn leave
those creditor banks unable to fulfill their own outstanding obligations. Second is
the risk that the failing bank may have substantial deposits on record with other
banks, which can find themselves holding worthless accounts from the failing
bank. Third, there is the risk of bank runs, in which case individual investors can
hear news of the bank failure, panic, and then run to the bank where they have
their own deposits, demanding to withdraw their money for fear of losing it to a
bank failure. As one can see, these types of risks apply to both domestic and in-
ternational bank failures, and can cause great disruption and losses in the global
economy. For more detail on the systemic risks involved in international banking,
see Scott & Wellons, supra note 1, at 110.
that hosts the branch or subsidiary of a foreign bank) to prevent bank collapses. In order to understand the regulating scheme, it is important to first understand one basic, yet very important, difference between host country regulation of foreign branches as opposed to foreign subsidiaries.22

In the case of foreign subsidiaries, the subsidiary must usually be sponsored or chartered by the host country in a manner such that the subsidiary acts as a separate entity, and not as 'part and parcel' of the foreign bank. In these subsidiary arrangements, the foreign subsidiary is usually subject to the same banking rules and regulations as domestic banks. This way, the regulatory duties belong mostly to the host country, and this allows the host country to control its own risk by promulgating standards that it believes are necessary to protect its own interests.23

When the foreign bank is set up as a branch, on the other hand, the duties of regulation and monitoring normally belong to the home country (the foreign country where the parent bank is located).24 When a foreign bank acts as a branch in the host country, the branch operates as 'part and parcel' of the foreign parent bank. This situation presents numerous difficulties for the host country, the most dangerous of which is the possibility that the foreign parent bank will go bankrupt. If failure of the foreign banking parent occurs, the host country branches are also bankrupt, as the branch operates as 'part and parcel,' and with the same funds, as the parent institution. If the same foreign bank has been operating as a subsidiary in the host country, then that subsidiary (because it is a separate entity) operates with its own separate monetary reserves. A foreign subsidiary in a host country can normally continue to operate in its regular fashion even if the foreign parent banking institution has gone bankrupt in the home country.25

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22 The regulation scheme regarding foreign branches versus foreign subsidiaries discussed here applies to the United States regulatory scheme, and is also the scheme in many other industrialized nations, though there is no internationally accepted standard. Id. at 111.

23 See Maximilian J.B. Hall, Banking Regulation and Supervision: A Comparative Study of the UK, USA and Japan 62-64 (1993) (describing the different approaches that three U.S. federal agencies have taken in regulating national banks and the theoretical rationale for each approach).

24 See Scott & Wellons, supra note 1, at 111-13 (discussing why this form of home country regulation is seen as most effective under these circumstances).

25 See Hall, supra note 23, at 75-78 (assessing a U.S. Treasury Department reform package for improving the regulation and supervision of the U.S. banking system).
This brings us to the organizational structure utilized by BCCI. BCCI Holdings, a Luxembourg holding company, was the entity on top of the corporate pyramid. BCCI Holdings owned two principal banks: BCCI S.A., which had been incorporated in Luxembourg, and BCCI Overseas, which had been incorporated in the Cayman Islands. These two banks had subsidiaries and foreign branches in various countries around the world. For example, the Luxembourg bank had over twenty branches in the United Kingdom, as well as a subsidiary in Canada.

This organizational structure led to a situation where there were two foreign bank parents for the numerous subsidiaries and branches around the world. Additionally, neither of the two banks carried out principal operations in their country of incorporation, Luxembourg or the Cayman Islands. Under these circumstances, two countries, instead of one, were responsible for monitoring and maintaining the safety and soundness of the banking organization as a whole.

As often happens when multiple parties have the responsibility for monitoring or regulating others, neither party is ultimately held accountable for the end result, and thus the regulation is weak or unsuccessful. "Further, since the principal operations of the banking organization were in neither country, the supervisors in these countries had a limited ability to make judgments about the safety and soundness of their two banks." Neither Luxembourg nor the Cayman Islands were able to effectively monitor the safety and soundness of their financial institutions, leading ultimately to the collapse of BCCI. When the parent institution collapsed, the financial loss was spread throughout the international economy via the numerous bank branches that had been operating in host countries around the globe.

How might this collapse have been avoided? Scott & Wellons offer a possible solution for future reference:

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26 See SCOTT & WELLONS, supra note 1, at 113 (describing in detail the complex set-up of this international banking institution).
27 Id.
28 See id. at 113-14 (discussing further the regulatory difficulties created by this kind of international institution).
29 Id. at 114.
30 Id. at 113-14.
In principle, this problem might have been cured if Luxembourg had authority to regulate the entire operations of the bank holding company, BCCI Holdings, but this was not the case. The problem might also have been cured if there had been an international agreement that there could only be one ultimate bank parent, that is, that one of the banks had to become a subsidiary of the other, but this was also not the case.31

In the wake of the BCCI collapse, there was call for a change or bolstering of international banking standards so as to avoid any possible future reoccurrences.32 And, in fact, there were some reactive changes made to the existing (voluntary) international banking standards by the Basle Committee,33 as well as the ‘post-BCCI Directive’ promulgated by the EU.34

Even with these changes though, the problems have not been completely eradicated. First, the Basle Committee’s minimum standards for international banking continue to exist solely as suggestions to be voluntarily adopted or neglected by individual countries. Second, the ‘post-BCCI Directive’ of the EU applies only to those countries in the EU, and the usefulness of the regulatory standards (however debatable) do not extend any further than that. Third, the updated Basle Committee standards still call for international banks to be supervised by a home-country authority “that capably performs consolidated supervision.”35 Therefore, “[g]iven that there are such large differences in the quality of supervision among different countries . . ., the effectiveness of the new guidelines depends on the ability of national authorities to monitor each others’ [sic] quality of supervision.”36

31 Id. at 114.
33 See STEPHANIE GRIFFITH-JONES, GLOBAL CAPITAL FLOWS: SHOULD THEY BE REGULATED? 162-164 (1998) (providing examples of some of the reactive changes and recommendations by the Basle Committee).
35 GRIFFITH-JONES, supra note 33, at 163.
36 Id.
Again, it seems that host countries are subject to the home countries’ monitoring and enforcement in order to avoid bank failures and systemic risk. The only real change here seems to be an increased awareness that host countries may want to make sure that the home countries are being diligent in their regulatory roles. Perhaps sensing the inherent weaknesses in this sort of regulatory scheme, the U.S. Comptroller of Currency suggested in 1991 that if the Basle Committee’s approach was not effective in providing for the safety and soundness of banking institutions, then “there may eventually be pressure for the International Monetary Fund to conduct formal supervisory reviews as part of its country surveillance procedures.”

3.2. The Barings Crisis

The events that took place during the Barings Crisis exemplify the difficulties of international financial regulation when the regulatory authority is divided among several regulating bodies. Barings was a financial group based in London that had over 100 subsidiaries in multiple countries. Baring business was divided into five separate units: banking, equity brokering and trading, corporate finance, international finance, and operations. Supervision and regulation of the key Baring units was split among the regulating bodies of several different countries.

The Barings scandal involved the unauthorized trading of a Baring employee, Nicholas Leeson, on the Singapore International Monetary Exchange (“SIMEX”) and the Osaka Stock Exchange (“OSE”). The trouble began when Leeson was chosen to head the settlement unit of the Baring Futures Division in Singapore. Leeson had been denied a broker’s license in the United Kingdom because of a fraudulent application, but this denial was never revealed to the authorities in Singapore when he applied for, and received, his license there in 1992.

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37 Id. (emphasis in original).
38 See SCOTT & WELLONS, supra note 1, at 987-88 (discussing Leeson’s background in trading and the evolution of his increasing responsibilities with Barings).
39 Id. at 988 (detailing Leeson’s involvement in futures arbitrage on the Tokyo Stock Exchange and the Osaka Stock Exchange).
Leeson had never before been involved in the trading of futures contracts; nonetheless, he quickly began engaging in futures transactions upon his arrival in Singapore. Many of the other Barings divisions carried out financial transactions on SIMEX through Leeson and his Singapore Division. The underpinnings of the crisis began when Leeson opened a secret account on SIMEX, and began to make a great number of unauthorized trades.

Leeson lost huge sums of money in these transactions, and he was able to hide the losses from his superiors both in Singapore and in London. Leeson had disabled the computer link between his trading system in Singapore and the London computer system so that his trades would not be picked up as irregularities by the system. In later investigations into how Leeson's activities were not detected, the Senior Barings Managers in Singapore said they "viewed BFS [Leeson's Singapore Division] as Mr [sic] Leeson's own responsibility and thus did not check Mr [sic] Leeson's activities. On the other hand, the Baring Group management in London maintained that BFS was a Singapore company accountable in the first instance to its local managers."  

By the time the collapse occurred in 1995, Leeson had lost $2.2 billion through his unauthorized trading activities. The unauthorized dealing went on for over two years, during which time his activities were never discovered. While auditors in Singapore failed to recognize or prevent Leeson's activities, an internal audit report in Singapore did recognize the potential for abuse. The report stated that "Mr [sic] Leeson occupied a very powerful position controlling both the front and back offices of BFS. He was both chief trader and head of settlements and was thus in a position to record the trades that he himself had executed in any way he wished."

In the aftermath of the Barings Crisis, as regulators were trying to determine the causes of the collapse, there appeared to be plenty of blame to go around. First, in the private sector, the Baring Group did little or nothing in the way of monitoring and regulating the activities of Leeson, an employee who was placed in a posi-

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40 For an explanation of futures transactions, see Ross et al., supra note 19, at 705-10.
41 Scott & Wellons, supra note 1, at 991.
42 See id. at 993 (providing financial figures detailing the gradual progression of Leeson's undetected losses).
43 Id. at 994-95.
tion of power, with the ability to control and edit the financial records that tracked his activities. Second, in the public sector, the inability of auditors and regulators on the SIMEX and OSE stock exchanges to detect any wrongdoing allowed Leeson to continue his trading unencumbered.

One of the few positive notes that resulted from the Barings Crisis was the effectiveness of the margin rules on SIMEX, which protected some of the losses due to Leeson’s trading. Margin rules continue to be one of the major tools used by exchanges to protect the safety and soundness of their institutions.

As was the case in the BCCI collapse, there were attempts made to change and tighten the regulations that failed to prevent the Barings Crisis. There was a change made in compliance audits of foreign-owned subsidiaries, wherein both the host and parent country of the bank are to be held equally responsible for audits and sanctions. The Windsor Declaration and the March 1996 Declaration for Information Sharing took further regulatory steps forward.

The Windsor Declaration was the result of a May 1995 meeting in Windsor, U.K., of representatives of the financial futures and options regulators from 16 countries around the globe. The key topics of discussion, which became components of the Windsor Declaration, included: the cooperation between market authorities; protection of customer positions, funds and assets; default procedures in the case of events like the Barings Crisis; and regulatory cooperation in emergency situations.

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44 Id. at 996-1001 (describing the regulatory scheme of SIMEX, including general surveillance and financial audits backed by fines of varying degrees).

45 Id. at 951-56 (providing details of the different forms of margin rules utilized for positions in stock, as well as specific forms of margin rules for trading futures and options contracts).


47 An option contract is an agreement that gives the owner of the option the right, but not the obligation, to buy or sell a specific asset at a specific price for a set period of time. For more information on options contracts and their place in the international financial markets, see Ross et al., supra note 19, at 705-10.

48 Representatives at the Windsor conference included regulators from Australia, Brazil, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, South Africa, Spain, Sweden, Switzerland, the United States, and the United Kingdom. Scott & Wellons, supra note 1, at 1012.

49 Id. at 1013.
About a year after the Windsor Declaration, the futures and options regulators continued their attempts to improve regulatory standards by promulgating the Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations. The idea was that authorities would share certain information with one another, on a confidential basis, in the event that the authorities became suspicious of the activities of a regulated party. Procedurally, the agreement allowed an authority to make a formal information request to another regulating authority if certain events occurred.

3.3. The Mexican Peso Crisis of 1994-1995

The Mexican Crisis of 1994-1995 is particularly important for a number of reasons. First, the Mexican Crisis revolved around the failure of a national economy rather than an individual bank or securities firm, and its potential significance for future crises, in the face of the increasingly interconnected international economy, earned it the dubious honor of being dubbed "the first major crisis of the 21st century." Second, the crisis in Mexico spread to a number of other economies, with crippling consequences, a phenomenon often called the "Tequila Effect." Third, the progress of Mexico's economy, prior to the crisis, had been considered a very successful venture; it had been held up as an example, a blueprint, of how developing countries and emerging economies could reach new prosperous heights. So, when it all came crashing down, there was great worldwide interest in determining what went wrong.

The factors that led to the crisis have since been analyzed, discussed, and debated repeatedly, in hopes of finding 'signs' of forewarning that can be relied upon to avoid similar crises in the

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50 The Declaration on Cooperation and Supervision of International Futures Markets and Clearing Houses was promulgated in March of 1996. Id. at 1015.
51 See Scott & Wellons, supra note 1, at 1015-17 (discussing the efforts of futures and options regulators to open their lines of communication and information sharing).
52 Griffith-Jones, supra note 33, at 100.
53 Scott & Wellons, supra note 1, at 1291.
54 See Griffith-Jones, supra note 33, at 104-15 (describing how initial economic success spurred foreign investment and further fueled economic progress and development).
future.55 Alas, while opinions as to the major causes vary (as they always do), there have been a number of factors credited for having had at least some impact on the turn of events. These factors include: the large current account deficit that Mexico had carried into 1993 and 1994, which was close to eight percent of the gross domestic product (GDP);56 the fact that much of the deficit was funded by short-term capital inflows;57 the Mexican commitment to a relatively fixed exchange rate, even, and perhaps especially, when the Mexican exchange rate seemed to be overvalued;58 the fact that Mexico had allowed such a large portion of its government debt paper to fall into the hands of non-residents;59 and the fact that a high proportion of the government debt paper was short-term.60

Having identified some of the factors that played a role in the Mexican Crisis, it is now essential to see if these factors can be utilized as indicators, or as ‘advice’ for better fiscal policy under similar circumstances. In order to do this, the following section of this Comment will briefly discuss the way in which the crisis unfolded and then examine how the situation may have been handled differently.

On December 20, 1994, the Mexican government devalued the peso fifteen percent against the dollar, and two days later it let the peso float.61 At the time of the devaluation, many observers felt it was the correct fiscal policy in light of the large current account deficit and the exchange rate.62 However, many of the same observers believed that the action was taken too late.63 The Mexican stock market index, which had been as high as 2600 at the start of

55 See generally Bradford DeLong et al., The Mexican Peso Crisis: In Defense of U.S. Policy Toward Mexico (discussing U.S. economic policy toward Mexico and debating whether this policy was a contributing factor of the Mexican Peso Crisis), at http://www.j-bradford-delong.net/Econ_Articles/themexicanpesocrisis.html (last visited Apr. 3, 2003).
56 GRIFFITH-JONES, supra note 33, at 100.
57 Id.
58 Id.
59 Id.
60 Id.
61 SCOTT & WELLONS, supra note 1, at 1257.
62 See GRIFFITH-JONES, supra note 33, at 124-26 (describing the massive financial crisis following the devaluation of the peso on December 20, 1994).
63 Id.
December, plummeted to below 1500 in early March of 1995 before it began to recover.\textsuperscript{64}

Of even more significance, perhaps, was the effect of the Mexican crisis on the rest of the world’s economies:

Even though the Mexican authorities on 20 December did what many observers had said was necessary (a devaluation of around 20 per cent), this decision precipitated an incredibly large financial and balance of payments crisis for Mexico, with strong ripple effects not just in Latin America, but throughout the developing world and even in some of the weaker developed economies.\textsuperscript{65}

Following the collapse in Mexico, other Latin American markets fell like dominoes. The major markets in Argentina, Brazil, Chile, and Peru all fell from December through mid-March, when they reached about sixty percent of their December levels.\textsuperscript{66} The Asian exchanges were also impacted. During January of 1995, there were declines of eleven to thirteen percent in Pakistan, the Philippines, China, India, South Korea, and Taiwan.\textsuperscript{67} Smaller declines hit Hong Kong, Thailand, Malaysia, Indonesia, and Singapore.\textsuperscript{68} The systemic risk that many people had feared was now spreading throughout the world.

But what, if anything, did we take from this? Was there anything to be learned about trends and warning signs, or could it all be attributed to random chance and a combination of unfortunate circumstances? At least one thing had become clear: governments and economies which have been quickly elevated from an influx of foreign investor funding are vulnerable to a situation where those same foreign investors lose faith in the system and quickly withdraw their funds.

This realization is supported by evidence of financial flows to developing countries since the Mexican Crisis. In 1993, non-bank private lenders and portfolio investors accounted for fifty-two percent of external financing. By 1995, non-bank private lenders and

\textsuperscript{64} SCOTT \& WELLONS, supra note 1, at 1257.
\textsuperscript{65} GRIFFITH-JONES, supra note 33, at 124.
\textsuperscript{66} SCOTT \& WELLONS, supra note 1, at 1258.
\textsuperscript{67} Id.
\textsuperscript{68} Id.
portfolio investors accounted for only sixteen percent of total external financing.\footnote{Id. at 1292.}

Of all the lessons learned from the Mexican Crisis, the most important was that the international financial architecture had become interconnected in a way such that systemic risk was now a real threat that had to be dealt with.

3.4. The Asian Crisis

As the effects of the Mexican Peso Crisis were finally being vanquished from both the markets and our minds, we were once again reminded of the fragile state of the international financial structure when the exchange rates in many countries in Asia collapsed, starting yet another crisis.\footnote{See Edward K.Y. Chen, \textit{The Asian Financial Crisis of 1997-8: A Case of Market Failure, Government Failure, or International Failure?}, in \textit{ESSAYS ON THE WORLD ECONOMY AND ITS FINANCIAL SYSTEM} 49, 49-63 (Brigitte Granville ed., 2000) (discussing the far-reaching effects of the Asian Financial Crisis).}

While the causes of a financial crisis are never easy to isolate and point to, the causes of the Asian Crisis in particular were, and remain, a hotly debated issue among economists and policymakers.\footnote{See generally SCOTT & WELLONS, supra note 1, at 1293-94 (discussing different viewpoints as to the cause of the Asian Financial Crisis).} The severity of the crisis in Asia only served to make the debate more important: "There had been at different times and in different regions debt crises, currency crises, banking crises, and stock market crashes. But at no other time had all four types of crisis happened simultaneously."\footnote{Chen, supra note 70, at 49.} Some pointed to market failure,\footnote{See id. at 50-51 (listing in detail the causes of the market failure).} or government failure\footnote{Id. at 51-52.} in fiscal policy to explain the Asian Crisis. Still others blamed the crisis on the inherent weaknesses and instability of the international financial architecture.\footnote{Id. at 53-54.} While debate raged on over the cause of the crisis, the impact of the crisis was visible to all. The crisis began in mid-1997 in Thailand, and spread to Malaysia, the Philippines, Indonesia, and Korea over a six-month time period.\footnote{SCOTT & WELLONS, supra note 1, at 1293.} The crisis served to place an entire region in a financial tailspin; the so-called...
Asian Tigers that had been the toast of the international economic community found themselves reeling, now hoping only to stop the bleeding.

But the impact of the Asian Crisis was felt outside of the region as well. "After the Asian Crisis hit, investors began to withdraw from Russia, draining perhaps $5 billion in just one month, November 1997, for example." This contributed to a Russian Crisis wherein the country defaulted on government bonds.

As occurred after the Mexico Crisis, the Asian Crisis sparked debate about reforming the International Financial Architecture to promote stability and prevent systemic risk. In a positive light, the Asian Crisis once again focused our attention on the International Financial Architecture; shortly thereafter, the G7 created a new International Group to help facilitate the coordination of International Financial Standards: The Financial Stability Forum.

4. THE FINANCIAL STABILITY FORUM

We have seen in the case of the BCCI Bank Collapse and the Barings Crisis that attempts to regulate international financial transactions have not been completely effective. It is not hard to see why: without a single set of financial rules and regulations, banks and firms operating across borders are often dealing with multiple sets of laws, and often are left to choose those that they may find most beneficial. And when the regulatory oversight of

77 SCOTT & WELLONS, supra note 1, at 1299.
78 Id. at 1298-1301 (describing fully the Russian default on financial instruments issues as part of an earlier debt restructuring). The huge withdrawal of foreign investor funds, coupled with already existing political instability and other weak financial indicators, led to further investor outflows. The cost of servicing Russian government debts increased, and this put pressure on the ruble, signaling weakness in the economy that prevented any new inflows of foreign capital. Id.
79 See C.H. Kwan, Asia in Search of a New Exchange Rate Regime, in ESSAYS ON THE WORLD ECONOMY AND ITS FINANCIAL SYSTEM 127 (Brigitte Granville ed., 2000) (discussing various viewpoints regarding the best way to stabilize the international financial architecture).
80 For example, in the case of the Barings Crisis, the Barings group decided to move much of their futures trading and arbitrage activity from the Osaka Stock Exchange to the Singapore Stock Exchange because of the lesser margin requirements, which allowed Barings to perform trades at lower costs, but did not provide as much of a buffer for safety and soundness precautions. See SCOTT & WELLONS, supra note 1, at 985-95. See also supra § 3.2.
these banks, firms, and other private actors are divided among multiple regulatory bodies, there is a reduction in accountability.\footnote{This happened in the Barings Crisis when both the London group and the Singapore group were responsible for Leeson’s trading activities, and so both groups were lax on monitoring him, because each felt the other would do the necessary monitoring. \textit{See} SCOTT & WELLONS, \textit{supra} note 1, at 985-95.}

We have further seen, in the case of the Mexican Crisis and the Asian Crisis, that our international financial system has become increasingly interconnected. Under these circumstances, a fiscal crisis in one country or in one region of the world can quickly spread throughout the global economy. The lack of a single set of economic regulations or principles, and the lack of a single authority to regulate international economic activity, often leave countries with only one recourse—to hope that those responsible for the fiscal policies of other nations are being responsible in their fiscal decision-making.

As one might guess, this kind of blind faith in the fiscal regulators of other economies does not sit well with many of the world’s policymakers. Instead, there has been a call for our international financial bodies to try to create and maintain a more unified set of standards in international financial regulation. This is often referred to as the call for a New International Financial Architecture.\footnote{See Lee C. Buchheit, \textit{A Lawyer’s Perspective on the New International Financial Architecture}, in \textit{THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE} 235, 237 (Rosa M. Lastra ed., 2001) (discussing the possible variations of a reformed international economic regulatory infrastructure).}

One of the newest pieces of the international financial puzzle, and an interesting step forward in the quest to create a more unified set of international financial standards, has arrived in the form of the Financial Stability Forum.

4.1. Financial Stability Forum Background

Discussed earlier, the financial crises of the 1990s, particularly the Mexican Crisis and the Asian Crisis, sparked great interest in the idea of reforming the international financial architecture. One such international body that became concerned with the possibility of future crises was the G7.\footnote{For a further description of the G7, \textit{see} Walker, \textit{supra} note 4, at 122 n.6.} In acting on this interest, the G7 requested that Hans Tietmeyer, the President of the Bundesbank, prepare a report offering suggestions as to how closer cooperation and coordination could be gained between the many international
financial regulatory bodies and the existing international financial institutions whose goal was to maintain international economic stability.\textsuperscript{84}

Upon completion of the report, Tietmeyer presented his findings to the G7 at a 1999 meeting.\textsuperscript{85} In his report to the G7, Tietmeyer proposed the creation of a new institution, the Financial Stability Forum, which would be comprised of: national authorities responsible for financial stability in significant international financial centers, namely treasuries, central banks, and supervisory agencies; sector-specific international groupings of regulators and supervisors engaged in developing standards and codes of good practice; international financial institutions charged with surveillance of domestic and international financial systems, and monitoring and fostering implementation of standards; and committees of central bank experts concerned with market infrastructure and functioning.\textsuperscript{86}

The G7 approved Tietmeyer's proposal, and the Financial Stability Forum convened on April 14, 1999, with Andrew Crockett—General Manager for the Bank of International Settlements ("BIS")\textsuperscript{87}—appointed as chairman of the Forum for a period of three years.\textsuperscript{88} Mr. Crockett's new Financial Stability Forum was charged with a list of lofty objectives: to assess vulnerabilities affecting the international financial system; to identify and oversee action needed to address these vulnerabilities; and to improve coordination and information exchange among the various authorities responsible for financial stability.\textsuperscript{89}

Another important issue regarding the Financial Stability Forum’s organizational structure revolves around its membership

\textsuperscript{84} Id. at 124-25 (discussing Tietmeyer's appointment and the reasons for his assignment).


\textsuperscript{86} See Financial Stability Forum, Objectives, supra note 18 (describing further the envisioned roles of these members and the coordinating role of the Financial Stability Forum).

\textsuperscript{87} For a description of the BIS and its place in the international financial architecture, see James R. Barth et al., Commercial Banking Structure, Regulation and Performance: An International Comparison, in MODERNIZING FINANCIAL SYSTEMS 119 (Dimitri B. Papadimitriou ed., 2000).

\textsuperscript{88} Financial Stability Forum, Home, supra note 16.

\textsuperscript{89} See Financial Stability Forum, Objectives, supra note 18 (discussing in more detail these objectives and possible approaches to reaching these objectives).
policies and procedures. First, the forty members of the Forum bring together representatives of the G7 countries; international financial institutions such as the IMF, the World Bank, BIS, and the Organization for Economic Co-operation and Development ("OECD"), international regulatory and supervisory groups such as the Basle Committee on Banking Supervision, the IOSCO, and the IAIS; and committees of central bank experts.\textsuperscript{90}

The ability to bring together these various international regulatory and supervisory bodies allows the Financial Stability Forum to act as a conduit, an instrument of information exchange and policy formulation in a collaborative effort with the many separate international financial institutions. This organizational structure may not seem extraordinary, but it creates the opportunity for a meaningful forum in which a single set of international standards can be discussed by a variety of interested parties.\textsuperscript{91}

4.2. What's Right with the Financial Stability Forum?

Also discussed earlier, the Financial Stability Forum holds a unique position as a global financial facilitator. Bringing together a vast array of regulatory and supervisory groups to discuss, examine, and hopefully cooperate in the creation of uniform international standards is indeed a great benefit of the organizational structure of the Financial Stability Forum.

Another promising project at the Forum, and perhaps the most impressive one to date, is the attempt to assemble a "Compendium of Standards."\textsuperscript{92} According to the Financial Stability Forum website:

The Compendium of Standards provides a common reference for the various economic and financial standards that are internationally accepted as relevant to sound, stable and well-functioning financial systems. It serves as a gateway or point of entry for financial authorities and market parties.

\textsuperscript{90} See Financial Stability Forum, Membership, \textit{supra} note 17 (listing member categories).

\textsuperscript{91} See Walker, \textit{supra} note 4, at 152 (discussing the benefits of a cooperative forum in promoting international agreement and fostering future cooperative efforts).

participants to access the sites where the complete standards, supporting documents, and assessment methodologies referenced in the standards are located. It also signals the importance attached by the international community to the implementation of these standards and sound practices, and facilitate the dissemination of information on them.\textsuperscript{93}

The Compendium of Standards set forth by the Financial Stability Forum, with the help and support of the member regulatory and supervisory bodies, represents an initial step towards a consolidated international financial set of rules and regulations.\textsuperscript{94} While the compendium is a promising first attempt to create a unified set of international economic regulations, there is still much work to be done in ‘working out the kinks.’\textsuperscript{95} For instance, problems have been identified in the Compendium of Standards with regard to gaps and internal consistencies.\textsuperscript{96}

The Compendium of Standards seems to be the long-term goal of the Financial Stability Forum; a functioning and controlling set of international standards would represent a culmination of sorts for the Forum’s efforts. Still, the agreement upon and widespread use of a single set of international financial standards may take some time to accomplish.

In the meantime, the Financial Stability Forum has utilized its ‘working groups’ format to identify and address smaller, more pressing problems in the international marketplace. By creating smaller, more manageable groups to work on specific problems, the Forum can take advantage of the vast experience and knowledge of its membership without the need for initial agreement among all forty members. The working groups investigate their mandated issues, and then create reports to present to the entirety

\textsuperscript{93} Id. See also Reserve Bank of Australia, Financial System Architecture (discussing the Compendium of Standards and the Financial Stability Forum’s strategies to get the standards implemented, such as market incentives), available at http://www.rba.gov.au/FinancialSystemStability/financial_system_architecture.html (last visited Feb. 19, 2003).

\textsuperscript{94} See Walker, supra note 4, at 152 (describing the benefits of a system like the Compendium of Standards in promoting global cooperation).

\textsuperscript{95} Id. at 151 (describing that the Compendium of Standards, while certainly a meaningful step towards progress, remains far from perfect).

\textsuperscript{96} Id. (discussing in greater depth some of the identified shortfalls of the Compendium of Standards and how those shortfalls may be addressed).
of the Forum’s membership, where any decisions can then be made by the fully informed group.

Initially, three working groups were set up during the first meeting of the Financial Stability Forum in 1999. These groups were to investigate highly leveraged institutions, capital flows, and offshore financial centers.\footnote{97}

The group on highly leveraged institutions was to “recommend actions to reduce the destabilizing potential of institutions employing a high degree of leverage (“HLIs”) in the financial markets of developed and developing countries.”\footnote{98} In order to accomplish this goal, the group was to focus on “the potential risk to the financial system presented by the failure of large HLIs and the effects of the activities of HLIs on the dynamics and integrity of financial markets in small and medium-sized economies.”\footnote{99}

The group submitted its report to the Financial Stability Forum in March 2000; the Forum endorsed the recommendations made in the report.\footnote{100}

The Offshore Financial Centers (“OFCs”) working group was given the task of considering “the significance of offshore financial centers for global financial stability.”\footnote{101} In carrying out its mandate, the group “reviewed the uses and activities of OFCs with a view to addressing problems created by OFCs with weaknesses in financial supervision, cross-border co-operation, and transparency that allow financial market participants to engage in regulatory arbitrage of several forms.”\footnote{102}

The OFCs group presented its report to the Forum in March 2000, which the Forum accepted and endorsed.\footnote{103}

The working group on Capital Flows performed its mandated task, and also presented its report to the Forum in March 2000, which was accepted and endorsed.\footnote{104}

\footnote{97 See Financial Stability Forum, Working Groups (detailing the assignments of the working groups), at http://www.fsforum.org/About/WorkGroups.html (last visited Jan. 11, 2002) (on file with author).}
\footnote{98 Id.}
\footnote{99 Id.}
\footnote{100 The actual report is available to the public on the Financial Stability Forum website at http://www.fsforum.org.}
\footnote{101 Financial Stability Forum, Working Groups, supra note 97.}
\footnote{102 Id.}
\footnote{103 The actual report is available to the public on the Financial Stability Forum website at http://www.fsforum.org.}
Following on the success of the initial three working groups, the Forum has since established two more working groups: the Task Force on Implementation Standards, and the Study Group on Deposit Insurance. The working groups seem to be a very effective format of operation for the Forum, and one that the Forum will likely continue to utilize in the near future.

4.3. What’s Wrong with the Financial Stability Forum?

The membership policies of the Financial Stability Forum, while presenting a great opportunity due to the input from a wide array of regulatory and supervisory agencies, also present a serious problem. As previously discussed, the Forum is composed of a number of international regulatory groups, and also representatives from all of the G7 countries.\footnote{The G7 consists of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. Further discussion of the G7 and its membership and policies can be found at http://www.imf.org/external/np/exr/facts/groups.htm#G7.}

Examining these membership policies, a lack of participation by lesser developed countries ("LDCs") and emerging economies is quite evident. The Financial Stability Forum claims that the membership policies will be expanded in time, one way or another:

Although direct membership was to be limited to the G7, efforts have been made from an early stage to extend the range of countries involved with its work. Senior representatives from Hong Kong, Australia and the Netherlands were accordingly invited to attend the second meetings in Paris while other countries will be involved through its working group structures.\footnote{Walker, supra note 4, at 129. To learn more about the utilization of working groups in the Financial Stability Forum, see Financial Stability Forum, Working Groups, supra note 97.}

While the Financial Stability Forum promises to expand participation in the future, many of those countries and groups currently locked out of the meaningful progress are not satisfied:

\footnote{The actual report is available to the public on the Financial Stability Forum website, at http://www.fsforum.org.}
A preemptive, pre-crisis credit line at the Fund (which no country wants to avail of) and a toothless Financial Stability Forum—where there is little developing country participation—appear to be the only “innovations” to emerge from the Asian, Russian, and Brazilian financial crises of the last three years.107

It seems counterintuitive that we would lock certain groups or countries out of the discussions and policy formulation for the New International Financial Architecture. Surely, as the world economies will almost certainly continue to become even more co-dependent, one would argue that even those countries which do not currently reside in positions of economic prominence should be able to offer their opinions, and help shape the future New International Financial Architecture.108


I would like to draw your attention to the fact that main [sic] dialogues for reform have been led by the G-7 countries. And, as such, views of emerging countries have often been overlooked.

We must remember that the recent crises are not entirely due to the vulnerability that existed within the crisis-hit countries’ own financial systems.

The shortcomings of the international financial system itself need be held accountable as well. That is, its incapacity to adapt to new developments in the world economy, especially the surge and the reversal of private capital flows.

In order to avoid such a calamity, our goal must consist of more than just strengthening [sic] domestic financial sector and implementing sound macroeconomic policies. To fully rectify the structural impediments in the international financial system, we need a much more unified effort, in which we all continuously take part.

*Id.*
When the goal is to create a single, unified body of international financial regulations, how can we expect the countries that do not participate to accept the new regulations, voluntarily or otherwise? The fact of the matter is that these regulations cannot be thrust upon unwilling parties; the Financial Stability Forum runs the risk of creating a wonderful set of new standards that no one will adopt.\textsuperscript{109} This issue was brought straight to the Chairman of the Forum, Andrew Crockett, following a presentation to the United Nations in May 2000:

After his speech, representatives of Southern governments followed each other in raising queries and concerns. Kenya began with a concern on the exclusion of African states, particularly the LDCs, from membership in the FSF. The woman representative from Cuba followed through by informing the speaker of the declaration made by country representatives at the South Forum (2000) of their refusal to implement any international standard or measure arrived at without their meaningful participation.\textsuperscript{110}

Mr. Crockett responded to the comments by voicing his opinion that the Forum would be more efficient if membership and policy ideas were rather homogeneous.\textsuperscript{111} But are homogeneous membership and policy formulation valid goals, when the standards that will be promulgated by the Forum are expected to be adopted globally?

\textsuperscript{109} See generally Alan Beattie, G24 Coalition Bristles at IMF Demands, FIN. TIMES.COM, Sept. 25, 2000 (“A coalition of developing and emerging market countries has attacked the idea that they should be compelled to adhere to international standards of fiscal and monetary policy.”), available at http://news.ft.com.


\textsuperscript{111} Mr. Crockett responded to the question:

In defense of exclusivity of membership in the FSF to industrialized and some key emerging economies, he opined: “We need to focus on best practice, not average practice.” Still very much preoccupied with nothing but dealing with ‘best’ practices and solutions, he threw a challenge to the body by asking how expansion in membership could be undertaken without creating a demand for everyone—including those with average and bad practices—to also want to join.

\textit{Id.}
We find a good example of this egocentrism in practice if we look at the Financial Stability Forum Report on Offshore Financial Centres.\(^{112}\) The aim of the report was to identify the most effective international standards which could secure proper financial supervision, cross-border cooperation, and transparency\(^{113}\) with respect to the offshore centers.\(^{114}\)

The report classified the offshore financial centers into three groups, each group defined by a certain lack of regulatory effectiveness. The Bermuda International Business Association ("BIBA") questioned the rankings, and its placement in the tier II group.\(^{115}\) BIBA, and several other financial centers placed on the list, fear that the countries conducting these reports are doing so partly out of a fear of the competition provided by the offshore centers.\(^{116}\)

In many countries, the offshore financial centers represent a significant part of the economy. Why would these countries submit to any suggestions proposed by the Financial Stability Forum? The Forum is effectively planning to cut off these countries' economic flows without inviting them to help create the standards by which they will be judged.

5. CONCLUSION

As we have seen, the international financial community is becoming more interconnected and interdependent every day.\(^{117}\) While this creates increased financial opportunities for market players, and may serve to equalize some of the economic inequity in our international system, it also opens us up to the dangers of

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\(^{113}\) For a definition of transparency rules, see SCOTT & WELLONS, supra note 1, at 1360.

\(^{114}\) See Walker, supra note 4, at 133 (discussing the reasons why the Financial Stability Forum might target these offshore financial centers).


\(^{116}\) Id.

\(^{117}\) See Bryant, supra note 13, at 218 (discussing reasons why the global economies are likely to continue their growing interdependence).
systemic risk, and threatens the safety and soundness of the International Financial Architecture.

The BCCI Collapse,\textsuperscript{118} the Barings Crisis,\textsuperscript{119} and the crises in Mexico\textsuperscript{120} and Asia\textsuperscript{121} serve to illustrate the difficulties inherently involved in regulating an international financial system where multiple sets of rules and numerous supervisory bodies exist. It seems that we might all be better off with a single set of international financial regulations.

The Financial Stability Forum represents a preliminary step in this direction, and its Compendium of Standards\textsuperscript{122} sets the bar for future achievements at a very high level indeed. Unfortunately, the progress that has been made by the Financial Stability Forum thus far has been tempered by the restrictions on participation which seem to threaten the Forum's ultimate goals. Only by opening membership to a wider group of countries, and allowing all countries to participate on some meaningful level, will the Financial Stability Forum eventually be able to establish a single set of international financial standards that will limit global systemic instability and be embraced by all.

\textsuperscript{118} A full discussion of the BCCI banking collapse is available at SCOTT \& WELLONS, supra note 1, at 113. \textit{See also} supra § 3.1.

\textsuperscript{119} For a more detailed discussion of the Barings Crisis, see SCOTT \& WELLONS, supra note 1, at 985. \textit{See also} supra § 3.2.

\textsuperscript{120} For a more in-depth look at the causes and effects of the Mexico Crisis, see GRIFFITH-JONES, supra note 33, at 100. \textit{See also} supra § 3.3.

\textsuperscript{121} For a fully-detailed discussion of the debate over the causes of the Asian Crisis, see Chen, supra note 70. \textit{See also} supra § 3.4.

\textsuperscript{122} Financial Stability Forum, Standards, supra note 92.