

INTERNATIONAL BANKING AND FINANCE LAW SERIES

From Crisis to Crisis

The Global Financial System
and Regulatory Failure

Ross P. Buckley & Douglas W. Arner



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Law & Business

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To Rashelle and Chantal

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Each have consulted to a range of banks, financial institutions and government departments in a wide range of countries.

List of Abbreviations

ABS	Asset Backed Securities
AECM	Aggregate Effective Currency Mismatch
ASEAN	Association of Southeast Asian Nations
BCBS	Basel Committee for Banking Supervision
BIS	Bank for International Settlements
BPS	Basis Points
BRIC	Brazil, Russia, India and China
CACs	Collective Action Clauses
CCPs	Central Counterparty Clearinghouses
CDO	Collateralized Debt Obligations
CDS	Credit Default Swaps
CFPB	Consumer Financial Protection Bureau
CFTC	Commodities Futures Trading Commission
CGFS	Committee on the Global Financial System
CLO	Collateralized Loan Obligations
CPSS	Committee on Payment and Settlement Systems
CRA	Credit Rating Agencies
CTT	Currency Transaction Tax
DSU	Dispute Settlement Understanding
ECB	European Central Bank
EESA	Emergency Economic Stabilization Act
EU	European Union
EUR	Euro
FAS	Financial Accounting Standards
FAT	Financial Activities Tax
FATF	Financial Action Task Force on Money Laundering
FCL	Flexible Credit Line

List of Abbreviations

FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FSAP	Financial Sector Assessment Program
FSF	Financial Stability Forum
FSOC	Financial Stability Oversight Council
FTAF	Forward Term Auction Facility
FTT	Financial transaction tax
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GBP	Great Britain Pound
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GLBA	Gramm-Leach-Bliley Financial Modernization Act
GSE	Government Sponsored Enterprises
HBOS	Halifax Bank of Scotland
HERA	Housing and Economic Recovery Act
HIPC	Highly Indebted Poor Country initiative
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IBRD	International Bank for Reconstruction and Development
ICSID	International Centre for Settlement of Investment Disputes
IDA	International Development Association
IEO	Independent Evaluation Office of the International Monetary Fund
IFC	International Finance Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commission
IRB	Internal Models-Based
ISDA	International Swaps and Derivatives Association
ITO	International Trade Organization
LDC	Less Developed Countries
LIBOR	London Interbank Offered Rate
LTCM	Long Term Capital Management
MAP	Mutual Assessment Process
MDB	Multilateral Development Banks
MDGs	Millennium Development Goals
MFN	Most-Favoured Nation
MIGA	Multilateral Investment Guarantee Agency
MMoU	Multilateral Memorandum of Understanding
NAB	New Arrangements to Borrow

List of Abbreviations

NFC	Non-bank Financial Companies
NGO	Non-Governmental Organisation
ODRF	OTC Derivatives Regulators' Forum
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
OTC	Over-the-Counter
OTS	Office of Thrift Supervision
PBOC	People's Bank of China
PRGF	Poverty Reduction and Growth Facility
PRSPs	Poverty Reduction Strategy Papers
ROSCs	Reports on the Observance of Standards and Codes
RTC	Resolution Trust Corporation
S&L	Savings and Loan
SAP	Structural Adjustment Policies
SDR	Special Drawing Rights
SDRM	Sovereign Debt Restructuring Mechanism
SEC	Securities and Exchange Commission
SIFI	Systemically Important Financial Institutions
SIV	Structured Investment Vehicles
SNB	Swiss National Bank
SOAS	School of Oriental and African Studies
SPV	Special Purpose Vehicle
SRF	Supplemental Reserve Facility
TARP	Troubled Assets Relief Plan
TRIPS	Trade Related Aspects of Intellectual Property Rights
UNICEF	UN International Children's Education Fund
UNCTAD	United Nations Commission on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNECLA	United Nations Economic Commission for Latin America and the Caribbean
UNEcoSoc	United Nations Economic and Social Council
UNICEF	UN International Children's Education Fund
USD	United States Dollar
WaMu	Washington Mutual
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Preface

Something is wrong with the global financial system. One might think the system would shift money from rich countries, where capital is in abundance, to those where it is scarce, while transferring risk from poor countries to rich ones, which are most able to bear it . . . The current global financial system does none of these things.¹

Joseph Stiglitz,
Nobel Laureate in Economics,
former World Bank Chief Economist,
in 2003.

It is a mistake to think that our international financial system was designed to deal with today's international capital flows. It was not.

When in 1944 John Maynard Keynes and Harry Dexter White proposed three international organisations to guide and assist the international economy, the international financial system was utterly different to the one we have today. Nations existed largely as financial islands. Capital flows between them were miniscule by contemporary standards.² Capital controls were in place between national economies to regulate and often prevent transnational capital flows.

Today finance is perhaps our most globalised activity. The price of credit in the United States affects the interest rates offered to home buyers in Australia or England. A currency crisis in Thailand affects share prices in Turkey and Hungary. The economic collapse of Russia sends the values of the thirty-year U.S. Treasury

1. J. Stiglitz, 'Dealing With Debt' (2003), 54.

2. Total debt flows were USD 13.4 billion in 1970, USD 272 billion in 2000 and USD 647 billion in 2006; *Global Development Finance 2002* (Washington DC, World Bank, 2002), 246 and *Global Development Finance 2007*, available at <http://siteresources.worldbank.org/INTGDF2007/Resources/3763069-1179948748801/GDF07_completeFinal.pdf>.

Preface

Bond to unprecedented highs. A sub-prime lending crisis in the United States freezes capital markets around the world. These changes have come about principally due to capital account liberalisation, the process by which barriers to capital flows between nations are eliminated and financial globalisation thus facilitated.

This book focuses upon why we have a system that is so crisis prone and deficient for debtors and creditors alike, and what can be done about it.

Hundreds, perhaps thousands, of books have been written on the international financial system in the wake of various financial crises, most recently the global financial crisis of 2008. What sets this book apart is not its topic, but the perspective from which it is approached. For this is a book by two lawyers, and, in Frank Partnoy's words, 'lawyers and legal academics are largely absent from the debate about financial crises. The commentary is dominated by economists, many of whom unfortunately vastly oversimplify or even misunderstand the role of law in . . . crises'.³

Partnoy's complaint is an important one.

Lawyers need to become more involved in working to enhance the global financial system. Law schools need more scholars teaching and researching international finance law. Around the world, law schools that believe they must teach international trade law, do not teach international financial law. Yet financial flows far exceed trade flows. At the same time, international financial transactions represent a far greater proportion of the practice of most major law firms than do trade transactions. Moreover, international finance, when it goes wrong, brings appalling suffering to the poorest citizens of poor countries, and as we have seen of late, can bring rich countries to the brink of bankruptcy. International financial law is important; it is only neglected because it is not understood.

We have written this book for several reasons. One is to address this widespread lack of understanding, hopefully with an accessible and interesting book. Another is to provide a general introduction to the international financial system and its regulation to assist students studying the topic. A third reason is to articulate our view of the system as one that works much to the detriment of poor nations and the benefit of rich nations, and in particular to the detriment of the poor within poor nations and the benefit of the rich within rich and poor nations alike.

In general, this book seeks to learn from history. For, as John Kenneth Galbraith said, '[h]istory has a way of repeating itself in financial matters because of a kind of sophisticated stupidity'.⁴ If this book seeks anything, it seeks to work against this sophisticated stupidity for mistakes in global finance sacrifice the lives of thousands and the futures of millions.

Ross Buckley, Sydney, Australia
Douglas Arner, Hong Kong

3. F. Partnoy, 'Why Markets Crash and What Law Can Do about It' (1999–2000), 741.

4. J. Galbraith, *The Sunday Times*, 25 Oct. 1987. The more well known, similar quotation is from George Santayana, 'Those who cannot remember the past are condemned to repeat it': Santayana, *Life of Reason* (1950–1956), vol. I, ch.xii

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