

**THE INTERNATIONAL SUPERVISORY
FRAMEWORK FOR FINANCIAL SERVICES:
An Emerging International Legal Regime**

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Abstract

This paper describes the current international framework for supervising financial markets and suggests that current efforts at cooperation and coordination amongst national regulatory authorities are insufficient at managing and minimising the risk of systemic failure in international financial markets. This paper will analyse the purpose, structure, and function of existing international and regional financial institutions, and discuss what gaps, if any, exist at the international level to reduce systemic risk and prevent future financial crises. The paper's overriding theme concerns how the activities of these international institutions exemplify the new phenomenon of international regulatory cooperation in the area of financial services.

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Introduction

Financial markets in the late 1990s are becoming increasingly multinational and deregulated.¹ Indeed, the increasing liberalisation of international commerce and the development of technology has furthered globalisation of financial markets.² This has shaped deregulation by promoting the removal of most restrictions on capital transactions, and by enhancing the flow of cross-border investment (Drucker, 1997). Moreover, the liberalisation of capital markets and the introduction of floating exchange rates in the 1970s have exposed international financial markets to an increased risk of systemic failure, which may disrupt macroeconomic performance.³ The risk of systemic failure is a negative externality that is produced by the failure of financial markets to price the systemic risk that is inherent in financial market transactions in an efficient manner.⁴ The recent collapse of financial markets in Asia in 1997 has been attributed to weak banking systems and to the failure of financial market actors to internalise the cost of their speculative activities.⁵ Consequently it has been argued that prevention of international financial crises requires not only cooperation between national financial supervisory authorities but also effective international supervisory standards in the areas of capital adequacy, competition and transparency to reduce systemic risk in financial markets.⁶

Although globalisation and liberalisation have provided substantial benefits to international financial markets, effective international standards are needed to minimise the risk of systemic breakdown. Further, recent collapses of major international banks⁷

have reminded financial supervisors of the importance of coordination and timely communication of material information.⁸

The leading industrial states have responded to these events by proposing a set of policy initiatives designed to increase the efficiency, stability and transparency of international financial markets.⁹ Although these proposals for a new international financial architecture remain vague and subject to much dispute, there is a growing consensus that international standards are needed to regulate international capital markets. This paper does not seek to offer reforms of the international financial system, but rather to describe the current international framework for supervising financial markets and to suggest that current efforts at cooperation and coordination amongst national regulatory authorities are insufficient at minimising the risk of systemic failure in international financial markets. This paper will analyse the purpose, structure, and function of existing international and regional financial institutions, and discuss what gaps, if any, exist at the international level to reduce systemic risk and prevent future financial crises.

In this paper, the term institution shall refer not only to formal organizations, such as the World Trade Organization or United Nations, but also to a broader meaning that includes persistent and connected sets of rules (formal and informal) ‘that prescribe behavioural roles, constrain activity, and shape expectations’ of states.¹⁰ The paper’s overriding theme concerns how the activities of these institutions exemplify the new phenomenon of international regulatory cooperation in the area of financial markets.

I. International Regulatory Framework: Background Perspectives

The internationalisation of modern financial services has depended to a great extent on computer technology, deregulation, and productive diversification and innovation.¹¹ The growth of financial conglomerates has increasingly eroded the distinction between banking and other financial services. Banks are no longer the major institutions in the process of intermediation. In the past decade, non-bank financial institutions, including securities firms, financial companies, and insurance companies, have joined the intermediation process in most major financial markets.¹² International financial conglomerates today are providing an array of products and services, including not only the traditional offerings of loans and deposits, but also *inter alia* insurance, investment options, and tax and estate planning. These modern financial institutions conduct diversified operations across borders to diversify their earnings and enhance profits. The liberalisation of restrictions on capital flows across national borders has increased international lending and deposit-taking activities. Increasing integration of financial markets benefits international capital flows and facilitates economic development.¹³

Cross-border financial services and the increasingly complex needs of bank customers have caused a substantial increase in competition in global financial services. This has resulted in the development of universal and specialised banks, whose functions exceed the scope of traditional banks.¹⁴ The rapidly expanding pace at which financial markets are liberalising and deregulating has been further facilitated by the adoption in 1997 of the WTO Financial Services Agreement that has eliminated many barriers to trade in financial services. The widespread availability of information and the ability of firms to emulate quickly profitable trading strategies will continue to put pressure on banks to stay competitive.

The use of innovative financial instruments to diversify the earnings of banks has also increased international banking activity.¹⁵ Expanded and diversified banking, however, requires disciplined adherence to supervisory standards that are adequate to address the evolving functions and activities of multi-functional financial institutions in an increasingly complex international financial system.¹⁶ Indeed, the expanding number, changing nature, and increasing complexity of international banks have highlighted the need for effective coordination of international banking supervision. In spite of the spread of international financial activities to emerging markets and offshore jurisdictions, the current system of international financial regulation is inadequate to supervise the activities of most multinational financial conglomerates.

Several international supervisory regimes have emerged in response to the liberalisation and deregulation of international financial markets. The Basle Committee on Banking Supervision (Basle Committee), founded in 1974, consists of representatives of twelve central banks that regulate the world's largest banking markets.¹⁷ The Basle Committee seeks to create common standards of banking oversight. The International Organization of Securities Commissions (IOSCO), a decade-old organization of securities commissions, consists of representatives of over 100 of the world's securities regulators and pursues a similar sort of harmonization for the world's security rules. The International Association of Insurance Supervisors (IAIS) first met in 1994 and consists of representatives from almost 100 of the world's insurance regulators interested in the international coordination of their policies with respect to insurance markets.¹⁸ Although these institutional initiatives are considered 'gentlemen's agreements' with no legally binding effect, they are increasingly viewed as important mechanisms for promoting convergence and harmonisation of national regulations based on the influence of international standards.

In addition, the most important international legal institutions or institutional organisations in charge of laying down supervisory rules that are binding on their member states are the World Trade Organisation (WTO) and its General Agreement on Trade in Services,¹⁹ the European Union²⁰ and its financial service directives, and the North American Free Trade Agreement (NAFTA)²¹ and its provisions on trade in financial services. The structure, purpose and legal principles of these international financial institutions provide the central elements of the current international supervisory regime for financial services and are discussed in this paper.

Current International Supervisory Structure

The Basle Committee on Banking Supervision

Two large international bank failures in 1974 prompted central bank governors of the G-10, Luxembourg, and Switzerland to establish the Basle Committee on Banking Supervision.²² The founding mandate of the Committee lies in a press communique from the central bank governors issued through the Bank for International Settlements (BIS) on February 12, 1975.²³ The Basle Committee states its "key objectives" to "strengthen international cooperation, improve the overall quality of banking supervision worldwide, and ensure that no foreign banking establishment escapes supervision."²⁴ The Committee has developed principles of "consolidated supervision" over the past decade and created a multinational framework for bank capital adequacy requirements, among other regulatory efforts. It describes itself as "a forum for ongoing cooperation between member countries on banking supervisory matters."²⁵ In fact, some experts have described the

Basle Committee as the most successful ongoing effort at international financial diplomacy in history.²⁶

The internal operations and deliberations of the Basle Committee are not disclosed to the public.²⁷ The Basle Committee works informally and operates by consensus. Its operations are distinguished by an emphasis on personal contacts, insistence on the nonbinding nature of the agreements it concludes, and an interactive and decentralized method of ensuring compliance. The Committee operates through a rotating chair and makes recommendations based on consensus. The Committee has declared that 'the development of close personal contacts between supervisors in different countries' has greatly helped in the handling and resolution of problems affecting individual banks as they have arisen.²⁸ The Committee pursues those contacts within its membership and has sought to develop others with outside banking regulators.²⁹ This quest for common ground is the Committee's substitute for binding agreements.

The Committee does not undertake a formal supranational supervisory role because its conclusions and policy guidelines do not have, and were never intended to have, legal force.³⁰ The Committee formulates broad supervisory standards, practices, and guidelines which national authorities use to implement the detailed arrangements--statutory or otherwise--which are best suited to each national system. In this way, the Committee encourages convergence toward common approaches and common standards without attempting detailed harmonisation of member countries' supervisory techniques. Nonetheless, although these standards do not reach the legal status of a treaty, they are viewed by member states as binding and eventually adopted into national law.³¹

In the past, the Committee has published its recommendations in draft form for public comment. These reports

range from generally worded documents to technical, mathematical regulations used to provide guidance for the implementation of the promulgations. After a comment period, the Committee reconsiders and then reissues a final version of its work, which the central bankers are then strongly encouraged to implement into domestic law. For example, the 1988 Capital Accord exemplified the Basle Committee's informal procedure and illustrated the Committee's expansive understanding of consensus.³² The Accord set universal minimum capitalization standards for international banks regulated by the members. The impetus for the Accord was the 1987 bilateral capital adequacy agreement between the United Kingdom and United States.³³ This agreement formed the basis for the draft proposal of the 1988 Accord that emphasised 'international convergence of supervisory regulations governing the capital adequacy of international banks.'³⁴ There was a six-month comment period, during which it received comments on its draft agreement from a variety of private bankers and other interested parties. The Committee revised the Accord and released a final version on July 15, 1988.³⁵ The Committee members then implemented the standards in their home markets. Since its promulgation, the Committee has regularly amended the Accord. The Committee characterises its capital framework as "not static, but . . . intended to evolve over time."³⁶

The Committee's attempts to reach consensus among national regulatory authorities is part of a broader harmonisation process that relies upon national implementation of internationally agreed upon standards for insuring that, over time and under the pressure of market forces and the desire of national regulators to give their institutions a competitive edge, harmonisation objectives are met.³⁷ Consequently, monitoring noncompliance is a decentralized task; neither the BIS, which serves as the Committee's secretariat, nor any other international organization takes a supervisory role. That job belongs to the committee members themselves and their staff.³⁸ Nonetheless, the Committee

has vowed that it "intends to monitor and review the application of the framework in the period ahead with a view to achieving ever greater consistency."³⁹ It has held meetings, according to the Federal Reserve, "to review questions relating to the implementation of the Accord and to facilitate a broadly consistent approach to implementation of the framework internationally."⁴⁰ The US General Accounting Office (GAO) has concluded that the capital adequacy standards promulgated in the 1988 Accord have been fully implemented by all the committee member countries. The Committee, however, has apparently considered experimenting with other means of ensuring compliance with its standards, including establishing a clearinghouse for world-wide supervisory practices and creating a formal peer review process to assess compliance.⁴¹

The Basle Committee has demonstrated its integral function in developing standards for regulating international banks through the adoption of the Capital Accord of 1988, the Basle Concordat, and the Committee's recent efforts to prevent financial crimes and to adjust capital adequacy measures to reflect true risk in the international marketplace.⁴² The 1988 Capital Accord established universal minimum capitalization standards (ultimately pegged at eight percent of assets) for international banks that were subject to regulation by the central banks of member states.⁴³ The eight percent capital adequacy ratio has been adopted by all the Committee's members.⁴⁴ Although member states have had some difficulty in achieving full adherence to the Capital Accord, its breadth and impact on regulatory standards of other non-member states have proved its importance in creating uniform reserve requirements for most of the world's largest banking systems.

But while Basle has accomplished complicated and technical international regulation, it has also developed more theoretical principles of banking supervision. Indeed, such principles of supervision marked the Committee's first achievement. The

regulatory phrase "consolidated supervision" derives from the Basle Concordat, drafted first in 1975 and revised by the Committee in 1983. The Concordat seeks to establish clear authority over all foreign banks that operate within the jurisdiction of Committee member states. This has encouraged collaboration between the host and home supervisors of transnational banking conglomerates. Host authorities are responsible for the operation of foreign banking establishments within their territories as individual institutions, while home authorities are responsible for them as part of larger banking groups.⁴⁵ The Concordat requires parent authorities to monitor the solvency of foreign bank branches.⁴⁶ It thus expanded the regulatory responsibilities of committee members beyond their borders as a matter of first principle.

The Committee has also sought to promote its policies on the 1983 Concordat to other non-member governments. This was demonstrated in the 1983 amendments to the Concordat in which the Committee

"strongly commends the principles set out in this report as being of general validity . . . and hopes that they will be progressively accepted and implemented by supervisors worldwide."⁴⁷

These standards were promulgated in 1992 and contain more proactive and forceful language regarding implementation, including a declaration that 'the G-10 supervisory authorities expect each other to observe' the standards, and a commitment that the Committee will take 'necessary steps to ensure that their supervisory authorities meet the standards as soon as possible.'⁴⁸

After consultation and the issuance of a joint report with the Offshore Group of Banking Supervisors, the Committee issued a

1990 supplement to the Accord designed to provide practical recommendations for the implementation of the Accord's provisions requiring consultation and flows of cross-border information among supervisory authorities. The Committee has recently amended the Accord to permit large banks to use their own models to determine the capitalization required for market risks incurred by their transactions.⁴⁹

More recently, the Committee has sought to develop common standards meant to prevent bank fraud and financial crimes. In 1989, it issued a Statement of Principles on Money Laundering, which has since been endorsed by central bankers outside of the Committee, including the Offshore Supervisors' Group.⁵⁰ The Committee has also set standards for bank supervision intended to prevent BCCI-type multinational fraud.⁵¹

International Organization of Securities Commissions (IOSCO)

IOSCO is a private organization that developed out of the Inter-American Association of Securities Commissions and Similar Agencies in 1984, when its members passed bylaws transforming it from a regional group to a global association of securities regulators.⁵² In 1996, its membership included seventy one securities regulators; nine associate members, consisting of other financial regulators that include the Commodities Futures and Trading Commission (CFTC); and thirty-five affiliate members, most of whom are stock and futures exchanges. Although the Basle Committee has limited its membership to the major developed countries, IOSCO follows a more inclusive policy of seeking to attract the regulators of developing and emerging market economies.⁵³ In some instances, IOSCO may even offer membership to non-governmental regulators.⁵⁴ The organization's bylaws declare that '[a] securities commission, or a similar governmental agency of countries from other continents, may

apply to become a member of the Organization.'⁵⁵ The same applies to a self-regulatory organization, such as a stock exchange, when there is no governmental regulatory agency. Recently, however, IOSCO has taken steps to limit new membership by resolving that future applicants for membership would be required to confirm that "they will be able and willing to adhere to IOSCO's principles."⁵⁶

IOSCO is not a formal international organization as such because it was not formed by treaty or inter-state agreement. It was formed through incorporation by a private bill of the Quebec National Assembly.⁵⁷ The organization's stated principles are: 'improving cooperation and coordinating and harmonizing securities and futures regulations on the international level.'⁵⁸ IOSCO's members commit themselves to the following: (1) to cooperate in order to maintain fair and efficient markets; (2) to exchange information designed to further the development of domestic markets; (3) to establish standards and effective surveillance of international securities transactions; and (4) to provide mutual assistance for enforcement.⁵⁹

IOSCO has four major components: (1) a Presidents' Committee, (2) an Executive Committee, (3) a General Secretariat, (4) and four Regional Standing Committees.⁶⁰ The organization's bylaws--its only governing document--are twelve pages long and consist of ten parts and a preamble.⁶¹ The Presidents Committee is most comparable to the general assembly of more traditional international organizations, and is composed of the presidents of all member securities agencies or their designees. The bylaws authorise the Presidents' Committee to exercise "all the powers necessary to achieve the purpose of the Organization."⁶² The presidents operate secretly at IOSCO meetings--under its bylaws, "[o]bservers and special guests may not attend meetings of the Presidents' Committee unless invited by the Chairman with the concurrence of a majority of the members."⁶³

The Executive Committee oversees IOSCO's operations. It is comprised of twelve members elected for two-year terms and of representatives from each regional standing committee. The Executive Committee "takes all decisions necessary to achieve the purpose of the Organization in accordance with the guidelines set by the Presidents Committee."⁶⁴ The Executive Committee established two important working committees: (1) the Technical Committee which consists of the securities regulators of the developed economies and principally examines the effect of international transactions on securities markets; and (2) the Emerging Market Committee composed of regulators from such countries and tend to focus on development issues. The former of these committees is called the Technical Committee, consists of regulatory representatives from sixteen of the world's most sophisticated securities markets, and has studied proposals that would relax regulatory barriers to access those markets.⁶⁵ The Technical Committee thus receives the most attention in the financial press. In IOSCO's 1994 annual report, for example, the work of the Technical Committee occupied nearly half of the report, receiving twice as much coverage as the Executive Committee that created it.⁶⁶ Thus far, however, the Technical Committee has only been able to issue reports on issues within its zone of competence, and has not yet proposed broader regulatory standards for economies in transition and other emerging markets.⁶⁷

The General Secretariat, IOSCO's third component, "coordinates" the organization's activities.⁶⁸ The fourth component of IOSCO's structure consists of the four regional standing committees.⁶⁹ These committees establish their own rules of procedure. New regional committees may be created upon the approval of the organizations as a whole--although the new committees "must, as a general rule, be representative of the region."⁷⁰ All of these parts of the organization function together

in an effort to meet the objectives set out by the Secretary General and to promote cooperation in the field of securities regulation.

In a similar manner to the Basle Committee, IOSCO seeks to achieve regulatory harmonization through consensus. Unlike the Basle Committee, however, and perhaps in recognition of its inability to achieve consensus on specific issues, IOSCO defines harmonization broadly. This is reflected in the comments of some IOSCO members who acknowledge that, whatever the merits of harmonization, "value should be attached to the possibility of giving issuers and investors a choice between quite different rules and regulations."⁷¹ Similarly, IOSCO officials have recognised that "harmonization does not necessarily mean that regulations must be identical."⁷²

In 1994, IOSCO's members resolved "to cooperate together to ensure better regulation on the domestic as well as on the international level," to exchange information and provide mutual enforcement assistance, and "to unite their efforts to establish standards and an effective surveillance."⁷³ In practice, these harmonization efforts entail the examination of a number of technical regulations. Thus, IOSCO has evaluated access to markets, capital requirements, clearing and settlement rules, accounting standards, and more traditional securities and futures rules among its members and has debated which standards are the most amenable to common standard-setting within its committees. It also discussed which standards are most effective on the domestic level. Its Technical Committee is currently attempting to develop international accounting and auditing standards and to facilitate information exchanges between regulators.⁷⁴

IOSCO also pursues its objectives through cooperation with a variety of other regulatory and private organizations. For example, it receives the

advice of stock exchanges through its consultative committees. IOSCO has also established contacts with the Basle Committee and has promised to develop a closer relationship with it in exchanging information and expertise.⁷⁵ Experts have acknowledged that in a formal sense, IOSCO and the BIS (Basle Committee) are collaborating and sharing information and developing standards that take account of the needs of their respective markets.⁷⁶ Moreover, IOSCO has worked closely with the International Accounting Standards Committee (IASC) and intends to implement international accounting standards for the global listing of securities in conjunction with IASC by 1999.

IOSCO monitors whether its members have adopted and implemented its standards. Although its principles and rules are not legally binding, the organization often seeks to ensure compliance through moral suasion applied to nonconforming regulators. For example, in 1994, IOSCO resolved to "monitor closely the ability of its members to obtain information from other jurisdictions, and to take such steps as may be necessary and appropriate to address the situation in the future."⁷⁷ That year it also invited its members to examine their own laws, regulations, and procedures in light of the issues identified at a 1994 conference in Tokyo. "[S]uch examination should be in the form of a written self-evaluation containing an assessment of each member's own ability to provide mutual assistance and cooperation to foreign securities and futures regulators."⁷⁸

IOSCO has not achieved the regulatory success of the Basle Committee in implementing global standards for securities traders. Its effort to develop and implement minimum capital requirements for securities firms failed in 1992 after opposition arose from US securities regulators against the capital adequacy formulas that were developed by the Basle Committee and endorsed by European securities regulators. IOSCO subsequently abandoned its efforts to reach a compromise on the issue. IOSCO's activities

largely centre around the preparation of reports on effective mechanisms that might be used to regulate the securities markets.⁷⁹ So far, though, it has failed to adopt any standards to supervise the ability of financial institutions to participate in the derivatives markets.⁸⁰ Nonetheless, IOSCO has passed some rules that have affected international securities regulation, including enforcement and information-sharing agreements. In 1986, IOSCO issued a Resolution Concerning Mutual Assistance that calls upon all securities authorities to provide assistance on a reciprocal basis for obtaining information related to market oversight and protection of each nation's markets against fraudulent securities transactions.⁸¹

Over sixty agencies have signed the declaration. IOSCO claims that it is "nothing short of the ancestor to almost all the Memoranda of Understanding in place today."⁸² In 1991, the organization approved a resolution outlining "Principles for Memoranda of Understanding," which now proliferate among securities enforcement regulators.⁸³ However, resolutions passed by IOSCO are not necessarily formally implemented on the domestic level. Only about half of the members have ratified the organization's 1992 resolution on money laundering--a high level compared to other IOSCO resolutions.⁸⁴ IOSCO has thus been less able than the Basle Committee to persuade its members to abide by agreements forged under its auspices.

International Association of Insurance Supervisors

While the Basle Committee has established its place at the forefront of international banking regulation and IOSCO has struggled to match that pace, IAIS is just beginning to define its role in the field of insurance regulation.⁸⁵ It was founded in 1994, in part at the urging of the Basle Committee. It then held two general meetings, both in conjunction with the annual meeting of the United States' National Association of Insurance

Commissioners (NAIC). IAIS held its first annual meeting outside of the United States in 1996, in Paris.⁸⁶

IAIS consists of two membership classes: (1) the charter members, who include the insurance regulators from sixty-seven countries and seventeen US states, joined the organization by the completion of its first annual meeting on June 16, 1994.⁸⁷ Most of the charter members send one delegation per country or state to the annual meeting. (2) the second class consists of new members, which can be admitted to the organization so long as they are "an insurance industry supervisor or agency, or an association of the public regulatory bodies with jurisdiction over insurance in a country."⁸⁸ IAIS also accepts applications from observers, which can include government organizations with an interest in insurance supervision, even if "the organisation is not directly responsible for insurance law or its administration," and "any other person or body nominated by the Executive Committee."⁸⁹

Members may vote, generally on a one-member, one-vote basis, except in the election of the Executive Committee, the approval of the annual budget of the organization, change of the bylaws, or the relocation of the General Secretariat, in which cases each country receives only one vote.⁹⁰ Observers may participate in IAIS functions, but may not vote or serve on the Executive Committee. While the Basle Committee and IOSCO's objectives include the establishment of uniform rules through the work of the organization, IAIS currently serves only as a forum for the exchange of information and experiences by insurance supervisors across the world. The organization "wishes" to: (1) formally establish an independent forum for meetings of insurance supervisors for their mutual benefit, (2) engender awareness of common interests and concerns among such insurance supervisors, (3) encourage wide international personal and official contacts among insurance supervisors, and (4) enhance the ability of

insurance supervisors to better protect insurance policyholders and to better promote and secure efficient insurance markets.⁹¹

IAIS's bylaws emphasize its role in "promot[ing] liaison and co-operation," "facilitat[ing] the exchange of views," "collect[ing] and disseminat[ing] statistical and other technical information," as well as "arrang[ing] other information of a general or specific nature."⁹² The organization does not yet have a mandate from its members to promulgate minimum standards or multinational regulations for insurance supervision. However, it is currently considering adopting such a role.

IAIS is composed of an Association in General Meeting to which all the members are invited, an Executive Committee that oversees the organization, and a small General Secretariat.⁹³ When in General Meeting, the Association may seek a report on the work of the Executive Committee and elect members to it, change the bylaws, and approve the annual report and financial statement of the association. The Executive Committee, consisting of between seven and thirteen members, is "limited to no more than one member per country and shall, as far as possible, be comprised of representatives from different geographical areas, as well as representatives from different interest groups."⁹⁴ These members serve for two-year terms and are elected at the General Meeting. The Executive Committee generally "takes all decisions necessary to achieve the objectives of the Association in accordance with the directions given by the Association in General Meeting."⁹⁵

IAIS's governing document is a set of bylaws that "do not impose legal obligations on members or the countries which they represent"⁹⁶ and may be amended by a majority vote of the General Meeting. The organization is financed by membership dues and its work is conducted through a committee system.⁹⁷ The internal operations of the IAIS are conducted in secret and its deliberations

are not released to the public unless there is a two-thirds vote of the members at a General Meeting.⁹⁸

While IAIS has not yet made strides towards the harmonization of insurance regulation, it has at least become a forum for information exchange and may become another important international financial regulator. In its bylaws, the organization's members resolve "to cooperate together to maintain just and efficient insurance markets for the benefit and protection of policyholders" and "to exchange information on their respective experiences in order to promote the development of domestic insurance markets."⁹⁹ To meet these goals, the organization has passed some resolutions and has sponsored a number of panels and studies on effective international insurance regulation. IAIS also maintains contacts with other organizations of insurance regulators and has made contacts with members of the Basle Committee. IAIS drafted model laws for the regulation of emerging insurance markets, and has researched a number of technical problems in insurance regulation.¹⁰⁰

But the organization mainly serves as a forum for information exchange.¹⁰¹ IAIS's most significant effort along those lines has been its approval of the Recommendation Concerning Mutual Assistance, Cooperation, and Sharing of Information.¹⁰² In 1995, fifty-one members signed the document, which outlined cooperative efforts for information exchanges. The Recommendation required signatories "to provide assistance on a reciprocal basis . . . for the prudential supervision of the insurance industry and obtaining information and documents related to market oversight or protection of each other's markets against fraudulent insurance transactions"¹⁰³ The signatories have also committed themselves to "the recommendation of legislation" to implement the exchange of material information.¹⁰⁴ Some insurance regulators view the agreement as a significant step in facilitating the exchange of information.¹⁰⁵ This model mutual

assistance agreement has been significant in fostering IAIS's role as an international financial supervisor, but it has more work to do in specifying its responsibilities and objectives on the international level.¹⁰⁶

Basle Committee, IOSCO and IAIS: A Comparison

Despite their different origins, objectives and accomplishments, the Basle Committee, IOSCO, and IAIS share a number of common characteristics. The membership of these organisations are composed of state regulatory agencies, not states. The founding documents that establish organisations emphasize flexibility in structure and encourage new members who are willing to adopt their principles. The internal operations and deliberations of all three organisations are normally not open to the public. They are, in some senses, forums for negotiation and communication.

Substate Actors. The members of these organizations do not act as representatives of national governments, but as substate actors. Each of these organizations consists of central banks, securities commissions, insurance regulators, and even some private market regulators--not of member states. Indeed, not all states have the same number of representatives in the organizations. Each of the organizations includes agencies who co-represent their states with other agencies. The members explicitly view themselves as representatives of their bureaucratic employer, rather than their national government.

Informal Creation. The three organizations were created informally through national or private agency actions. They were each created by regulators, not by treaty or ratified charter. The idiosyncrasy of the IFOs' founding documents is striking. IAIS's founding document is its certificate of incorporation as a nonprofit organization in the state of Illinois. IOSCO similarly derives its

legal existence from a private bill passed by the Quebec National Assembly. The Basle Committee, unlike IOSCO and IAIS, does not even have a legal existence on the national level. Its existence was first marked by a press release issued through the BIS, and the Concordat that defines its approach to banking supervision lays down no requirements or framework for the organization itself.

Flexible Structures. The casual beginnings of IFOs are matched by an informal approach to internal rules and restrictions. For example, the Basle Committee has promulgated no public bylaws or constitution. Both IAIS and IOSCO have promulgated bylaws, but those laws are permissive and open-ended, rather than restrictive and definitive--the former organization's are eight pages long, the latter's are twelve pages long. IAIS's bylaws permit its Executive Committee to take "all decisions necessary to achieve the objectives of the organization,"¹⁰⁷ while its tiny secretariat "executes all other functions that are assigned" to it.¹⁰⁸ IOSCO's bylaws grant the Presidents Committee "all the powers necessary to achieve the purpose of the Organization,"¹⁰⁹ while its Executive Committee "takes all decisions necessary to achieve the purpose of the Organization" ¹¹⁰

The enabling tenor of the bylaws of both organizations, comparable to bylaws a business might pass for itself, suggests that the organizations should be viewed as conduits for ongoing and flexible relationships.¹¹¹ By contrast, other international organizations have much more formal rules of order. The UN General Assembly, for example, has promulgated over 160 rules of procedure.¹¹² The unencumbering bylaws of IFOs make their goals and means flexible and less dependent on the status envisioned for the organizations at their founding.

Some argue that the flexible internal arrangements of these organisations suggest that they are not concerned with specific delegations of authority, but instead focus on the content of their regulatory standards and other promulgations. Less emphasis is

placed on whether clear procedures were followed in adopting these such standards. According to this argument, this flexibility has also enabled the most important financial regulators to have a central role in these organizations.¹¹³

These organisations are characterized by decentralized organization and action. They have small bureaucracies, limiting the amount of centralization each organization can hope to attain. For example, the Basle Committee, the most effective of the financial regulators, has not yet created a secretariat for itself and instead relies on the BIS for administration. The small size of these bureaucracies makes it impossible for them to monitor compliance with organization guidelines; this task is delegated to the members.

The small budgets of the organizations also inhibit the development of a strong central voice. IOSCO's annual revenues do not amount to \$750,000, and revenues for IAIS in 1994 did not exceed \$125,000.¹¹⁴ The Basle Committee apparently does not disclose its dues; however, since it does not support a secretariat, they are presumably also minimal.

The lack of legal force in these agreements may be a strength in persuading member state regulators to adopt their standards. Basle Committee members celebrate the organization's extra-legal status as flexible. One observer described the Basle Accord as a "gentlemen's agreement among central banks," but another has suggested that the Committee's pronouncements, which are generally enforced in the twelve member countries, have assumed normative standards and may be considered international soft law. This quasi-legality may be an important assurance that the promulgations of the organizations have some democratic legitimacy when enacted. Because the implementation process occurs on the domestic level, vesting the regulations with all their legal authority at that level preserves some sense of local autonomy in the face of international regulatory cooperation.

Furthermore, although IFO promulgations lack formal international legal authority when implemented at the domestic level, they gain at least local legal legitimacy. In this way these organisations assume some legal legitimacy at the national level.

Each organisation also maintains links to other international and regulatory organizations. The organizations assiduously maintain connections with one another and have created an interlocking web of financial regulators. All three have joined forces in the Tripartite Group, which is currently considering regulatory strategies to oversee financial conglomerates that perform banking, underwriting, and insurance functions.¹¹⁵ The Basle Committee, meanwhile, has encouraged the development of regional organizations of central bankers and usually sends observers to regional meetings. The Committee also invites commentary from regional organizations on its regulatory proposals and has developed a supplement to its Concordat in conjunction with the Offshore Group of Bank Supervisors meant to assist non-members in the implementation of Basle-style procedures. IOSCO and IAIS have also cultivated ties with regional securities and insurance regulators.¹¹⁶ Additionally, IOSCO works closely with private groups of self-regulatory organizations.

Although the Basle Committee, IOSCO, and IAIS have different characteristics, they possess a number of commonalities in the way in which they are organized and in the manner in which they seek to attain their objectives. All are not international organizations per se, and therefore have no legal personality; they are informally constituted, containing flexible internal organizations and decentralised bureaucracies. These organizations often operate secretly and informally; however, they manage to achieve influence through a kind of decentralized enforcement of their agreements that utilises their links with various regional and national regulators. Featuring

tiny central bureaucracies and small annual budgets, the organizations rely on their members to enforce any regulations issued by the groups and to monitor the compliance of other members. The organizations themselves operate secretly and informally. Their regulations have no legal force but, at least in the case of the Basle Committee, have enjoyed full compliance.

Binding International Legal Rules For Financial Regulation: The World Trade Organisation, the European Union, and NAFTA

International Organisations Under International Law

International law has recognised international organisations as legally cognisable beings since the late nineteenth century and has developed a jurisprudence and academic literature defining them and establishing their prerogatives. Unfortunately, that jurisprudence and literature is difficult to apply to international financial organisations (IFOs) that conduct financial regulation. On a basic level, international law defines international organisations by state membership, tangible manifestations of organisational bureaucracy, and an adequate legal pedigree. All three attributes are lacking in the Basle Committee, IOSCO, and IAIS. Moreover, the IFOs do not meet the standards for international organisations set by legal literature and settled practice.

First, IFOs do not look like traditional international organisations as defined by the Restatement (Third) of the Foreign Relations Law of the United States. The Restatement suggests that an international organisation "is created by an international agreement and has a membership consisting entirely or principally of states"¹¹⁷ and that "statehood . . . is generally a minimum qualification for membership in international organisations."¹¹⁸ International organisations are normally composed entirely or

mainly of states and usually established by treaty."¹¹⁹ One leading scholar defined them as "organisations created by a multilateral inter-governmental agreement [that] possess some measure of international personality"¹²⁰ Based on these sources, it does not appear that international organisations could be composed of state agencies representing their own interests, as well as those entities subject to their regulatory purviews. In fact, regulators from the SEC, the CFTC, and the Federal Reserve suggest that they attend IFO meetings as representatives of their agencies, rather than their nations.¹²¹

In addition, IFOs are not created by a treaty but by a less formal promulgation of bylaws; in the case of the Basle Committee, not even bylaws have been published. The Restatement provides a restrictive definition for the term "organization": an international organisation must have a headquarters, staff, and budget to truly qualify as international subjects. IAIS, the Basle Committee, and IOSCO have tiny staffs and budgets, however. Indeed, the insurance supervisors have no headquarters and no permanent employees whatsoever. Finally, the Restatement suggests that international organisations, once constituted, possess "status as a legal person, with capacity to own, acquire, and transfer property, to make contracts," and the like.¹²² Neither IOSCO nor IAIS have availed themselves of these rights. They derive their legal personality from a provincial and a state incorporation, respectively, and hold assets and make contracts as corporate entities rather than as international beings. Since the Basle Committee has no formal charter, its capacity to own property and make contracts is even more unlikely. Consequently, the regulatory rules and standards adopted by IFOs have less force than do those of a traditionally defined international organisation. When states violate legal obligations to international organisations as covered by the Restatement, they are obligated to provide redress. But the promulgations of the three organisations considered here are in theory not binding on member states. As

former Basle Committee chairman Peter Cooke observed, the committee's conclusions are not intended to have legal force. IFOs, therefore, cannot create the legal obligations to which traditional international organisations are entitled. IFOs thus do not qualify as traditional international organisations under the definition of the Restatement or other leading texts, and are not subject to the rights and duties of international organisations.¹²³

The World Trade Organisation

The World Trade Organisation (WTO) negotiations on financial services concluded successfully on 12 December 1997 after seventy WTO member states reached a landmark multilateral agreement that further liberalises international financial markets.¹²⁴ This landmark agreement brings trade in financial services under the WTO's multilateral rules on a permanent and most-favoured nation basis. The agreement covers more than ninety five percent of trade in banking, insurance, securities and financial information. The December 1997 Financial Services Agreement serves as a protocol to the General Agreement on Trade in Services. The Financial Services Protocol will not become effective until specific schedules of commitments are agreed to for each signatory state. These schedules of commitments will determine the extent to which each signatory state will be obliged to liberalise its financial service sectors.

GATS and Financial Services

The General Agreement on Trade in Services ('GATS') has two major components: a framework agreement, which establishes overall rules and disciplines for trade in services, together with various annexes, including one on financial services; and each country's schedule of specific commitments and exemptions. In addition to the Financial

Services Protocol discussed above, there is an Understanding on Commitments in Financial Services that was adopted in 1995 and is now used by most of the OECD countries to supplement the requirements of the framework agreement.¹²⁵ There are two important concepts in the GATS: (1) Most-Favoured Nation treatment – e.g. a country is to accord no less favourable treatment to the banks of one foreign country than that accorded to those of any other, subject to exceptions for regional economic arrangements and reciprocity provisions. (2) Market Access – e.g.: limitations on the numbers, assets, and types of legal entities through which foreign financial institutions may offer financial services.

The WTO addresses financial services from the perspective of trade liberalisation and has identified national regulation as a barrier to free trade, while at the same time advocating liberalisation as promoting financial sector stability.¹²⁶ The WTO is an established international organisation with legal personality that provides a forum for intensive negotiating efforts to obtain binding commitments and a strong enforcement mechanism for such commitments. The primary goal of the WTO is to reduce tariff and other trade barriers by eliminating discriminatory treatment in international commerce. The WTO's main functions are to facilitate the liberalisation of international trade and investment and to serve as a forum for international trade negotiations; and to administer the dispute settlement system.¹²⁷

The WTO's emphasis on competition and liberalisation of financial markets creates a potential conflict with the responsibility and authority of national financial regulators to apply standards of prudential governance to the activities of financial institutions operating in their markets. WTO negotiators recognised this possible conflict by providing a specific exception for prudential regulation and supervision – a so-called prudential carve-out:

Notwithstanding any other provision of the Agreement, a member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.³² Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement

If a dispute arose as to whether a measure to restrict trade in financial services was legitimately taken for prudential purposes, it would be referred to the Dispute Settlement Body, assuming the states in dispute could not agree to resolve the dispute through alternative resolution.

The weakness of the WTO system is that it promotes the deregulation and liberalisation of capital markets as a primary objective, while failing to give equal importance to the need of some member states – especially emerging market and developing economies – to take effective measures to reduce systemic risk and volatility in capital markets that retards sustained economic development. Moreover, the WTO's overall regulatory framework of national treatment schedules of commitments and market access guidelines often fail to take account of the importance of having appropriate prudential regulatory regimes in place to accommodate the significant economic restructuring that occurs in response to liberalisation and deregulation.

Regional Organizations

European Union

In developing the supervisory framework for banking and financial services in a European Common Market, the European Community adopted the principles of home country control and of minimum harmonization.¹²⁸ According to the principle of home country control, regulatory authority over banks that conduct activities through their branches in other member 'countries' lies with the competent authorities in the state where the institution's head office is located. According to the principle of minimum harmonization, member states are required to harmonise what are considered the essential areas of banking regulation while being free to surpass the minimum standards of equivalence and to maintain national regulation in areas not harmonised. The minimum standards to be incorporated in national regulation by all member states were established in directives issued by the EC Council.¹²⁹

EC regulation does not prescribe the type of banks or banking system a member country must have. Each country continues to develop its traditional banking system under the impact of increasing competition in the European market. According to the EC Banking Directives, the same type of activity will be subject to the same rules, whether it is carried out by a universal bank, an investment bank, or another specialized bank.¹³⁰ Similarly, EU directives do not require a particular structure of banking supervision. Regulatory responsibilities may be allocated according to types of institutions or tasks. Thus, the European Union (EU) has established a fixed set of rules with which the banking sector of a potential new member state will have to comply. There is no case-by-case negotiation on the terms of mutual recognition of the banking and supervisory rules (as there is in the case of third countries that are not EU member states). Rather, the new EU member state will have to comply with the EC banking directives. Potential future members have always adjusted

their national legislation to EU standards in an expeditious manner to prepare for membership.¹³¹

Home-country rules are based on common objectives and trust in each other's standards. The advantage of mutual recognition is that it generates a competitive process of regulation that leads eventually (in theory) to convergence of regulatory standards. Mutual recognition based on home country rules reaches a common standard more quickly than if based on host country rules.

The North American Free Trade Agreement (NAFTA)

The financial service regulatory regime in NAFTA applies to Canada, Mexico and the United States. In contrast to the European Union, NAFTA adopts the host country principle. The host country principle is based on the dominance of national regulatory standards. Foreign banks must adhere to the regulatory standards of the host country. This principle also applies to the providers of cross-border financial services. If the regulatory standards of a NAFTA state party are not discriminatory *de jure* against foreign financial institutions, there will be compliance with the host country principle.¹³² NAFTA requires host country treatment to be based on both national treatment and most-favoured nation status. National treatment and most-favoured nation status are the primary principles governing the provision of financial services under NAFTA.

Each federal state party of the NAFTA must ensure that states or provinces do not violate the national treatment or most-favoured nation standards. This means that each party cannot treat another NAFTA party less favourably than it treats a third party (either a NAFTA or non-NAFTA country).¹³³ There are two aspects to national treatment: (1) verification of whether the practice of national treatment in fact matches the principle; and (2)

the relationship between national treatment and reciprocal treatment in fact involve national treatment given by country A to banks of country B and whether such treatment is economically equivalent to the national treatment accorded by country B to banks of country A. This latter point is significant because US banking and securities regulation is far more stringent than corresponding regulations in Canada, Mexico, and the European Union. As a result, national treatment granted by the US is not comparable to reciprocal treatment granted by other states. The United States' leading position in international financial markets and the reserve currency status of the US dollar enhance the bargaining power of US regulators to insist on higher standards of regulation that are applied through the national treatment principle.

It is important therefore to note that national treatment and MFN status does not mean reciprocal treatment. The discrepancy between national treatment and reciprocal treatment was directly addressed by the Second Banking Directive, which directs the EC Commission to make proposals to the Council of Ministers to obtain in other countries 'effective access comparable to that granted by the Commission to credit institutions from that third country.'¹³⁴ The negotiating leverage that the US exerts because of its large financial market and the role of the US dollar enabled it to prevail in rejecting EU demands for reciprocal treatment.

One of the weaknesses of the national treatment principle is that financial service providers may undertake regulatory arbitrage. For example, all things being equal, financial service providers tend to migrate from high to low regulation areas. On the other hand, the search for lower regulatory areas is constrained by the customers' desire to purchase products from stable financial institutions. Reputable banks often can pay lower interest rates on deposits than banks with weaker reputations. A bank can build reputation, not only by maintaining a higher ratio of reserves to deposits, but also by choosing a jurisdiction that offers a credible

deposit insurance system and where strict prudential supervision is applied. For example, the competitive threat to the US banking system that is posed by the Cayman Islands in the US dollar deposit market is limited by reputational considerations.¹³⁵ On the other hand, the growth of the Eurodollar market in the early stages was only marginally constrained by reputational considerations. The highest interest rates on dollar deposits available in London and Luxembourg were not the result of higher expected default risk of the financial institutions, but of regulations that imposed ceilings on deposit interest rates in financial institutions in US territory.

A crucial distinction should be made therefore between regulation that enhances reputation from regulation that is outright anti-competitive. Differences in regulatory burden due to differences in deposit insurance and quality of supervision enhance the reputation of the banking system and need not lead to regulatory arbitrage, whereas interest rate ceilings do. This is important to understand because high-regulation countries that adopt the host country principle fear a race to the lowest standard and seek international coordination of regulation to minimize the effects of regulatory arbitrage.

IV IMPLICATIONS FOR FUTURE REFORM

The Basle Committee, IOSCO, WTO, IAIS, EU and NAFTA are the leading international regulatory responses to the dramatic liberalisation and deregulation of international financial markets. This globalisation is exemplified by the growth of the banking industry. International banking has thus developed from a relatively unimportant sideline activity of a few major institutions to an important financial activity that accounts for a significant portion of the assets of a number of large banks. Similar changes have occurred in the international securities and insurance markets. The value of transactions in stocks and bonds of all types involving

parties residing in different countries increased fourfold during the mid-1980s, while US reinsurers doubled the premiums they earned from foreign clients during that decade.¹³⁶

As more financial transactions involve transnational elements, however, the specter of financial institutions migrating to countries with lax regulatory regimes and thereby damaging the safety and soundness of financial markets elsewhere becomes, at least to regulators, more real. IOSCO and IAIS have accordingly expanded during their short lifetimes to include representatives from a majority of the world's countries. The Basle Committee has focused more narrowly on the prudential regulation of the world's leading banking systems. One example of that regulation--the Basle Committee's 1988 Capital Accord--obligated American banks to add \$10 to \$15 billion to their capital reserves; Japanese banks, \$26 to \$50 billion; and French banks, \$13 billion.¹³⁷ Such regulatory efforts have proven to be controversial. Although the US Securities and Exchange Commission has declared that "[c]ooperative efforts through multilateral organizations, such as IOSCO, should be continued and strengthened,"¹³⁸ and Congress has expressed its support,¹³⁹ opponents of the international organisations believe that they can create powerful and disruptive effects in the world economy. In 1992, Richard C. Breeden, then chairman of the SEC, and William Isaac, a former chairman of the Federal Deposit Insurance Corporation (FDIC), suggested that the Basle Committee was partially responsible for the recession of the early 1990s. Breeden and Isaac claimed that the committee's bank capitalisation requirements had so restricted credit that "it is hardly surprising the economy cannot seem to pull itself out of recession."¹⁴⁰

CONCLUSION

While the structure of the international financial system has dramatically changed and will continue to change as a result of competitive pressures and technological advances, financial service providers will remain engaged in the full range of financial activities – from traditional banking to securities activities to insurance – which will provide a plethora of new financial products for businesses and consumers.¹⁴¹ In this new global environment, the complexity of banking structures presents a challenge to banking supervisory regulators who must oversee increasingly complex banking functions. These expanding financial activities and the vast transformation of the international banking system demonstrate the need for effective coordination and supervision of multi-national financial institutions. Although international cooperation amongst national regulators concerning global banking supervision can compensate for the inadequacy of supranational regulatory bodies, there will be gaping regulatory gaps due to linkages among types of financial services and therefore difficulties would occur in supervising financial institutions with various functions. Accordingly, the international institutions analysed in this article represent significant steps in the direction of adopting an international regulatory framework that allocates certain responsibilities to supranational bodies to supervise and in some instances to impose binding obligations on states and their multinational actors in the areas of financial services.

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¹ See Dani Rodrik, 'Sense and Nonsense in the Globalization Debate', *Foreign Policy*, 19, 22 (Summer, 1997); Peter F. Drucker, 'The Global Economy and the Nation State', 76 *For. Aff.*, 159, 165 (Sept/Aug. 1997); and Alex Y. Seita, 'Globalization and the Convergence of Values', 30 *Corn. Intl' L.*, 429, 433-39 (1997).

² See Alan Greenspan, 'Technological Change and the Design of Bank Supervisory Policies,' in *Technology Policy Implications for the Future of Financial Services*, (Federal Reserve Bank of Chicago, 1997) 1.

³ See R.C. Merton & Z. Bodie, "A Conceptual Framework for Analyzing the Financial Environment" in D.B. Crane et al. *The Global Financial System: A Functional Perspective* (1995) 21-22.

⁴ Regarding the need to regulate risk, see Andrea M. Corcoran, 'Markets Self-Assessment and Improvement of Default Strategies After the Collapse of Barings', 2 *Stan J. L. Bus. & Fin.* (1996) 265, 265-71.

⁵ See Andrew Crockett, *Global Capital Markets and the Stability of Banking and Financial System, Banking Soundness and Monetary Policy, Issues and Experiences in the Global Economy*, (C. Enoch & J.H. Green, eds., 1997) 89, 91.

⁶ See Joseph J. Norton, *Devising International Supervisory Standards for Banks*, 31-35 (1995).

⁷ Renowned financial collapses include Luxembourg's Bank of Commerce and Credit International and the US savings and loan disaster in which US taxpayers paid \$50 billion to bail out poorly-managed savings and loan banks. See Michael P. Malloy, Forward and backward: Death and Transfiguration Among Savings Associations, 59 *Fordham L. Rev.* 1 (1991). See Ethan Kapstein, *Supervising International Banks: Origins and Implications of the Basle Accords* (1991) 185.

⁸ Richard Dale, *International Banking Deregulation: The Great Banking Experiment* (1992) 15.

⁹ See Group of Ten, *The Resolution of Sovereign Liquidity Crises* (May, 1996).

¹⁰ See R. O. Keohane, *International Institutions and State Power: Essays in International Relations Theory* (1989) 3.

¹¹ See Organization for Economic Cooperation and Development, *Regulatory Reform in the Financial Services Industry, Where Have We Been? Where Are We Going?*, 67 *OECD Financial Market Trends* 32, 41 (June 1997).

¹² See Robert E. Litan & Jonathan Rauch, US Department of Treasury, *American Finance for the 21st Century* (1997) 26 (mentioning that non-banks' invasion of banking has prompted banks to seek the freedom to enter other areas of financial services, such as insurance and securities). This has occurred in the US market where the entry of non-banking institutions into the banking business has forced banks to expand business activities into non-traditional banking areas in order to remain competitive.

¹³ In 1996, net international capital flows to developing countries exceeded \$235 billion; this amounted to 0.8 percent of world GDP, and more than two percent of developing country GDP. See Stanley Fischer, 'How To Avoid International Financial Crises and the Role of the International Monetary Fund (Oct. 14, 1997) <www.imf.org/external/np/sec/mds/1997/mds101497.htm>.

¹⁴ The term 'universal bank' differs from traditional banking. While traditional banks can conduct certain types of business, universal banks may, at least in theory, offer any kind of banking business anywhere to anyone. For an analytical discussion of the concept of universal banking, see J. Canals, *Universal Banking, International Comparisons and Theoretical Perspectives* (1997) 83.

¹⁵ See 'Survey of International Banking, A Comedy of Errors,' *Economist*, (Apr. 10, 1991) 9 (observing that even though banks eagerly invented many different financial products, they failed to adopt adequate risk management programmes).

¹⁶ We adopt the term 'financial conglomerates' to describe multifunctional financial firms that often serve as holding companies for subsidiaries and affiliates that provide a wide range of financial service activities. See Philip I. Blumberg, *The Multinational Challenge to Corporation Law* (1993) 6-10.

¹⁷ The Basle Committee was established in 1974 by the Group of Ten (G10), which were the ten member countries of the International Monetary Fund plus Switzerland. It consists of representatives from banking supervisors and central banks of the Group of Ten countries and meets on the premises of the Bank for International Settlements ('BIS'). The BIS itself was organised in 1930 as both a bank and an international organisation to promote cooperation amongst central banks on a multilateral basis. Its first operation was

to process settlements of international payments associated with German reparations as part of the 1929 Young Plan. As a bank, the BIS holds deposits for other central banks, engages in capital markets activities and provides lending facilities to its central bank members (including, most recently, Mexico). As an international organisation with legal personality, the BIS seeks to promote international monetary cooperation by hosting meetings among central bank experts, conducting statistical research, and publishing some of its results periodically. See M. Giovanoli, 'The Role of the BIS in Monetary Cooperation and Its Tasks Relating to the ECU', in *Current Legal Issues Affecting Central Banks* 1, 39 (comparing BIS with other financial institutions).

¹⁸ See Intl' Ass'n of Ins. Supervisors, 1994 Annual Report 2 (1995)[hereinafter IAIS 1994 Report]

¹⁹ The Uruguay Round negotiations produced in January of 1995 the World Trade Organisation Agreement that contained a new framework for regulating trade in services, the General Agreement on Trade in Services (GATS). The impetus for these negotiations occurred in the context of Uruguay Round of Multilateral Trade Negotiations under the auspices of the General Agreement on Tariffs and Trade See J. Croome, *Reshaping the World Trading System*, (1995) 122-30. The decision to include services in the Uruguay Round was a result, in part, of a growing recognition of their importance in international trade, and also of an insistence on their inclusion by the major western developed countries led by the United States. *Ibid.*

²⁰ European Community Treaty (Treaty of Rome), arts. 67-73 (requiring member states to 'progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in the Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.' The European Union is a treaty organisation established by the Maastricht Treaty of 1992. The Maastricht Treaty brought together under one umbrella the 'three pillars' of the Union of which the European Community (EC) is the most substantial. The EC has responsibility for regulating banking and investment services.

²¹ Can.-Mex.-U.S., 32 I.L.M. 289, *final draft revision* 6 Sept. 1992, *entered into force*, 1 Jan. 1995.

²² General Accounting Office, *International Banking: Strengthening the Framework for Supervising International Banks* (Washington DC, 1994) 37.

²³ The Basle Committee has promulgated no formal constitution or bylaws and has few staff or facilities. The Committee ordinarily meets four times per year in Basle at the BIS. See Norton, *supra* note 6, at 176-77 n.18.

²⁴ William A. Lovett, 'Conflicts in American Banking Regulation: Renewed Prudence, Retrenchment, and Struggles Over Growth Potential' 12 *Ann. Rev. Banking L.* 443, 458 (1993).

²⁵ See Norton, *Supervisory Standards*, *supra* note , at 177.

²⁶ J. Forsyth, Interview at Centre for International Studies, University of Cambridge.

²⁷ See General Accounting Office, *supra* note 22, at 22.

²⁸ Annexure C, *supra* note , ¶ 7.

²⁹ See Norton, *supra* note 6, at 182. The Committee maintains relations with regional banking supervisory agencies and both attends and supports the biennial conferences of banking supervisors that have been held since 1979. *Ibid.*

³⁰ *quoted in* Norton, *Supervisory Standards*, *supra* note 6, at 177.

³¹ See C. Freeland, 'The Work of the Basle Committee', in 2 *Curr. Legal Issues Affecting Central Banks* 231, 232 (R. C. Effros ed., 1994) 233.

³² See E. Kapstein, *Governing the Global Economy* (1994) 103-128(detailed account of negotiation surrounding formulation of capital accord).

³³ *Ibid* at 114-15. The US and UK governments called the agreement 'Convergence of Capital Adequacy'.

³⁴ Basle Comm. On Banking Supervision, *International Convergence of Capital Measurements and Capital Standards* (1988)(amended in 1995), *reprinted in* 1 *Compendium of Docs. Produced by the Basle Committee* at ¶ 1 (1997).

³⁵ See Kapstein, *supra* note 32, at 118.

³⁶ Annexure C, *supra* note , at ¶ 5.

³⁷ See C. C. Liechtenstein, 'Bank for International Settlements: Committee on Banking Regulation and Supervisory Practices' Consultative Paper on International Convergence of Capital Measurement and Capital Standards, 30 I.L.M. 967, 969 (1991)[hereinafter Liechtenstein].

³⁸ General Accounting Office, *supra* note 22, at 36.

³⁹Liechtenstein, *supra* note 37, at 975 n.21.(citing Letter SR 90-23 (FIS) from the Federal Reserve Associate Director of Supervision (July 3, 1990).

⁴⁰International Convergence, *supra* note ?, at 4.

⁴¹*Ibid.*

⁴²The Basle Committee has effectively replaced what had been known as the ‘college’ of bank regulators that was formed by the Bank of England in the 1960s to share and gather information on an informal basis amongst financial regulators in various countries. The college was discredited after the Bank of England’s failure to predict the BCCI affair. See discussion in Norton, *supra* note 6, at 248.

⁴³See Price Waterhouse, *Bank Capital Adequacy and Capital Convergence* (1991) 8

⁴⁴ See Annexure C, *supra* note , at ¶ 4.

⁴⁵See Freeland, *supra* note 31, at 235.

⁴⁶Committee on Banking Regulations and Supervisory Practices, Principles for the Supervision of Banks’ Foreign Establishments (1983) 6; Norton, Supervisory Standards, *supra* note 6, at 179.

⁴⁷General Accounting Office, *supra* note 22, at 42.

⁴⁸ *Ibid.*

⁴⁹ See *supra* note 54.

⁵⁰ See Freeland, *supra* note 31, at 238.

⁵¹ See General Accounting Office, *supra* note 22, at 38. The standards are set out in the Committee’s Minimum Standards for the Supervision of International Banking Groups and Their Cross-Border Establishments.

⁵²See Paul Guy, ‘Regulatory Harmonization to Achieve Effective International Competition,’ in F.R. Edwards & H.T. Patrick, (eds.) *Regulating International Financial Markets: Issues and Policies* (1992) 291.

⁵³Indeed, its membership covers eighty-five percent of the world’s capital markets. See Intl’ Org. of Sec. Comm’ns, IOSCO Annual Report 1994, 26-32 [hereinafter IOSCO Annual Report 1994]. Associate members cannot vote or serve on the organization’s executive committee. See By-Laws of the International Organization of Securities Commissions, pt. 2, ¶ 2 (July, 1997).

⁵⁴See IOSCO Annual Report 1994, *supra* note 53, at 4. The regulatory agencies that join IOSCO appear in some circumstances as strikingly dissimilar. For example, the SEC has over 2600 regulators doing market oversight, while Japan until recently only employed 200. See Peter E. Millspaugh, ‘Global Securities Trading: The Question of a watchdog, 26 *Geo. Wash. J. Intl. L. & Econ.*, 355, 360-61 (1992).

⁵⁵IOSCO By-Laws, *supra* note 53, pt. 2, ¶ 4.

⁵⁶See ‘Securities Regulators Adopt Resolution to Reinforce International Cooperation’, 26 *Sec. Reg & L. Rep. (BNA)* 1431 (Oct. 28, 1994)[hereinafter Securities Resolution].

⁵⁷See An Act Respecting the International Organization of Securities Commissions, ch. 143, 1987 S.Q. 2437 (Can.)(incorporated under a private act as non-profit corporation). It has created and funded a permanent secretariat in Montreal.

⁵⁸See Guy, *supra* note 52, at 295.

⁵⁹ IOSCO Annual Report 1994, *supra* note 53, at 28-9.

⁶⁰See IOSCO By-Laws, *supra* note 53, pmb1.

⁶¹*Ibid.*

⁶²*Ibid* pt. 3, ¶ 9.

⁶³*Ibid* pt. 5, ¶ 26. Any member of the President’s committee may submit a resolution that the committee may examine and if necessary those resolutions are put to a vote – majority support by those members in attendance. *Ibid.* pt. 3, ¶ 10.

⁶⁴ See *ibid.* pt. 3, ¶ 10.

⁶⁵ *Ibid* pt. 5, ¶ 26.

⁶⁶ See Guy, *supra* note 53, at 291-92. Technical Committee is composed of 16 agencies that regulate some of the world’s larger securities markets, including Australia, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Ontario, Quebec, Spain, Sweden, Switzerland, the United Kingdom and US.

⁶⁷Guy, *supra* note 52, at 296.

⁶⁸IOSCO’s by-laws require the Secretary General to, *inter alia*, ‘keep[] up records of the Organization,. . . assist[] the Committees of IOSCO in their functions,... [and to] represent[] IOSCO in meetings with other organizations, subjeckt to review of the Executive Committee. . . ‘ IOSCO By-Laws, *supra* note 53, pt.6, ¶

34. The Secretariat is located in Montreal and consists of four people, one of whom works part time. The organization is financed by membership dues of US\$5,000 per member per year. *Ibid* pt. 4, ¶ 23.

⁶⁹ See IOSCO Annual Report 1994, *supra* note 53, at 16.

⁷⁰ *Ibid* at 19.

⁷¹ See Guy, *supra* note 52, at 299-301 (quoting German Stock Exchange Federation Executive Vice President Ruediger von Rosen who emphasized this point). By-Laws, *supra* note 53, pt 7, ¶ 39.

⁷² *Ibid*. pt. 5, ¶ 27.

⁷³ See 'Convergence, More than Harmonisation, Is Key Word in Cautious Working Group Sess.,' 2 Intl' Sec. Reg. Rep. (BNA) No. 20, 8 (Sept. 27, 1989).

⁷⁴ Guy, *supra* 52, at 293.

⁷⁵ See Saul S. Cohen 'The Challenge of Derivatives, 63 *Fordham L. Rev.* (1993) 2017 n.127.

⁷⁶ See Richard Lapper, 'Securities and Bank Regulators Step Closer', *Fin. Times*, (July 14, 1995) p. 6.

⁷⁷ See IOSCO, IASC Announce Plan to Produce Standards for Global Offerings, BNA Intl' Bus. & Fin. Daily, (July 13, 1995), available in LEXIS, Banking Library, Bnaibf File

⁷⁸ See Frank S. Shyn, 'Internalization of the Commodities Market: Convergence of Regulatory Activity, 9 *Am. J. Intl' L.*, 597, 636-37 (1994).

⁷⁹ See SEC Letter to IOSCO on Capital Adequacy, *Intl' Sec. Reg. Rep.*, (Nov. 3, 1992) 11 [hereinafter SEC Letter].

⁸⁰ The European regulators favoured a 'building block' approach which differentiates between general risk (such as changes in the market or economy) and specific risk (such as those presented by the specific security at issue). The SEC believed that 'the building block approach will not yield sufficient levels of capital to protect markets in the face of major disruptions.' SEC Letter, *supra* note 79.

⁸¹ See IOSCO Resolutions, Resolution Concerning Mutual Assistance ('Rio Declaration') (visited June 1, 1997) <http://www.iosco.org/resolutions/resolutions.html>.

⁸² Intl' Org. of Sec. Comm'ns, IOSCO Annual Report 1989 1. But some have noted that the US SEC was primarily responsible for persuading IOSCO to adopt the Resolution on Reciprocal Assistance, and has also been primary movant behind adoption of MOUs between securities regulators.

⁸³ Technical Comm., Intl' Org. of Sec. Comm'ns., Principles for Memoranda of Understanding, released at the XVIth Annual Conference, available at IOSCO, (visited June 1, 1997) <http://www.iosco.org/publ-docs/d...-1991-principles-of-memoranda.html>.

⁸⁴ See IOSCO Annual Report 1994, *supra* note 53, at 8.

⁸⁵ See Int'l Ass'n of Ins. Supervisors, 1994 Annual Report 2 (1995)[hereinafter IAIS, 1994 Annual Report]. IAIS is a nonprofit corporation incorporated in the State of Illinois, USA.

⁸⁶ See IAIS Executive Committee Reports on 1995 Activities, IAIS Newls. (Intl' Ass'n of Ins. Supervisors), Winter 1995, 1. For example, the US Federal Reserve, Federal Reserve of New York, the Federal Deposit Insurance Corp., and the Office of the Comptroller of the Currency send representatives to the Basle Committee meetings. Moreover, the Ontario Securities Commission and the Quebec CVM are full members of IOSCO. See IOSCO Annual Report 1994, *supra* note 53, at 28-29. France and Germany each send two representatives to IAIS meetings, as does each US state. 1994 Annual Report, *supra* note 53, at pt. 4.

⁸⁷ See International Association of Insurance Supervisors By-Laws, app. A[hereinafter IAIS By-Laws].

⁸⁸ *Ibid* pt. 2, ¶s 4-5.

⁸⁹ *Ibid* pt. 3, ¶ 10.

⁹⁰ *Ibid* pmb1.

⁹¹ *Ibid*. pt. 1, ¶1.

⁹² See IAIS By-Laws, *supra* note 87, pt. 3, ¶ 11 & pts. 4, 6.

⁹³ The General Secretariat keeps records of the work of the IAIS, examines and makes recommendations on applications for membership, and keeps the reports of the organisation. Otherwise, it "assists the Executive Committee in its functions" and "executes all other functions that are assigned to [it] by the Executive Committee." IAIS has entered into a services contract with the American National Association of Insurance Commissioners to serve as the secretariat of the organisation. NAIC has in turn delegated that responsibility to one of its employees, a recent law school graduate.

⁹⁴ See IAIS By-Laws, *supra* note 87, pt. 7, ¶ 35.

⁹⁵ *Ibid* pt. 4, ¶ 19.

⁹⁶ See IAIS Annual Report, *supra* note 85, at 2.

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- ⁹⁷ The organization has established seven committees, including ones handling Budget, Basic Market Data, Education, Directory, Emerging Markets, Supervision of Financial Conglomerates, Exchange of Information, and Conference Planning. *Ibid.* pt. 1, ¶ 2.
- ⁹⁸ See IAIS, 1994 Annual Report, *supra* note 85, at 2-3. Moreover, the business meetings of the association have also been closed to non-members.
- ⁹⁹ IAIS By-Laws, *supra* note 87, pmb1.
- ¹⁰⁰ IAIS's 1994 research focus was reflected through its discussion panels that addressed reinsurance regulation, supervision of financial conglomerates, catastrophic risks, insurance in developing countries. See IAIS, 1994 Annual Report, *supra* note 85, at 4-32.
- ¹⁰¹ US insurance regulator David Walsh claimed that IAIS is "a very good vehicle for regulators to get to know one another and to develop the kind of relationship where you just pick up the phone and say, 'What's going on here?'" See IAIS Newsl., Summer 1995, at 1.
- ¹⁰² See Recommendation Concerning Mutual Assistance, Cooperation, and Sharing of Information, *reprinted in* IAIS Newsl., Summer 1995, at 5.
- ¹⁰³ IAIS Establishes Committee of the Future at Annual Conference, IAIS Newsl. (Intl' Ass'n Ins. Supervisors), Summer 1995, at 1 [hereinafter Future].
- ¹⁰⁴ *Ibid.*
- ¹⁰⁵ See statement of Brian Atchinson, Maine's superintendent of insurance and a former NAIC president, concluded that "certainly in the United States this is going to make our jobs more possible.". IAIS website.
- ¹⁰⁶ IAIS established in 1995 a Committee of the Future to determine whether it should develop standards for the future and represent insurance supervisors in the same way the Basle Committee represents bank regulators.
- ¹⁰⁷ IAIS By-Laws, *supra* note 87, at pt. 4, ¶ 19.
- ¹⁰⁸ *Ibid.*
- ¹⁰⁹ See IOSCO Bylaws, *supra* note 85??, at pt. ¶ 20.
- ¹¹⁰ See generally, IAIS By-Laws, *supra* note 87.
- ¹¹¹ See IOSCO By-Laws, *supra* note 85. See also, IAIS, pt. 5, ¶ 24(e).
- ¹¹² See Rules of Procedure of the General Assembly, *reprinted in* Basic Documents of the United States 41-67 (ed., Louis Sohn, 1968).
- ¹¹³ See Gary N. Klieman, 'Better Forum Needed to Negotiate Terms of Foreign Competition, Am. Banker, (Jan. 4, 1996) at 5.
- ¹¹⁴ See IOSCO By-Laws, *supra* note , pt. 4, ¶ 23.
- ¹¹⁵ See Peter Hayward, 'Prospects for International Cooperation by Bank Supervisors', 24 *IntlLaw.*, 787, 788-91 (1990). Hayward, the secretary of Basle Committee in 1990, stated, 'Supervisors need to be able to respond to market developments and a much more rigid agreement would have considerably weakened supervisor's ability to ensure that the intent of the 1988 agreement continued to be upheld.' *Ibid.*
- ¹¹⁶ Hal Scott, 'The Competitive Implications of the Basle Accord,' 39 St. Louis U.L.J. 885 (1995).
- ¹¹⁷ See Norton, Supervisory Standards, *supra* note 6, at 255.
- ¹¹⁸ Restatement (Third) of United States Foreign Relations Law, § 221 cmt. B [hereinafter Restatement (Third)].
- ¹¹⁹ *Ibid.*
- ¹²⁰ Derek W. Bowett, *The Law of International Institutions* (4th ed., 1982), Ch. 11.
- ¹²¹ One SEC regulator noted that: "We don't claim to represent the US as a whole," *Ibid* at § 222 cmt. A.
- ¹²² Restatement (Third), *supra* note 118, at § 221.
- ¹²³ Not surprisingly, when commenting on its section defining jurisdiction in order to prescribe activities of foreign branches and subsidiaries, the Restatement does not mention IOSCO and it mentions the Basle Concordat only once (without reference to the Basle Committee).
- ¹²⁴ See 'WTO Achieved Landmark Agreement on Financial Services, 25 *WTO Focus*, (Dec. 1997) 1-2. The Protocol to the
- ¹²⁵ See Key, 'Financial Services in the Uruguay Round and the WTO', G-30 Occasional Paper 54, (1997)
- ¹²⁶ See M. Kono & L. Schuknecht, 'Financial Services Trade, Capital Flows, and Financial Stability, Working paper (WTO, Geneva: 1998) 2-4.
- ¹²⁷ The decision-making powers are vested in a Ministerial Conference which is held every two years. In between times these powers are exercised by a General Council, which also acts as the Dispute Settlement

Body and the Trade Policy Review Body. Member states are required to ensure that their laws, regulations, and administrative procedures conform to their obligations under the various trade agreements of the WTO.

¹²⁸ See J. J. Norton, 'The European Community Banking Law Paradigm: A Paradox in Bank Regulation and Supervision – Reflections on the E.C. Second Banking Directive', in *International Banking Regulation and Supervision: Change and Transformation in the 1990s* (eds. J. Norton, C. Cheng and I. Fletcher) (Graham & Trotman, Martinus Nijhoff Pub, 1994.) 49-63.

¹²⁹ See Second Banking Coordination Directive, 89/646/EEC, [1989] OJ L386/1; Own Funds Directive 89/299/EEC; Solvency Ratio Directive 89/647/EEC; Consolidated Supervision Directive 92/30/EEC, [1992] OJ L110/52; Prudential Supervision Directive 95/26EC, [1995] L168/7; Investment Services Directive, 93/22/EEC; Capital Adequacy Directive 93/6/EEC, [1993] OJ L 141/1 (introducing capital requirements for market risk and extends harmonised solvency supervision to investment firms).

¹³⁰ See First Banking Directive (1977), art 1. Second Banking Directive (1989) art 1(6).

¹³¹ This occurred in the case of Austria and Finland before they became EU members and is now occurring in the application of Poland to join the EU.

¹³² See S.J. Key & H.S. Scott, *International Trade in Banking Services* (Washington D.C.: Group of Thirty, 1991). *De jure* national treatment does not automatically mean *de facto* national treatment.

¹³³ NAFTA, art. 1405.

¹³⁴ Norton, *supra* note 128, at 76. The US was very concerned that it should be able to continue its more stringent regulatory standards against the EU and that the principle of national treatment and MFN would prevail.

¹³⁵ R.J. Herring and R.E. Litan, *Financial Regulation in the Global Economy* (Washington D.C.: Brookings, 1995) 81.

¹³⁶ See David E. Van Zandt, 'The Regulatory and Institutional Conditions for an International Securities Market', 32 *Va. J. Intl' L.* (1991) 47, 57-58.

¹³⁷ Peter Norman, 'Capital Ratio Is Set by Banks of 12 Nations', *Wall St. J.*, (12 July, 1988), at 3.

¹³⁸ See US Federal Register (hereinafter Fed. Reg.) 46,963 (1988). Moreover, former SEC Commissioner David Ruder has written 'the need to foster international cooperation and coordination between securities regulators.' See David Ruder, 'Effective International Supervision of Global Securities Markets', 14 *Hast. Intl'l & Comp. L. Rev.*, 317, 331 (1991).

¹³⁹ See International Lending Supervision Act of 1983, 12 U.S.C. §3901(b) (1998) (US federal banking agencies are required to 'consult with the banking supervisory authorities of other countries to reach understandings aimed at achieving the adoption of effective and consistent supervisory policies and practices with respect to international lending').

¹⁴⁰ See 'Thank Basle For the Credit Crunch' *Wall Str. J.*, (Nov. 4, 1992) at A4. Breeden later explained that capital adequacy standards developed by the Basle Committee triggered "the immense reduction of commercial lending by banks in the US" during the early 1990s. See 'Go Slowly in Developing Common Rules, SEC Chairman Tells IOSCO Gathering', 24 *Sec. Reg. & L. Rep.* (BNA) 1667 (Oct. 30, 1992).

¹⁴¹ Dr. Ross Cranston, *Principles of Banking Law* (Oxford: 1996) ch. 11.