



INTERNATIONAL BOARD ON ECONOMIC REGULATIONS

**How the Future of Financial Regulation is Taking
Shape around the World:
Best Practices and Lessons Learned**

2017 Annual Report

The International Board on Economic Regulations (IBER), founded by the *Fondation pour le Droit Continental* (Civil Law Initiative), was inaugurated on 7 July 2015 during a press conference at Quai d'Orsay under the distinguished patronage of the French Minister of Foreign Affairs and International Development. The Board is made up of eminent leaders in the economic and legal fields from all around the world, from developed, "emerging" countries and developing countries alike. The IBER issued its first conclusions on the regulation in July 2016. The Board chose to focus its second annual report on financial regulation, marking the 10-year anniversary of the subprime crisis, and more than 8 years after the G20 summit in London.

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EXECUTIVE SUMMARY

The International Board on Economic Regulations decided to address financial regulation in its second annual report, marking the 10th anniversary of the subprime crisis.

Drawing on a comparison of national regulatory systems in Europe, North and South America, Asia, Africa and the Middle East, an analysis of supranational approaches to financial regulation since the G20 summit in London (April 2009), and a dissection of best practices highlighting areas for improvement, the Board developed 17 recommendations. These recommendations primarily address countries in the process of building their own financial regulation system, as well as those interested in reforming their existing system with the aim of achieving greater economic stability. They also address international forums for discussion, having stalled after building momentum in 2009.

Above all, these recommendations tell the story of a sizeable paradigm shift affecting global governance of financial regulation: with the arrival of the new US President, who has embraced an America-first policy as evidenced by his first several months in office, and the United Kingdom breaking off from the European Union, triggering disruptive competition not only between the UK and the EU but also between the Member States themselves, the danger of regulatory easing on the banking and financial markets is quite real, bringing with it the spectre of another seismic shake-up of the global economy.

The 17 IBER recommendations on financial regulation, which are national as well as international in scope, are broken down into 9 categories:

1. Have an international framework of conduct capable of laying the foundation for a level playing field: expanding and completing the work achieved at the G20 summits in London and Pittsburgh and by the Basel Committee, with proper diplomatic intelligence;
2. Rethink the way local and international regulations are interconnected: balancing the reality of the limited potentialities of a veritable supranational regulation with the aim of building a network structure;
3. Rethink the role played by local financial regulators, both in terms of their duty to establish technical rules and their duty to supervise and penalise parties guilty of breaching the rules;
4. Improve regional coherence and opportunities for regulatory intervention;
5. dispel systemic risk, notably by cutting ties between banks that are “too big to fail and shadow banking, without creating “shadow shadow banking”;
6. Invest fully in the field of bilateral financial diplomacy;
7. Disseminate macroprudential supervision in order to slow and defuse systemic risks;
8. Revisit the Glass-Steagall Act, provided an international consensus is reached;
9. Do not curb financial innovation if it is positive for the real economy.

Introduction

1.1. Origins of the IBER

1.1.1. The International Board on Economic Regulations arose from four observations

Four observations coincided to create the International Board on Economic Regulations (IBER).

First observation: economic regulation is still predominantly designed at the domestic level, whether in terms of institutional architecture and governance, relations between parties or legal and jurisdictional framework. And yet, what economist would dare suggest that today, or even for the past thirty years or more, the increasingly globalised and interconnected economy, founded not only on a ceaselessly growing web of intersections between already-transnational players, but also trade and free competition, is still firmly rooted in a strictly national framework? There is a patently obvious disconnect between economic reality and the fundamental design of regulation.

Second observation: thirty years after the term “regulation” made its debut in the economic and legal vocabulary, its meaning has radically changed. No longer does regulation merely designate the State's traditional methods for intervening in economic mechanisms. Today, this concept refers to very modern tools, combined under the somewhat catch-all term “soft law”, which no longer have anything to do with conventional tools when it comes to responsiveness, flexibility and economic realism. And it is precisely for this reason that, in the broadest sense of the term, the definition of “regulation” largely exceeds the more traditional definition.

The current economy, shaped over the last three decades by such major phenomena as financialisation, disintermediation and digitisation as the foundation of innovation, can no longer be regulated with tools designed for the 20th century economy. This new economic paradigm, specific to the advent of the “liquid” society and economy referred to by British sociologist Zygmunt Bauman, calls for a more imaginative approach. The IBER therefore asked itself where it might seek out innovative and practical ideas on regulation, and believes it found a key in comparing and contrasting best practices from around the world.

Third observation: regulation is on track to becoming a key concern for emerging or developing countries in the years to come. Indeed, these countries are still in the process of structuring their economy, which in many cases has been rushed due to exponential growth and the unprecedented transformation of the business landscape (sector, size, organisation methods), never-before-seen in so-called developed countries. These countries are in need of solutions, recommendations and an understanding of their unique challenges and difficulties. Meeting this need for perspective is precisely what the IBER seeks to accomplish with its comparative approach.

Fourth and final observation: existing institutions currently reflecting on what might constitute “good regulation” are primarily focused on microeconomic analysis. The IBER wishes to promote another complementary view or regulation, as seen through a macroeconomic but also institutional, legal and jurisdictional prism. To this end, it has established its own dashboard to analyse the features, strengths and weaknesses of the methods of regulation implemented around the world.

1.1.2. The IBER wishes to promote an original and specific approach that complements the approach taken by existing institutions

The Board has given itself the following tasks:

- 1) Comparing the various existing legal systems on the normative, institutional and procedural fronts;
- 2) Deriving best practices in terms of regulation from this comparison, capable of effectively combining economic efficiency, legal security and democratic requirements;
- 3) Using these observations to formulate indications and recommendations for economic regulators, governments, corporations as well as the entire international scientific, economic and legal community, focusing primarily on developing countries.

In the interest of completing this analysis and assessment, the Board has created its own dashboard, inventorying the criteria to be taken into consideration (see Appendix 1). Unlike the most commonly used approaches, this dashboard focuses less on the microeconomic aspects of regulation and more on the macroeconomic and institutional aspects.

1.1.3. The IBER operates as an international panel comprised of leading experts from all corners of the globe

The IBER is an international panel of leading experts from around the world, administratively backed by the Civil Law Initiative, but working independently. Its composition will evolve and expand over time. The preparatory work for this report involved experts from China, the US, Brazil, Columbia, the UK, the Democratic Republic of Congo, Syria and France, all shedding light on practices in virtually all continents (Australia was not represented) (see Appendix 2: Members of the IBER).

1.2. After an inaugural report on the regulation of competition, a second annual report on financial regulation

1.2.1. Tenth anniversary of the subprime crisis: stakes of financial regulation

For its inaugural report, the IBER chose to address the regulation of competition. For its second report, the Board wanted to conduct an overview of financial regulation around the world, ten years after the financial crisis was triggered by the US subprime market crash, whose recessive consequences on the real economy took a tangible toll still observed today in many countries.

Although the ties between the world of finance and the real economy violently and empirically manifested with the crisis, they nevertheless remain relatively complex. A recurring debate in recent years has focused on the compatibility between strict regulation of financial activities and growth. The work undertaken by the Bank for International Settlements (BIS) confirms, however, that the banks with the most capital are those that placed the fewest restrictions on credit during the crisis. Similarly, the International Monetary Fund (IMF) has demonstrated through its work that the relationship between finance and growth is more complex than we imagined with the crisis: past a certain point, if the banking and financial sector grows too fast, it hurts growth by causing bubbles to form which destabilise the sector by triggering a recessive spiral that spreads to the real economy. Furthermore, by generating excess profits and thus “excessive salaries” in the financial and banking sector, bubbles threaten

to distort the allocation of human resources, putting other sectors of the economy at a disadvantage because the prospect of such high wages siphons off brainpower and talent.

Without investing intellectually and politically in crisis prevention, the damages of financial stability in the real economy prove extremely costly to fix. It cannot be denied that the 2008 crisis highlighted the absolute need to strengthen financial stability in order to protect the real economy. Today, many countries have yet to restore their GDP to pre-crisis levels or successfully re-absorb the resulting rise in unemployment, and are still suffering from the deterioration of their public finances. They are penalised as a result in their economic policy decisions, mainly because a portion of private-sector debt has been shifted out of the banking sector and become public debt (cost of bail-out operations). The cumulative GDP losses stemming from the eruption of the financial crisis have been estimated by the IMF at one-fourth of global GDP¹.

After the US financial crisis, followed by the economic and global crisis in the late 2000s, a large number of projects were launched with the aim of examining 1) the quality and quantity of capital, serving as a “sponge” to absorb any losses and prevent failures liable to start a domino effect, 2) liquidity requirements to enable banks to better withstand a liquidity shortage on the interbank market, 3) the balance sheet size of mega-banks incurring systemic risk, i.e. the infamous “too big to fail” banks, subject to better supervision than before, 4) supervision of major institutions through the Banking Union in Europe, for example, 5) resolution of banking issues, and 6) the enhancement of deposit insurance mechanisms.

However, these projects are not advancing at the same rates depending on the country and region of the world, and nowhere have they been fully realised.

An indisputable and undisputed source of the 2007-2008 crisis, namely excess securitisation and the growing complexity of financial products and vehicles, is threatening to make a disturbingly rapid comeback, with shadow banking increasing in magnitude since the early 2010s to top pre-crisis volumes.

Inset 1: Countries unevenly impacted by the 2007-2008 financial crisis: Brazil's resilience

Not all countries were impacted equally by the 2007-2008 financial crisis. Brazil came out relatively unscathed. It should be pointed out that Brazil had already begun to bolster its financial regulatory framework in the wake of the multiple crises that hit its financial sector, particularly in 1998-1999.

First, the capitalisation of Brazilian banks was much higher than that of US banks, undoubtedly generating a weaker leverage effect. The requirements imposed on Brazilian banks by the local authorities are stricter than Basel III. The Brazilian financial system's exposure to derivative securities and products is also traditionally much lower.

Furthermore, Brazilian banks are controlled by large shareholders, meaning control is not overly fragmented, giving each shareholder incentive to call for strict management without excessive risk-taking.

Brazil also had the foresight to establish a particularly solid credit risk management agency (*Central de Risco de Crédito*) in 1997, tasked with overseeing the financial solidity of lenders and enabling financial institutions to share information. The result has been a small number of failures and better management of credit risk.

¹ IMF World Economic Outlook, April 2015

1.2.2. International financial regulation is not yet tangible enough, despite the timid progress achieved since the 2008 crisis

On 8 November 2008, Pascal Lamy, then Director-General of the World Trade Organisation (WTO), made the following surprising observation: *“I notice that there are global organisations for trade², health³, environment⁴, telecommunications⁵, food⁶. There are two black holes in global governance: finance, with its bursting bubbles, and migration, an area where there is no bubble, but daily dramas.”*

Despite the worldwide interconnection of the capital markets, financial regulation systems are still predominantly national in scope. Methods of analysis continue to depend on the post-WWII financial environment, a time when capital flows between countries were limited and for the most part controlled by the political and monetary authorities, under the coordination of the IMF.

And yet, the internationalisation of financial flows did not start yesterday, or in the 21st century for that matter: in fact, it can be traced back to the “temporary” suspension of the gold standard by US President Richard Nixon in 1971, which triggered the privatisation of international capital flows. The development of international flows has begun to take off again under the impact of financial deregulation policies and the liberalisation of capital movements dating back to the 1980s in industrialised countries (via actively deregulatory policies enacted by US President Ronald Reagan and UK Prime Minister Margaret Thatcher), followed in the 1990s by several emerging and developing countries.

Over the last 45 years, governments have strived to develop cooperation between their monetary and financial authorities, sometimes bilaterally, but more often through international forums, generally organised by business line and drawing a distinction between banking, insurance and markets in financial securities. Such international forums have adopted the mission of developing a set of standards, defined by consensus, giving rise to a body of international soft laws. Even so, it took the first globalised financial crises in the 1990s, preceded themselves by the 1987 crisis, for governments to view regulation of the international financial markets as a critical issue in its own right. The first illustration of this new-found awareness was the 1995 G7 summit in Halifax, in the wake of the Mexican sovereign debt crisis of 1994. No concrete initiatives were launched, however, until after the Asian and Russian crises in 1997 and 1998, resulting in the flagship decision to create the Group of Twenty (G20), alongside the September 1999 G7 summit in Washington⁷.

International forums were expanded as a result of the 2007-2008 financial crisis, though without going so far as to assign a supranational regulatory role to international financial institutions such as the IMF and the World Bank. These forums also saw their scope of intervention broadened, highlighting the importance of a systemic approach to risk as opposed to the macroeconomic approach taken by regulators, the procyclicality of prudential rules, the regulation of large and complex financial institutions invested in several fields of activity, the cross-border dimensions of crisis management, and the inadequate consideration of questions concerning the actual availability of bank capital and liquidity.

² World Trade Organisation, established in 1995.

³ World Health Organisation, established in 1948.

⁴ World Environment Organisation, currently being established.

⁵ International Telecommunication Union (ITU), established in 1865.

⁶ Food and Agriculture Organisation of the United Nations (FAO), established in 1945.

⁷ For the first nine years of its existence, the G20 convened finance ministers and central bank governors, while focusing its discussions on macroeconomic issues. It was not until 2008 at its inaugural meeting, comprised for the first time of Heads of State and Government, that the G20 truly addressed the issue of financial regulation.

The fact of the matter is, since the Pittsburgh summit of September 2009, the G20 has struggled to make progress in communication on financial regulation. Political momentum appears to have flagged. The projects announced at the April 2009 G20 summit in London are nowhere near complete or undertaken locally by the participating countries.

There are several cumulative factors behind this lack of progress. First, legal traditions vary depending on the region of the world. Second, before the crisis, regulation was broken down into myriad levels. These in turn were isolated between the various levels of a country's administration (federal and sub-federal, central and regional) and different types of activity, which had the paradoxical effect of increasing the power of lobbyists in the banking and financial sectors. Furthermore, the political economy can sometimes result in a wait-and-see attitude rather than premature interventionism, which would send a negative signal and have a destabilising effect on the whole economy, a trend exacerbated by the constant recognition of any associated moral hazard.

Finally, the crisis did not affect all countries equally. It did, however, prove that each State is the ultimate guarantor of its financial system, including for the country's foreign transactions. In maintaining this financial responsibility, governments are often unwilling to give up sovereignty in this area, further complicating the organisation of a truly supranational system as opposed to the one that exists today.

1.2.3. A unique set of circumstances with the election of Donald Trump and Brexit, with a temptation in some States to retreat from the world of finance, potentially setting the stage for the reshaping of financial regulation and competition

Paradoxically, even though the 2007-2008 financial crisis is still very fresh in everyone's mind, a new phase of financial deregulation now appears to be taking shape.

The world's major economic zones are in the midst of a global competition to attract capital. Regulation is a key factor in this competition, though obviously not the only one. Jurisdictions practising lax regulation may attract businesses in the short term, but they run the risk of seeing them pull up stakes just as quickly if a crisis of confidence hits.

It is not so much a decline in the internationalisation of standards that should be feared, but rather the easing of financial regulation. And yet, to operate in an optimal environment for everyone, the rules of the game need to be clear: we cannot have some sort of contest between global marketplaces to see whose financial regulator is willing to make the lowest bid to attract banks or asset management companies. This particularly applies to the United States, where the new President's blunt determination to deregulate the financial industry could consolidate the domination of US banks. It also applies to the UK and the EU, not to mention among the 27 EU countries themselves, each of which wants to take advantage of the potentialities offered by Brexit.

Brexit's potential impact on financial regulation in Europe and the UK is a sign of the times. However, the key element associated with Brexit is the fact that so many EUR clearing activities are located in London. For security reasons, once the UK has actually left the European Union, clearing houses doing substantial business in Euros will need to be directly supervised by the European authorities. Furthermore, those bringing major systemic risk to bear on the euro zone should only be able to provide their services by establishing their operations in the euro zone. This new rule being considered by the European Commission would almost certainly lead some of the financial activities based in London to relocate to continental Europe.

Of course, the UK could see this as a form of punishment meted out by Brussels for leaving the EU and, since turnabout is fair play, be tempted to retaliate through all-out deregulation.

Meanwhile, the new US President has made no secret that he wishes to repeal Dodd-Frank, accusing the 2010 act of going too far in its goal to prevent a 2008-level disaster by placing too many constraints on banks, and thus the US economy, by curbing lending. Based on the report presented by the US Treasury Department on 12 June, the White House is planning to tailor the regulatory approach based on the size and complexity of regulated firms. In that case, the Volcker rule, which prohibits banks from speculating for their own account, would no longer apply to banks with less than \$10 billion in assets. Such smaller banking institutions would also see their liquidity coverage ratio obligations relaxed. Furthermore, stress test requirements would be raised, switching financial institutions from a quantitative balance sheet size approach to a more qualitative approach focused on risk-taking and complexity of operations.

Experience has shown, however, that deregulation gives rise to greater risk-taking and inevitably causes new bubbles to form.

1.2.4. A volatile purpose that defies regulation: can finance really be regulated?

Regulating any sector assumes that all players and activities in that sector are known. Therefore, regulating finance is an essentially arduous task given the eminently volatile and complex nature of its purpose. Above all, the nature of financial innovation is such that the sector is always one step ahead of its regulator. It is much easier to skirt regulations in the financial sector than in any other, creating a veritable black box that eludes regulation: shadow banking.

The shadow banking system, which has been proven to be difficult if not impossible to regulate, will cost \$100,000 billion worldwide in 2017⁸, according to the Financial Stability Board. The region of the world where shadow banking is the most prevalent in volume terms is Europe. The main players in the shadow banking industry are investment funds, to the tune of 40% in 2015. In second place are broker-dealers, with hedge funds coming in third.

Shadow banking refers to the tendency of banks to develop “off-balance sheet” activities at the microeconomic level. It has in fact become common practice to conduct transactions in a way that keeps them off conventional balance sheets and thus outside the scope of regulatory authorities. Under this definition, the shadow banking industry comprises a hodgepodge group of banks and non-bank institutions (investment banks, speculative funds, mutual funds, pension funds, insurance companies) that skirt the rules of the financial sector, despite conducting lending activities and transforming deposits into long-term loans just like any other bank. Without access to deposit insurance or central bank refinancing operations, however, shadow banking players are potentially more vulnerable to the slightest shock.

This is all the more problematic considering how pandemic shadow banking has become. If disrupted, the entire “standard” banking system suffers as a result. The subprime crisis is perfect proof. In this free-for-all environment, however, it is impossible to predict shocks or prevent crises with any certainty. While the 2008 crisis initially had the effect of curbing shadow banking, it nevertheless made a big comeback in the 2010s for one simple reason: shadow banking tends to grow when interest rates are low and banking regulation becomes stricter – two very prominent features of the current environment. The short-term decline was thus

⁸ See the FSB's Global Shadow Banking Monitoring Report 2016 (published on 10 May 2017). The FSB estimated the shadow banking industry at \$92,000 billion in 2015, i.e. 150% of global GDP, versus \$80,000 billion in 2014. In comparison, shadow banking was limited to \$26,000 billion in 2002.

followed by a phenomenal increase in this type of activity. The stricter regulations become, the more shadow banking expands and finds clever ways to take advantage of technology.

True, Basel III sets limits on certain shadow banking activities, but in reality, nothing is really identified or binding – the main fear being that a chain reaction would be set off, creating “shadow shadow banking”⁹.

Ten years after the subprime crisis, despite being the very cause of said crisis, shadow banking has defied efforts at regulation by governments and central banks alike, and as a result off-radar deals, transactions and loans are once again threatening global financial stability.

Inset 2: The Exponential Rise of Shadow Banking

In the course of its work, the Financial Stability Board (FSB) has developed an annual policy framework for monitoring the evolution of shadow banking activities. The fifth annual Global Shadow Banking Monitoring Report, published in November 2015, covered 26 jurisdictions (6 of which in the euro zone), totalling 90% of the world's financial assets.

The FSB uses two methods to estimate shadow banking activities: a broad measure and a narrow measure. The narrow measure is the most telling, as it is based on the estimate of risks associated with five economic functions, with the aim of reducing the scope of review to activities presenting a real systemic risk. These five functions are 1) management of cash client pools with features that make them susceptible to runs, 2) loan provision that is dependent on short-term funding, 3) intermediation of market activities that is dependent on short-term funding or on secured funding of assets, 4) facilitation of credit creation and 5) securitisation and funding of financial entities.

The results of the narrow measure are as follows: shadow banking activities that generate systemic risk were estimated at \$36,000 billion in 2014, i.e. 59% of GDP and 12% of the financial assets held by the 26 jurisdictions under review. Cash client pools alone (investment funds, alternative investment funds, money market funds) represented 60% of assets under management. The United States, which bears systemic risk in terms of shadow banking, is in pole position with \$14,200 billion. Next comes the UK at \$4,100 billion, followed by the euro zone at \$8,280 billion, i.e. 23% of assets under management.

Whether from the narrow measure or broad measure standpoint, the US, the euro zone and the UK lead the way with three quarters of shadow banking assets. Even so, shadow banking activities are nevertheless running rampant in emerging countries such as China, India, Indonesia and Russia.

In France, the *Haut Conseil de Stabilité Financière* (High Council for Financial Stability) has estimated shadow banking assets at €1,144 billion, i.e. 55% of GDP and 15% of banking sector assets, versus €7,770 billion for the banking sector, giving a ratio of 1 to 7.

It should be noted that estimates vary according to the calculation method used.

More than the magnitude of the phenomenon, it is the momentum that is worrying, as well as the factors driving this momentum. One factor is the effect of quantitative easing policies implemented by several central banks: the persistently low interest rate environment reduces potential returns on investment; as a result, financial players are driven to seek higher returns from non-banking entities. Another factor is the outcome of strategies devised by regulated entities to circumvent regulations: the tightening of banking regulations in the wake of the crisis has put a strain on bank resources and lending capacities, paradoxically sparking an increase in shadow banking activities. Finally, shadow banking can be attributed to a long-term trend: for some time, the development of a financial system shadowing the bank financing system was even supported by the government authorities. Such was the case in the US, for example, with the backing of securitisations by quasi-public corporations Fannie Mae and Freddie Mac.

Source: French Senate Report No. 607, on behalf of the European Affairs Committee, on the improvement of the transparency and regulation of the shadow banking system, by Senator François Marc.

⁹ See *Le Shadow Banking* by Constantin Mellios and Jean-Jacques Pluchart, 2015.

1.2.5. Turbulence in the European banking sector in summer 2017: the sign of a future crisis?

In Europe, summer 2017 saw very strong concerns over the fragility of the banking sector make their way back to the forefront.

First in the Italian banking sector: four banks were bailed out by the State. The rescue of Italian banks Veneto Banca and Banca Popolare di Vicenza, crippled by bad debt that was subsequently transferred to a bad bank, proved very costly for Italian taxpayers at a price tag of €10 billion or 0.6% of the country's GDP. Spanish banks also found themselves in trouble. Banco Santander bought Banco Popular for one symbolic euro, but also acquired all of its assets, including the bad debt.

These bank crises were handled by the national government, in a snub to the Banking Union which sought to avoid the State having to get directly involved in bank resolutions.

Not even Germany was spared, raising fear of an even more widespread European systemic risk. The IMF issued a warning in 2016 on the fact that Deutsche Bank was the biggest contributor to systemic risk for the global banking system, with the Fed chiming in to say the bank had failed its annual stress test. And yet German banks, led by Deutsche Bank, are at the hub of the German industrial complex, financing all major German corporations.

Nine years after the collapse of Lehman Brothers, the renewed vulnerability of the European banking system has prompted fears of the same domino effect for not only the European economy but also the global economy.

2. Time to take stock: busting the myth of international financial regulation once and for all

2.1. An admirable effort by the G20 summit in London on 2 April 2009 – but no true financial regulation on an international scale

At the G20 summits in Washington (November 2008) and London (April 2009), a supranational approach to reforms aimed at better supervising and controlling the financial sector was initiated with the following four main objectives:

- making financial institutions more resilient by improving their ability to absorb shocks;
- putting an end to the “too big to fail” problem, with systemic corporations taking too many risks and jeopardising the stability of the financial system;
- conducting trades over-the-market directly between operators, a sounder way to trade;
- developing a shadow banking system that actually serves to finance businesses and the economy.

While the reforms as announced were at first glance impressive by their very scale, the process itself was very sequential. The primary focus was on banks: quite a few significant advances have been made in the banking industry. There is much progress to be made in other areas, however.

The aim of improving the financial strength of banks gave rise to the Basel III accords, adopted on 16 December 2010 by the Basel Committee on Banking Supervision (BCBS), comprised of the central bank governors of the most advanced global economies¹⁰.

¹⁰ Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, South Africa, South Korea, Spain, Switzerland, the United Kingdom, the United States and Turkey.

First, Basel III recommended tightening the capital adequacy ratio:

- 1) by improving the quality of the capital under consideration by changing the definition of said capital, primarily by restricting financial instruments eligible as Tier 1 capital and gradually excluding certain hybrid securities;
- 2) by establishing a more conservative valuation of assets;
- 3) by raising the minimum level of capital requirements from 2% to 4.5% by 2015, then 7% by 2019, by incorporating an additional conservation buffer of 2.5%.

Second, Basel III introduced a leverage ratio that limited bank debt by capping total exposure (on- and off-balance sheet) at 33x Tier 1 capital by 2018.

Finally, Basel III introduced two liquidity ratios:

- 1) a Liquidity Coverage Ratio (LCR) encompassing the obligation for banks to have a very high-quality stock of liquid assets, which can be easily converted into cash to meet their liquidity needs for a 30 calendar-day liquidity stress scenario. Liquid assets are weighted by quality;
- 2) a Net Stable Funding Ratio (NSFR) encompassing the obligation for banks to maintain a stable funding profile based on longer-term stable sources of funding.

Raising the CET1 target to 7% meant banks were faced with a capital shortfall estimated at €374.1 billion by the Basel Committee at 31 December 2011. Additional resources stemming from the proposed liquidity ratios were estimated at €4,300 billion.

Inset 3: Basel Committees

The development of soft law in international finance was driven by the establishment of the Basel Committees in 1975, headquartered at the Bank for International Settlements (BIS), which serves as the secretariat for the Committee. The BIS is itself an international organisation. Established in 1930 to administer the settlement of reparations imposed on Germany after World War I, the BIS has evolved to become a body that promotes cooperation and coordination among central banks. It serves as the secretariat for the Basel Committees, backed by staff provided by the regulatory authorities. Standards are formally produced by the Basel Committees and not by the BIS.

The Basel Committees were created in late 1974 by the Group of Ten Countries (G10), comprised of the central banks of the world's principal economies. The Committees report to the central bank governors and, where they are separate, to the Heads of Supervision of its Member States, of which there are currently 27. The body of Basel Committee standards serves as a reference in most countries where banks exercise international operations, even when these countries are not Committee members. All regulators take part in the biannual International Banking Supervisors Conference (ICBS). The Basel Committees are not vested with supranational authority. For their standards to be implemented, they must be endorsed and transposed into national law (or regional law in the case of Europe).

The most well-known committee is the Basel Committee on Banking Supervision (BCBS), which established the Basel I Accord (1988) on minimum capital requirements and the Basel II Accord (2004), which revised and expanded these requirements. It also published a series of documents entitled "Core Principles for Effective Banking Supervision" and "Core Principles Methodology." The G20 commissioned the Committee to undertake a set of initiatives in the wake of the 2008-2009 financial crisis, collectively referred to as Basel III.

The Committee on Payment and Settlement Systems (CPSS) drafts standards on the efficiency and security of payment and settlement systems. Membership was increased after the crisis and its scope of activity was expanded.

The Committee on the Global Financial System (CGFS) monitors developments in global financial markets and analyses their implications in terms of financial stability. As such, its objective is not to set standards, but its work calls for an active interest in financial market standards.

Source: "Le rôle des institutions financières internationales dans la régulation du système financier" (The role of international financial institutions in the regulation of the financial system), Christophe Destais, Deputy Director of the CEPII (French research centre in international economics), 2011.

Non-binding standards are therefore produced by relatively technical international bodies.

Some authors (Eatwell, 2011) have spoken of the “rampant internationalisation” of financial regulation through organisations operating on the basis of mutual recognition and consensus to create soft laws. Soft laws consist of a set of codes, collections of best practices and guidelines implemented by each institution holding national authority which, when breached, do not give rise to legal penalties issued by international organisations or courts. Insofar as they are not legally binding, using soft laws steers clear of the cumbersome problems inherent in drafting, signing and amending international treaties. Conversely, they do not offer the same guarantees in terms of transparency, reporting obligations and enforceability for parties accountable to the law.

Setting aside the issue of accounting and auditing standards, which are not unrelated to financial stability, there are three categories of standard-setting bodies:

- Basel Committees (see Inset above);
- the International Organisation of Securities Commissions (IOSCO) (see Inset below);
- the International Association of Insurance Supervisors (IAIS, created in 1994 and, like the Basel Committees, headquartered at the BIS).

Inset 4: International Organisation of Securities Commissions

IOSCO comprises securities and derivatives market regulators from around the world. It was created in 1983 and was built up from an institution whose geographic scope was limited to North and South America. Its Secretariat was established in Madrid in 1999. IOSCO began setting standards in the wake of the financial scandals of the early 2000s.

Its “ordinary” members are national securities commissions or professional organisations with significant authority over securities or derivatives markets in their respective jurisdictions. Its associate members are other national regulators, where the country in question has several regulatory bodies. Affiliate members are other stock exchanges and professional organisations. Only ordinary members have the right to vote. IOSCO has 114 ordinary members, 11 associate members and 74 affiliate members. Its activity is divided up among several committees. The most important standard-setting committee is the Technical Committee, which is divided into 6 sub-committees specialising in accounting, disclosure and transparency, regulation of trading venues, regulation of financial intermediaries, cross-border enforcement, regulation of investment funds, and regulation of rating agencies.

In 1998, IOSCO adopted a set of “Objectives and Principles of Securities Regulation” which are subject to an ongoing adaptation process. These objectives and principles address the role, independence and supervision of auditors, accounting transparency, conflicts of interest and the exchange of information between member country authorities in the interest of facilitating their activities.

Source: “*Le rôle des institutions financières internationales dans la régulation du système financier*” (The role of international financial institutions in the regulation of the financial system), Christophe Destais, Deputy Director of the CEPII (French research centre in international economics), 2011.

The international forums responsible for producing soft laws emerged along the lines of traditional finance sectors – banking, insurance and markets – echoing the compartmentalisation of the industry encouraged by the measures undertaken after the 1929 stock market crash in the US (Glass-Steagall Act) and World War II in Europe.

The lines between these compartments began to blur, however, with the liberalisation of capital flows, financial deregulation in the 1980s and 1990s, and innovation in the sector. As demonstrated by the crises in the late 1990s and late 2000s, blurred lines made it possible for risks to build up in areas where they escaped regulation.

At the international level, the various organisations bringing together regulatory authorities initiated coordination efforts in the mid-1990s with the creation of the Joint Forum of Financial Market Regulators, comprising the Basel Committee on Banking Supervision (BCBS), the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), focusing initially on the supervision of financial conglomerates. The number of countries represented in this forum is much smaller, however, than in the organisations themselves, as it only includes the G7, Australia, Belgium, Denmark, the Netherlands, Spain and Switzerland. The European Commission is an observing member.

2.2. States nevertheless maintain control over the regulation of their financial system

First of all, systemic risk observatories have been established in several geographic areas alongside traditional financial regulators at the macroprudential level. These new arrivals in the regulatory landscape focus on the links between institutions, developments in economic sectors and the balances – or imbalances – prevalent in large macroeconomic groups.

Inset 5: France's recent macroprudential financial regulation system

France established a macroprudential body in charge of supervising financial risk in two steps during the post 2007-2008 crisis period.

Step 1 was the creation of a Financial Regulation and Systemic Risk Board (Corefris) by the Banking and Financial Regulation Act of 22 October 2010. Corefris, comprised of representatives of the Banque de France and financial sector supervisory authorities, was tasked with advising the Minister for the Economy on the prevention and management of systemic risk.

With the enactment of the Separation and Regulation of Banking Affairs Act of 26 July 2013, Corefris became the *Haut Conseil de Stabilité Financière* (HCSF) (High Council for Financial Stability), making it the French macroprudential authority in charge of supervising the financial system as a whole, with the aim of preserving its stability and its ability to ensure a sustainable contribution to economic growth.

The HCSF is also tasked with facilitating cooperation and the exchange of information between the institutions represented by its members. Such exchanges help limit supervisory blind spots and better incorporate risks associated with the interconnections between different players or sectors and interactions between regulations.

The HCSF has 8 members: the Minister of Finance (who chairs the HCSF), the Governor of the Banque de France and Chairman of the *Autorité de contrôle prudentiel et de résolution* (ACPR) (French Prudential Supervisory and Resolution Authority), the Vice-Chairman of the ACPR, the Chairman of the *Autorité des marchés financiers* (AMF) (French Securities Regulator), the Chairman of the *Autorité des normes comptables* (ANC) (French Accounting Standards Authority) and three qualified experts selected for their expertise in the monetary, financial or economic field, each appointed by the President of the National Assembly, the President of the Senate and the Minister of Finance. The HCSF meets on a quarterly basis and publishes an annual report on its activities.

The tools available to the HCSF dovetail with the tools developed on a European scale. The transposition of the European Capital Requirements Directive (CRD IV) and the application of the European Capital Requirements Regulation (CRR) equipped the HCSF with several capital requirements “buffers”:

- the systemic risk buffer serves as a form of capital protection in the financial system, in addition to the regulatory ratios set for systemic institutions. It can range from 0% to 3%, going as high as 5%, of exposures as from 2015;
- the countercyclical capital buffer requires financial institutions to use a buffer of capital to protect against excess aggregate credit growth associated with the build-up of systemic risk. The CCyB is set to be implemented over the following timetable: 0.625% of total risk-weighted exposure as of 2016, 1.25% in 2017, 1.875% in 2018, and 2.5% of capital in 2019.
- Under Article 458 of the CRR, to address macroprudential or systemic risk identified at the

national level, Member States can impose stricter national measures, compared to those defined at the European level, in terms of capital requirements, requirements for major risks, reporting requirements, capital conservation buffers, liquidity requirements, risk weights for targeting asset bubbles in the residential and commercial property sector, and financial sector exposures.

Furthermore, under the terms of Article 49 of the “Sapin 2 Act” of 9 December 2016, the HCSF is entitled to restrict withdrawals from life insurance policies in the event of a major crisis, for a maximum period of 6 months.

Source: French Ministry for the Economy and Finance.

Similar institutions have been created in the United States¹¹, China¹², the United Kingdom¹³ and Europe¹⁴.

Moreover, given the role played by brokers in triggering the crisis, all around the world concerns have been raised over the supervision of certain types of products (such as derivatives) and market activities, embodied in plans to segregate deposit activities from certain investment banking activities. This is often referred to as the return of the Glass-Steagall Act¹⁵. The debate swelled when the Libor crisis erupted in summer 2012 (see Inset below). A growing number of experts have called for Europe to adopt such legislation to prevent potential conflicts of interest and limit the risks of systemic contagion in the event of a crisis.

No strict separation was enacted, but tools were developed to segregate deposit and capital markets activities around the world.

In the UK, the Vickers Commission recommended in September 2011 that retail banking activities be ring-fenced from investment banking activities. The recommendation is scheduled for implementation in 2019. Ringfencing is not aimed at dismantling banking groups; rather, retail banking activities would become a separate arm with their own Board of Directors and higher capital requirements. In a sense, the idea is to make the retail banking arm a “sanctuary” within banking groups, in the interest of protecting them from the risks inherent in investment banking via an explicit guarantee of protection from the State. To this end, the investment banking arm would no longer be able to use deposits for speculative purposes and would no longer be backed by the State.

¹¹ The Financial Stability Oversight Council (FSOC) was established by the Dodd-Frank Act of July 2010 and is chaired by the US Secretary of the Treasury.

¹² In July 2017, Chinese President Xi Jinping announced that the powers given to the People's Bank of China in terms of macroprudential supervision and prevention of systemic risk would be expanded, and that a Commission for Financial Stability and Development would be created under the authority of the State Council.

¹³ The Financial Policy Committee, comprised of 13 members and, though independent, works under the aegis of the Bank of England, was created by the Financial Services Act of 2012.

¹⁴ The European Systemic Risk Board (ESRB) was created on 16 December 2010, on the recommendation of a High-Level Group chaired by Jacques de Larosière and tasked with considering how financial supervision could be strengthened to better protect European citizens and rebuild trust in the financial system. In 2009, the de Larosière report recommended that a Union-level body be established with a mandate to oversee risk in the financial system. At the same time, the Single Supervisory Mechanism (SSM) was set up under the aegis of the European Central Bank (ECB), further enhancing the European institutional framework: while the national macroprudential authorities maintain primary responsibility for intervention, the ECB is able to tighten the macroprudential measures undertaken in States belonging to the SSM.

¹⁵ The Glass-Steagall Act is the name by which the Banking Act of 1933 is known, and which established 1) the incompatibility between deposit and investment banking activities, 2) the Federal Deposit Insurance Corporation and 3) the cap set on interest rates for bank deposits. Criticised since the mid-1970s and largely skirted by the banking industry, the Glass-Steagall Act was repealed in 1999 under the Clinton Administration.

In the US, the Dodd-Frank Act of July 2010 did not apply to the banking group itself, but prohibited any bank that collects deposits from conducting a certain number of transactions, including proprietary trading in particular, and limited bank holdings in hedge funds and private equity funds to a maximum of 3% of own funds.

In Europe, also in 2010, the European Commission Markets in Financial Instruments Directive (MiFID) imposed transparency obligations on hedge funds, making it mandatory for them to trade in derivatives on organised platforms. In 2012, the Liikanen Report recommended segmenting banking activities within banking groups in order to isolate hedging and other speculative activities. More importantly, as of 1 January 2015, the European Banking Union was implemented, transferring to the European Central Bank the responsibility for supervising major banking groups, instigating resolution mechanisms for bank failures and securing deposits of up to €100,000.

Third, in some countries such as the United Kingdom, the very institutional architecture of financial regulation was overhauled after the crisis. Prior to the 2007-2008 financial crisis, the only regulator of the UK financial industry was the Financial Services Authority (FSA). The FSA was criticised for having several flaws, however, considered responsible for preventing the crisis from spreading, namely that it 1) failed to identify financial stability risks, 2) did not react in a timely and appropriate manner, 3) neglected its role as a prudential supervisor and instead focused on regulating the behaviours of financial institutions, and 4) relied too heavily on “tick-box compliance”, naively trusting in financial sector operators and thus failing to conduct an extensive strategic analysis of risks. The FSA was seen as a regulator wearing blinders, much too focused on compliance with rules and losing sight of the bigger picture.

For these reasons, the FSA was disbanded in 2013 and replaced with two new regulatory authorities: the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The Bank of England also plays a major role in the UK financial regulation system, holding authority over the supervision of financial market infrastructures, including clearing houses in particular. It also oversees the stability of the interbank payments system.

2.3. Increasing regionalisation: towards the polarisation of financial regulation

• The European Union

In perhaps a slightly paradoxical way, even though the financial crisis arose in the United States, the European Union very quickly and proactively took measures to strengthen financial regulation at the regional level.

In the insurance sector for example, the ambitious Solvency II Directive, adopted by the European Union on 22 April 2009, aims to build a harmonised regulatory framework for insurance companies. Solvency II rests on three pillars:

- Pillar 1 defines standards for calculating technical provisions and capital provisions, and introduces two levels of capital. Its objective is to adapt the level of a company's capital to its actual risk exposures (including in particular financial risks, which are the most significant, but also insurance and operational risks). The level of capital should be proportionate to the risks associated with the assets and liabilities held by insurers. The more an asset is considered risky, the higher the corresponding capital requirements. For example: the capital requirement for a government bond is zero because it is deemed risk-free, whereas the capital requirement is higher for a stock, which is considered high-risk;
- Pillar 2 sets requirements for the governance of insurance companies and establishes qualitative standards for internal risk management. It stipulates how the supervisory authority should exercise its powers;
- Pillar 3 addresses the transparency of insurance companies.

In the banking sector, in addition to the European Systemic Risk Board (ESRB), an analysis was undertaken from 2010 onward in the wake of the euro zone debt crisis, leading to the creation of the Banking Union in April 2014. The main idea underpinning the establishment of the Banking Union was to break the link between banking crisis and sovereign debt, by preventing the financial system from being taken hostage by “too big to fail” banks. The Banking Union implemented the Single Supervisory Mechanism, under the authority of the European Central Bank, to supervise and sanction the 130 largest banks in the euro zone. It also implemented the Single Resolution Mechanism, comprised of a Single Resolution Board and a Single Resolution Fund, operational since 1 January 2016, with the aim of relying as little as possible on European taxpayers and the real economy to bail out struggling banks. The fund is expected to reach €55 billion by 2025.

• Western and Central Africa: a longstanding tradition of regionalism

Most financial markets in Western and Central Africa, an area where the majority of countries are members of the *Organisation pour l'Harmonisation en Afrique du Droit des Affaires* (OHADA) (Organisation for the Harmonisation of Business Law in Africa), are subject to integrated regulation.

The banking industry serves as a precursor of integrated regulation in Western and Central Africa, with the objective of regulating monetary policy in an effort to combat the substantial risks in this sector. Community organisations in charge of regulating monetary policy in these regions, which arose in the wake of the crisis that rattled the sector in the 1980s, are divided into two regional divisions: one in Central Africa covering the CEMAC area¹⁶ and the other in Western Africa covering the UEMOA area¹⁷.

It was during the second half of the 1980s that true banking regulation began to be established, because the credit institutions in the CEMAC region were experiencing serious problems stemming not only from the international economic environment, but also from myriad managerial failures. This process was expanded when the six CEMAC Member States signed the convention to create the *Commission bancaire de l'Afrique centrale* (COBAC) (Central African Banking Commission). This regional institution, in charge of overseeing and supervising the activity of credit institutions, supports the *Banque des Etats de l'Afrique centrale* (BEAC) (Bank of Central African States) in its general duty of regulating banking activities.

In the UEMOA area, the *Commission Bancaire* (Banking Commission) is responsible for supervising banking activity. It was created on 24 April 1990 by a convention that entered into force on 1 October 1990, predominantly with the aim of strengthening supervision of banks and financial institutions by assigning a supervisory role to a supranational body rather than to national banking supervision committees. Like COBAC, the UEMOA Banking Commission is part of a vast institutional reform undertaken in response to the economic and financial crisis of the 1980s.

As for the financial markets, Central Africa is home to the Central African stock exchange and the Douala Stock Exchange. The *Commission de surveillance des marchés financiers de l'Afrique centrale* (COSUMAF) (Central African Financial Markets Supervisory Commission) is responsible for regulating and supervising CEMAC's regional capital market. Cameroon created

¹⁶ CEMAC: *Communauté Economique et Monétaire de l'Afrique Centrale* (Central African Economic and Monetary Community). CEMAC is made up of six States: Cameroon, the Central African Republic, Chad, Equatorial Guinea, Gabon and the Republic of the Congo, and Equatorial Guinea.

¹⁷ The UEMOA: *Union économique monétaire Ouest-Africaine* (West African Economic and Monetary Union). The UEMOA has eight members: Benin, Bissau Guinea, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal and Togo.

the *Commission des marchés financiers* (Financial Markets Commission) to supervise the national financial market in 1999.

Supervision of the financial markets in the UEMOA area was assigned to the *Conseil régional de l'épargne publique et des marchés financiers* (CREPMF) (Regional Council for Public Savings and Financial Markets), created in 1996.

Central and Western Africa has thus proved to be a pioneer in the regionalisation of financial regulation.

Furthermore, the fact that virtually all UEMOA and CEMAC Member States belong to OHADA has had a certain impact on the prudential regulation system adopted in the region. This system is actually quite original in that it borrows from both the French separate regulation approach and from the Anglo-Saxon unified regulation approach. Accordingly, while the cross-functional rules derived from OHADA's uniform acts apply the same way to all parties, the banking and financial sectors are subject to their own specific prudential rules¹⁸.

It should be noted that prudential regulations in Central and Western Africa are traditionally very strict: in fact, the financial crisis in the 1980s left much more of a stigma in terms of systemic risk than the 2007-2008 crisis. The management ratios imposed on credit institutions for the purposes of prudential regulation are therefore particularly draconian in this region of the world¹⁹.

On the other hand, compliance has yet to be incorporated in the regulatory mindset in Africa for one simple reason: there are no officers trained in compliance. That being said, some corporations have set up internal structures tasked with managing compliance.

• The Arab world : unity in diversity

As a whole, banking regulation in the Arab world is assigned to the central banks. From one country to the next, the central banks are vested with broad powers to carry out their traditional duties of ensuring monetary stability, financial stability and banking regulation. Few countries have established separate commissions to regulate the banking sector, such as Lebanon, which created the Banking Control Commission of Lebanon within the Central Bank of Lebanon.

Regulation of insurance activities also varies in scale. Sometimes this role is given to the central banks, as in Lebanon, Qatar and Bahrain, and sometimes to special departments in the Ministry of Finance or the Economy, as in Algeria and Jordan. Other times they are supervised by financial regulation authorities, as is the case in Egypt, Oman and Palestine, or by a separate specialised regulatory authority, as in Morocco, Tunisia and Syria.

Paradoxically, financial regulation has undergone considerable development in the last decade with the establishment of specialised financial regulation authorities. The emergence of financial regulators in the Arab world first came about in the late 1970s in Northern Africa, beginning with Egypt in 1979, Morocco and Algeria in 1993, Tunisia in 1994 and finally Libya in 2010. Middle Eastern countries were late to follow suit, starting only in the late 1990s, and it was not until the 2000s that the trend gathered pace: Jordan in 1997, Oman in 1998, the United Arab Emirates in 2000, Saudi Arabia in 2003, Iraq and Palestine in 2004, Syria and Qatar in 2005, Kuwait in 2010 and finally Lebanon in 2011.

¹⁸ Ebénézer D. Keuffi, *La régulation des marchés financiers dans l'espace OHADA* (Regulation of the Financial Markets in the OHADA region).

¹⁹ Roland Tcheumalieu M. Fansi, *Droit et pratique bancaire dans l'espace OHADA* (Law and Banking Practices in the OHADA region).

To meet international requirements, Arab countries tend to have their financial regulators operate independently of the executive branch, both organically (collective responsibility, multiple disciplines and prevention of conflicts of interest) and from a functional standpoint (no rules governing reporting and supervisory lines). As a result, Arab financial regulators are not part of the ministerial hierarchy: they are separate public structures vested with legal personality as well as administrative and financial autonomy. Of course, this distinction should be taken with a grain of salt, as an analysis of the solutions adopted by these regulators shows that they are not completely independent from the executive branch.

The majority of Arab countries place great importance on dividing this responsibility between two regulatory divisions: financial regulation and prudential regulation. While the latter is generally handled by the central banks, the financial regulators take charge of the oversight and supervision of the financial markets, i.e. the stock exchanges, market infrastructures and financial market operators. However, several countries such as Morocco, Tunisia, Algeria and Syria, have opted for more of a specialised approach in accordance with a multi-division model: one regulator specialising in the financial markets, another specialising in insurance, and the Central Bank regulating banking activities.

As they are aware of the risks of having overlapping areas of expertise and too many cooks in the kitchen, so to speak, several solutions have been put forward to clarify the regulatory system and prevent the risk of conflicts of authority: most countries have decided to appoint members from certain regulatory bodies to sit on the boards of other regulatory bodies; some countries, such as Saudi Arabia, have made cooperation and coordination between the financial regulator and the Central Bank a legal requirement; in other countries, the various regulators take the practical approach of signing cooperation and coordination agreements, as is the case in Kuwait.

A second series of countries tends to extend the scope of operation of financial regulators to activities outside those of the financial markets. When Oman established the Capital Market Authority (CMA) in 1998, it was simultaneously tasked with regulating the financial markets and insurance activities. Similarly, when it was created in 2004, the Palestinian financial regulator was mandated to regulate the activities of the financial markets, insurances companies, leasing companies and real estate financing companies. When the 2008 financial crisis hit, however, a series of reforms swept the financial regulation system, steering it towards a more integrated model in a number of Arab countries, although with radically different choices: either to strengthen the role of the financial regulator or that of the Central Bank.

The crisis taught some countries that they needed to expand the financial regulator's scope of authority²⁰. For example, the Egyptian Financial Supervisory Authority (EFSA) was given a much broader license than its predecessor, the Capital Market Authority (CMA). Whereas the CMA only supervised financial market activities, the EFSA regulates the capital markets, futures exchanges, insurance activities, real estate funding, financial leasing, and factoring and securitisation. Along the same line, the social and popular protest movement that swept across Egypt in 2011 led to constitutional reforms that strengthened the independence of the EFSA, which now belongs to the category of "independent bodies and regulatory authorities" set forth in the Constitution²¹.

Other countries have chosen to adopt a more integrated model aimed at strengthening the role of central banks in the financial regulation system. On the one hand, the majority of Arab countries have introduced reforms to provide their central bank with new resources and new internal structures in order to better mitigate systemic risks and ensure financial stability. For

²⁰ On its website, the Jordan Securities Commission firmly stated its determination to continue persuading the public authorities to choose a single, integrated model of financial regulation: http://www.jsc.gov.jo/public/mainEnglish.aspx?page_id=1454.

²¹ Egyptian Constitution of 2014, article 221

example, countries such as Qatar, Lebanon, Jordan and Tunisia have created departments in charge of ensuring financial stability or combating money laundering and terrorist financing. On the other hand, a number of countries have gone so far as to merge their financial regulator and central bank. While Bahrain has stuck with a model that gives the central bank responsibility for financial and banking regulation, Lebanon has put the central bank governor in charge of the Capital Markets Authority. Similarly, under a radical reform introduced by the government of Qatar in 2012, the central bank governor is now in charge of overseeing the Financial Markets Authority²². Both Lebanon and Qatar thus opted to give the central bank governor authority over various financial activities: financial regulation, banking regulation, regulation of insurance activities and prevention of money laundering.

2.4. The proliferation of institutional models

Thus far, no real institutional model for financial regulation has shown itself to be optimal and fully tested.

And for good reason: in so-called developed countries, the national financial regulatory authorities as they exist today are still relatively young. For example, the *Autorité des marchés financiers* (AMF) (French Securities Regulator) was established in France in 2003²³, i.e. less than 15 years ago. In many respects, the way that these authorities were designed in the early 2000s is already obsolete. With the 2007-2008 crisis, a new generation of institutional architecture took shape in the field of financial regulation. Take micro-supervision, for example, which was subject to reforms in Europe (especially in the UK) and the United States where, under the Dodd-Frank Act of 2010, the structure and powers assigned to different financial authorities were redefined because they were seen as out-of-date and bureaucratic. And, as mentioned above, special bodies were created in several parts of the world in the early 2010s to address macro-supervisory issues.

The only conclusion that might be drawn, without issuing a judgement as to the superiority of either model, is that on the one hand there are single integrated regulatory bodies that combine prudential regulation and market regulation – as in the United States – and on the other hand, there are bilateral structures – as in France, where the AMF oversees the financial markets and asset management industry and the ACPR oversees banks and insurance companies.

The objective is not to argue that either model is more effective. On the contrary, it is to recognise the need to stop thinking along these traditional lines and to build a more agile model that is better suited to the reality of financial transactions.

The US model is not a cure-all, for that matter. The financial regulation system operating in the United States is largely the result of a historical accident. This does not mean it is ineffective, but rather that others may implement entirely different frameworks to obtain the same results.

²² The Chairman's Message published on the QFMA's website stresses that the development of the Qatari financial sector depends on enhancing regulatory entities and increasing coordination and cooperation among them “*in order to create an integrated regulatory and supervisory model that helps to enhance competition and attract more local and foreign investments.*”

<https://www.qfma.org.qa/English/CeoMessage.aspx?id=40>.

²³ From the merger of the *Conseil des marchés financiers* (Financial Markets Council), the *Commission des opérations de bourse* (Securities Commission) and the *Conseil de discipline de la gestion financière* (Financial Management Disciplinary Council).

Inset 6: Regulation of the banking and financial sector in the United States: an institutional architecture attributable more to accidents of history rather than economic policy planning

The United States began regulating banks and other financial institutions at the dawn of the Republic. Alexander Hamilton, the very first Secretary of the Treasury, advocated and created the first central bank. Federal regulation of securities and trading came later, after the Great Depression of the 1920s. Regulation of derivatives, real estate funding and other financial institutions is a more recent phenomenon, as is the country's participation in international financial regulations.

Banking regulation in the United States

Today, banking regulation in the US is primarily governed by four federal bodies:

- the Office of the Comptroller of the Currency: a federal institution which, under the authority of the US Department of the Treasury, charters and supervises national banks to ensure their financial solidity and prevent systemic risk; it was established by the National Bank Act of 1864 [one of three Acts dating from 1863, 1864 and 1865-66, which served as the legal cornerstone of US banking regulation and the US banking system in general. The National Bank Act of 1863 created the central bank that preceded the Federal Reserve, created in turn by the Federal Reserve Act of 1913, which also established the charterisation of national banks by the federal government];
- the Federal Deposit Insurance Corporation (FDIC): an agency created in 1933 to address the thousands of bank failures arising in the wake of the 1929 stock market crash. Since the FDIC began operating on 1 January 1934, no depositor has lost a single penny of insured deposits due to a bank failure. The agency receives no Congressional appropriations: it is funded by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in US Treasury securities. An independent agency of the federal government, the FDIC protects depositors and is the principal regulator of chartered banks that are not part of the federal reserve system. It insures bank deposits in the US for at least \$200,000. The FDIC is considered to be a pillar of the people's trust in the US financial system in that it not only insures deposits by individuals in banks and trust institutions, but also limits the impact of a bank failure on the real economy and the financial system. Its role was expanded in 2008 after the financial crisis: it now insures part of the debts of US financial institutions;
- the National Credit Union Administration (NCUA): an independent federal agency created by Congress under the New Deal of 1934 (Federal Credit Union Act), which regulates and supervises all federal credit unions as well as those of States having chosen to be insured at the federal level. It is noteworthy that, after spending five years in the early 2010s strengthening the regulatory framework in preparation for the advent of a new crisis, in 2015 the NCUA embarked on a sweeping "regulatory relief" plan resulting in 15 modernised regulations to reduce compliance burdens;
- the Federal Reserve Board of Governors (the "Fed"), which regulates reserves to ensure the stability of banks and trusts, and which serves as the main prudential regulator of a variety of financial institutions, including foreign bank branches operating in the United States, and the principal regulator of all "systemically important" financial institutions by virtue of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law by President Barack Obama on 21 July 2010. Considered as an answer to the 2007-2008 crisis, the Dodd-Frank Act ushered in major changes in US financial regulation, making it the biggest shake-up of the system since the regulatory reform enacted during the Great Depression of the 1930s. The full title of the Dodd-Frank act explains its objectives: "*An Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.*". The Federal Reserve System governs US monetary policy and acts as the financial agent of the United States.

Some regulators are vested with regulatory power over financial institutions while others exercise their authority over the financial markets or activities. Consequently, financial sector players may be required to simultaneously answer to several regulators.

This multiple-regulator structure has often been the result of historical "accidents." Consequently, there is no single organisation that exercises authority over all financial markets, activities and institutions. As a general rule, there tends to be one (or more) regulators for each type of financial

regulation. This type of system is not as simple and effective as it could be, and calls for structural reforms on regulation are periodically raised in the United States. The Dodd-Frank Act is only the most recent attempt at regulatory reform, creating two new agencies and several regulatory offices, as well as a new “regulatory architecture” whose very survival may be called into question by the Trump Administration, in light of the President's most recent statements in favour of trimming down – if not outright dismantling – the Act. In June 2017, the US House of Representatives set the wheels in motion when it passed the Financial Choice Act, which undid many of the provisions of Dodd-Frank.

Securities regulation in the United States

As it stands, securities are predominantly regulated at the federal level, although a few limited types of securities are still governed by the States. There are two main types of securities regulations: regulation of securities issuers and regulation of the markets where securities are bought and sold.

The Securities and Exchange Commission (SEC), a quasi-independent agency vested with broad powers of regulation and execution, is the principal federal regulator. The SEC regulates stock exchanges, broker-dealers, clearing houses, mutual funds, investment advisors (including speculative funds with assets exceeding \$150 million), nationally recognised ratings agencies, swaps dealers, the main swaps participants and swap execution platforms, and corporations involved in the public trading of shares. The SEC is also authorised to establish accounting standards for all publicly listed companies. One of the SEC's main regulatory obligations is the regulation of initial public offerings, which it does via a system of laws and regulations requiring the full disclosure of certain aspects of the issuer's activities and risks and prohibiting any false or misleading statements or omissions related to the buying or selling of securities.

The Commodity Futures Trading Commission (CFTC) regulates the futures markets, brokers and commodity pool operators, commodity trading advisors, swap dealers and swap execution facilities. The Dodd-Frank Act considerably expanded the CFTC's areas of authority by eliminating exceptions on OTC trading of certain derivatives.

Unlike banking regulators, the SEC has no authority to intervene in a broker-dealer's business, despite the fact that it applies the net capital rule which requires broker-dealers to maintain a cushion of required liquid assets in excess of their required minimum capital amount. Also unlike banking regulators, the SEC does not regulate the “security and solidity” of individual companies. The collapse of Bear Stearns²⁴ is a glaring illustration of the difference between banking regulation and securities regulation in the United States: even though the SEC was monitoring the financial position of Bear Stearns, when the company's failure was imminent, it was the Federal Reserve and not the SEC that stepped in to facilitate the sale of Bear Stearns to JP Morgan by purchasing \$30 million in toxic assets. The Dodd-Frank Act assigned new regulatory responsibilities to the SEC in terms of “security and solidity.”

Source: E. Murphy, *Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets*, Congressional Research Service, 30 January 2015.

What, after all, would qualify as a “good regulation”? In their flagship work, *Understanding Regulation: Theory, Strategy and Practice*, Baldwin, Cave and Lodge listed five criteria to define a “good” regulation:

1. Does the legislative authority support the action or regime?
2. Is there an appropriate scheme of accountability?
3. Are procedures fair, accessible and open?
4. Is the agency acting with sufficient expertise?
5. Is the action or regime efficient?

²⁴ The failure of Bear Stearns, one of the largest investment banks and securities trading and brokerage firms in the United States, was a precursor to the Wall Street collapse of September 2008 and the subsequent financial crisis.

There are several architectural frameworks for regulatory institutions that could very well meet these five criteria.

On this point, the 2008 financial crisis simply taught that, in addition to prudential and market regulation, any regulatory structure must improve on what was done in the past to determine risks. The Basel III directives are a good first step in the right direction.

2.5. Many failings, design flaws, questions and reservations remain

2.5.1. The challenges of coordinating different levels of regulation: from communication deficits to time inconsistencies

When regulatory authorities are fragmented and their areas of authority overlap, rules may be applied inconsistently as a result. Case in point: some US banks are federally chartered while others are state-chartered. Studies have shown the regulators of state-chartered banks tend to be more lenient than regulators of federal-chartered banks²⁵.

The intervention of a distant regulator can shed light on the losses and abusive practices of certain banks. This type of regulator will not necessarily achieve better results than a local one, however. While a supranational regulator relies on the local expertise of its national counterpart, the latter is little inclined to seek out information on an institution, fearing that the supranational regulator will then impose unwelcome measures as a result²⁶.

These tensions are exacerbated by regulatory delays or indecision. Empirical studies have confirmed that regulatory authorities the world over tend to react slowly when a banking crisis hits and are often much too lenient. The Savings and Loan crisis that swept the US in the 1980s, the 2007 subprime crisis, the savings bank crisis in Spain, and the 2017 Monte Paschi bank crisis in Italy all underscored this tendency towards delayed reaction on the part of the banking authorities.

Conversely, regulators prove much stricter before the fact in a bid to discourage excessive risk-taking. And when a crisis is systemic in nature, the cost of non-intervention is so high that regulators feel obligated to step in²⁷.

Also related to the question of whether an opportunity for regulatory intervention should be taken is the fact that quickly closing a financially struggling bank can trigger a financial contagion effect. This is because it conveys the message that the regulator failed to conduct proper supervision, thus draining confidence in other banking institutions subject to the same regulatory authority²⁸.

Finally, as the decision to intervene is taken as an irreversible sign, government authorities are driven to postpone as many interventions as possible because they consider that the resulting costs cannot be recouped. They would sometimes rather wait and see if economic conditions improve to a point where the crisis resolves itself without any intervention on their part²⁹.

²⁵ See Agarwal et al., *Inconsistent regulators: evidence from banking*, 2014.

²⁶ See Carletti et al., *Supervisory incentives in a banking union*, 2016.

²⁷ See Acharya and Yorulmazer, *Too many to fail: an analysis of time inconsistency in bank closure politics*, 2007, and *Cash-in-the-market pricing and optimal resolution of bank failure*, 2008.

²⁸ See Morrison and White, *Reputational contagion and optimal regulatory forbearance*, 2013.

²⁹ See Lucchetta et al., *Closing a bank or making it safer?*, 2017.

Consequently, in banking regulation as in other areas of financial regulation, national and supranational entities constantly run the risk of sparking commotion and turmoil through belated action and time inconsistencies.

2.5.2. Circumvention of regulation

The temptation to over-regulate finance tends to be counterproductive in that it creates circumvention strategies, allowing shadow banking to prosper. Government authorities should absolutely bear this in mind to avoid over-complicating standards. In the end, standard-setters are always one step behind financial innovators (see section 1.2.4).

2.5.3. Undeniable power wielded by the United States

There is one key factor that the design of any financial regulation structure cannot neglect: the role of the United States.

At least one study (S. Gadinis, *The Politics of Competition in International Financial Regulation*³⁰) has postulated that the coordination of policies between various financial regulators has a significant positive impact on financial activity, but at the same time the success or failure of said coordination depends, at least in part, on whether or not US dominance is threatened by major competitors of US corporations and markets, and also on whether financial activity is centralised in a single jurisdiction or spread out among several separate jurisdictions.

All research and studies would seem to indicate that the US puts up regulatory obstacles to prevent investors from switching sides to join the competition if US dominance is threatened in a centralised market, whereas in a dispersed market, the US promotes policy coordination as a means of eliminating any advantages held by its competitors across all markets.

Taking the 1988 Basel Accord as an example, Gadinis argues that the banking market is a diversified market in which most activity is conducted locally. In the mid-1980s, when Japanese banks were viewed as a threat to US dominance in the banking industry (a diversified market), Congress adopted the International Lending Supervision Act, which set capital sufficiency standards for US banks and called for the US Treasury to impel other governments and central banks to take measures to strengthen the capital bases of their banking institutions. The Basel Committee favoured a similar agreement, which fell short of US targets, however. That being the case, instead of backing the Basel Committee recommendations, the US decided to negotiate bilateral agreements with other countries, including the UK, whose capital sufficiency standards were more robust – standards which applied to foreign banks, such as Japanese banks, operating in their country. Gadinis stressed that the United States would only encourage and promote cooperation in financial regulation in circumstances that would enhance its competitive position.

Whether true or not, Gadinis' theories establish an argument that should at the very least be considered by those who believe cooperation in financial regulation to be a worthwhile objective.

³⁰ 49 Harvard International Law Journal 447 (2008).

2.5.4. About China³¹

The Chinese financial system is on the path toward maturity. Unfortunately, this lack of maturity has the potential to destabilise what is now the world's leading economic power.

Characteristic features include a relatively hermetic bond market, volatile and closed-off markets dominated by speculative investors, and several (three) fairly inexperienced regulators, especially when it comes to managing communication to the public and among themselves.

The contrast between the relatively rapid, albeit slowing, pace of China's economic growth and its conservative financial regulation system – ill-equipped to deal with the realities of the finance industry – is a recipe for conflict. In a word, the Chinese financial regulation system is ultra-compartmentalised. It is unrealistic, however, to hope for a transition towards unified regulation in the medium or short term. The three existing regulatory commissions (for banks, insurers and securities) are undoubtedly here to stay. The People's Bank of China (PBoC) is also certain to take on board increasing regulatory functions, such as defining and implementing monetary policy and overseeing foreign exchange. Rather than expecting or hoping for the simplification of existing structures, a more realistic objective would be improved coordination between them.

Big changes are taking place in terms of the modernisation of the financial system. International investors are gaining access to certain market segments, a greater variety of issuers is being encouraged to raise funds, and derivatives are starting to make an appearance as risk-hedging vehicles.

Financial institutions, and especially major commercial banks, are owned by the State and dictated by the demands of the political agenda – which are not always aligned with economic rationale – all of which means that funding is still struggling to make its way towards the sectors of the future. Furthermore, bank balance sheets are weighed down by non-performing loans.

The crashes that rocked the Shanghai and Shenzhen stock exchanges in summer 2015 and January 2016 raised serious questions as to the ability of the Chinese financial system – and regulatory framework for that matter – to effectively meet the challenges it faces.

A veritable legion of challenges, indeed. The two principal challenges are 1) meeting the needs of an evolving economy (finance should promote the shifting of investments from capital-intensive industries to industries consuming few natural resources, to the restoration and improvement of the environment, and to services), and 2) reducing reliance on unregulated operators in the shadow banking industry.

China's shadow banking industry ranks fourth in the world, after the euro zone, the United States and the United Kingdom, but takes second place in terms of growth, behind Argentina. In some ways, the prevalence of shadow banking in China is a veritable time bomb with the potential for a formidable domino effect. Meanwhile, regulating shadow banking is a particularly delicate prospect in that it is highly connected to the banks, especially small and mid-size institutions, which are in turn overly dependent on shadow banking funds. In fact, the role of shadow banking in the Chinese economy has become a growth driver that the country's top decision-makers are keen on stimulating. It has reached the point that doing too much to impede shadow banking activities could trigger a financial, economic and social crisis.

³¹ See *Banque & Stratégie* (Banking and Strategy), April 2016 No. 346, *Cahier de prospective bancaire et financière*, and *La finance chinoise dans la nouvelle phase de la réforme économique* (Chinese finance in the new phase of economic reform), Michel Aglietta, February 2011, *Revue d'économie financière*.

2.5.5. Other flaws in the system are so many warning signs

Current problems still abound and, in addition to the aforementioned points, include:

- the fact that international trade has yet to be re-balanced;
- the troubling observation that IFRS accounting standards, and in particular the application of the concept of fair value (valuation of assets at Mark-to-Market), have not been revised despite their evident procyclicality;
- the disappointment of seeing that initiatives taken to limit the role of ratings agencies have yet to effect any visible changes. The role of ratings agencies, and notably the explicit reference to their rating of financial regulations, have in fact not been changed.

From a more local standpoint:

- the supervision of banks and insurance companies in the United States, a central player in the financial sector, remains piecemeal at best, and the future of regulation is now completely uncertain in light of President Trump's announcements;
- in Europe, the Banking Union has come under attack by the national resolution of the Italian banking crisis in summer 2017;
- the consequences of Brexit in terms of competitive one-upmanship, or at the very least a sort of bidding war, on the financial deregulation front, are unpredictable, not only between the UK and the EU but also between the 27 members of the Union;
- Solvency 2 has already shown its design flaws: the principle of Mark-to-Market valuation is extremely harmful (the insurance business calls for long-term analysis, but this standard subjects the insurer's business to market instability); the assessment of an insurer's solvency over a very short-term period of one year is totally inappropriate for this activity; Solvency 2 requires an insurance company to hold sufficient capital at all times to be able to withstand a 200-year shock. This suggests a lack of dynamic vision when it comes to new risks, and this mechanism is procyclical in that it requires the safety buffer to be reconstituted in own funds while the risk has already materialised. After wanting to be head of the class for so long, Europe may well shoot itself in the foot and set the stage for the evasion of financial activities, and particularly insurance.

3. Recommendations: what new model should be built for tomorrow? what directions should be taken?

3.1. Have an international framework of conduct capable of laying the foundation for a level playing field: expanding and completing the work achieved at the G20 summits in London and Pittsburgh and by the Basel Committee, with proper diplomatic intelligence

It may seem pessimistic, but the arguments above clearly show that many signs currently visible today point to the advent of a future financial crisis of systemic consequence. We must not wait until we are standing at the edge of the abyss for authorities around the world to put their heads together and find a way to breathe new life into international financial regulation. Momentum has flagged since 2009. Also since 2009, no G20 summit has really ended with concrete recommendations on this point. We need to get this momentum going again, starting now.

Recommendation No. 1: Restore international strategic momentum to 2009 levels. France could spearhead this movement.

This restoration is necessary to achieve a level playing field and thus avoid triggering counter-productive phenomena of competition theory or stowaway behaviour. In particular, Europe should refrain itself from throwing its weight around all on its own.

The United States, by nature wary of rules decided at the international level, even when it has actively participated in such international organisations (the fiasco surrounding Congress' refusal to join the League of Nations nearly a century ago is a perfect example), had only very partially adopted the Basel II rules developed before the crisis. Hesitation was also a factor for Basel III, whose rules were deemed by the US to be too uniform and not suited to the highly diversified US system and its very specific real estate funding mechanism. It took five years after the collapse of Lehman Brothers for US regulators to begin integrating Basel III standards in their supervisory dashboard, with a few exceptions applied to smaller banking institutions. It cannot be said, however, that the US banking system is unregulated: on the domestic front, the adoption of the Dodd-Frank Act was a big step, especially considering that it introduced the Volcker Rule prohibiting retail banks from conducting proprietary trading activities and restricted certain market transactions. Dodd-Frank even went further than Basel III by imposing a doubly strict capital buffer. The same is true for the method used to calculate certain liquidity ratios.

In any event, it is mandatory to talk about the potential disasters of a non-cooperative financial regulation strategy for all parties concerned. This is the only way Basel III can ever truly be finalised, eight years after it was launched.

Inset 7: Finalise Basel III or move on to Basel IV

While banks are busy finalising the adaptations to solvency and liquidity associated with Basel III rules, new developments are being considered to round out these requirements – collectively known as “Basel IV”, although this term is not yet fully recognised and some would rather call it an extension of Basel III. The discussions held by the Basel Committee since 2016 have been focused on the issue of internal models used by banks for their own historic data. As such, the matter lies on the border between internal control and external prudential regulation.

These developments can affect the denominator of the solvency ratio and thus have a direct impact on credit risk, market risk and operational risk. Ideally, a transparent and effective comparison should be made, in accordance with a shared methodology, between the risk-weighted assets of various banks. By using their own calculation methods, banks today are largely under-estimating their risks. Moreover, regulators simply do not have the human resources needed to assess these internal models in their entirety for each supervised bank.

Regarding credit risk, a complete overhaul of the standardised method is being considered, with the possibility of using external ratings for jurisdictions that would allow it, implementing floors to govern existing internal models, or reviewing the prudential treatment of securitisations.

Developments in market risk include a fundamental review of the trading book (FRTB) and call for reducing the possibilities of regulatory arbitration between the trading book and the banking book. The widely criticised statistical tool, Value at Risk, could be replaced by the less procyclical Expected Shortfall.

For operational risk, the idea is to implement the new Standardised Measurement Approach (SMA), discontinue internal ratings-based methods (particularly the Advanced Measurement Approach or AMA) and introduce a variable not merely consisting of net banking income, but instead one that would better reflect banking activity, notably including a history of operating losses.

The adoption of the new “Basel IV” framework, which would strengthen the requirements imposed on the entire banking sector, is far from given, considering the strong criticism it has drawn from banks and regulators alike.

The issue of establishing floors, alongside a less ambitiously calibrated leverage ratio, has generated a big debate because it would essentially impose two constraints to achieve a similar objective. Europe sees the leverage ratio as a backstop and so should not be calibrated too high. It is not intended to serve as a backstop, however, in the US, where measuring risk is not considered something that should be at the heart of supervision. For Americans, the important thing is to guard against risk at the end of the distribution chain, through stress tests.

Criticisms of the finalisation of Basel III, or the shift towards “Basel IV”, are predominantly political in origin: the government authorities are afraid that extreme caution will discourage banks from fulfilling their fundamental duty of funding the economy.

Bear in mind that Basel rules are soft laws through and through, and can thus be considered as mere recommendations: they are only enforceable if transposed into local law.

Sources: Revue banque No. 795, April 2016; Revue banque No. 800, October 2016.

Recommendation No. 2: Finalise Basel III and restore a reasonable level playing field by having an international discussion of the harmful effects of any cavalier strategy in terms of financial (de)regulation.

3.2. Rethink the way local and international regulations are interconnected: balancing the reality of the limited potentialities of a veritable supranational regulation with the aim of building a network structure

Local financial regulation will always have a role to play because, irrespective of the international component of the financial sector and the markets, local aspects will always be important if not predominant. That being said, given how quickly the international system evolves, there are several forces at work that have an impact on the system and thus need to be factored in when we consider the future of local financial regulation and how it should interact with the internationalised system.

An article entitled “Fundamental Forces Driving United States and International Financial Regulation Reform”, presented to the Global Science and Technology Law Institute in Seoul, South Korea by Professor Lawrence G. Baxter of the Duke University Faculty of Law, identified seven factors:

1. The long-term impact of the Crisis (and all financial crises);
2. The increase in the “financialisation” of the global economy, seemingly disproportionate to the growth in the real economy;
3. The dramatic increase in financial interconnectedness worldwide.
4. The human factor in finance;
5. Growth in the critical yet little understood and regulated shadow banking system;
6. Deep technology revolution, which continues to transform the dynamics of the global economy;
7. “Next convergence” between Western and emerging economies, which is changing the global economic profile and presenting profound new challenges to financial reform in terms of efficiency, fairness and balance.

These factors highlight a “disturbing truth”: despite having an extremely detailed and robust financial regulation system, the 2008 crisis proved that the US was unable to prevent the crisis. Post-crisis remedies such as the Dodd-Frank Act, and Basel III on the international level, have yet to fully prove their merit (see above). The euro zone financial crises have shown that,

even in an integrated economy like the European Union, direct supervision of transnational banks is still difficult.

There is yet another “disturbing truth”: in spite of globalisation and efforts to harmonise local financial regulations, unequal distribution of wealth persists and continues to be a considerable and insurmountable problem. The pressures exerted by growing financial inequality around the world will continue to seriously undermine the harmonisation of financial regulation.

As long as the global economy comprises the economies of sovereign States or regionally integrated States such as the European Union, **it may be impossible to have an international financial regulation system with a solid means of execution.** Local regulation will very clearly see its role as financial police officer confirmed.

The most effective global financial regulation system will undoubtedly be founded on “best practices” applied by individual States that are best able to protect their own interests. In their statement at the London Summit in 2009, the G20 Leaders said, “*We each agree to ensure our domestic regulatory systems are strong. But we also agree to establish the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires.*” **Some have asked for an international regulation and supervision system to be created³², but this is improbable or inadequate.**

Recommendation No. 3: On the diplomatic front, do not promote the creation of a World Finance Organisation.

The best international financial reform mechanism would be what Anne-Marie Slaughter referred to as “**the network**.” She describes networks as exhibiting “*patterns of regular and progressive movement among like government units working across the borders that divide countries from one another and that demarcate the domestic from the international sphere.*”³³ In a draft for the Tulane Conference on Responsible Regulation, Professor David Zaring of the Wharton School wrote that “*Post-crisis financial regulation is essentially only done through networks (...) For financial regulation, the precision and possibly enhanced compliance pull of a treaty or a tribunal has been no match for the flexibility of the confederations of regulators acting on agendas provided by political leaders meeting in concert.*”³⁴

Yet **we already have the Joint Forum of Financial Market Regulators**, comprised of the Basel Committee on Banking Supervision, IOSCO and the IAIS. As explained above, however, the number of countries represented in this forum is much smaller than in the organisations themselves, as it only includes the G7, Australia, Belgium, Denmark, the Netherlands, Spain and Switzerland, while the Europe (through the European Commission) is only an observer.

Rather than create a new network, this existing forum should be revisited and expanded.

Recommendation No. 4: Revisit the work done by the Joint Forum of Financial Market Regulators and expand its scope to at least include all the member countries of the Basel Committee, IOSCO and the IAIS.

³² See for example E. Denters, Regulation and Supervision of the Global Financial System: A proposal for Institutional Reform, Amsterdam Law Forum, Vol. 1, No. 3 (2009)

³³ Anne-Marie Slaughter, A New World Order, Princeton University Press, (2004)

³⁴ D. Zaring, Post-Crisis International Financial Regulation, International Finance Reformed, 2011, pg. 8

Whether or not it occurs within a formal network or through regular contacts and exchanges of information, close cooperation between national regulators is one of the best ways to improve the effectiveness and efficiency of regulation on an international scale. An excellent example of this principle is the Libor scandal.

Inset 2: Successful cooperation among international regulators: the Libor scandal

The Libor (London interbank offered rate) was established by the British Bankers' Association in 1970. It is the rate that the world's major banks charge each other to lend billions of dollars used to finance their activities. Libor rates are calculated on the basis of information that banks report to one another on their borrowing capacity. However, there is no independent body responsible for verifying the accuracy of the information disclosed by banks to obtain new loans.

In light of such a glaring initial flaw, a scandal was inevitable: in 2011, a massive Libor rigging operation was uncovered involving a pool of financial institutions, led by Swiss bank UBS.

The resolution of the Libor scandal is unanimously seen as a successful example of cooperation among national regulators. No fewer than 60 regulatory agencies around the world lent their support to the FCA, notably through joint investigations, data sharing and transmission of bank records.

3.3. What role should local financial regulators play? Necessarily bespoke responses

Traditionally, local regulators serve three functions. Firstly, they establish technical rules. Secondly, they oversee compliance and supervise. Thirdly, they punish violations.

By nature, local regulators are good at making fast decisions and being responsive, unlike their slower international counterparts, which work on a consensus basis.

There is no standardised recommendation, however, to steer the various countries towards better regulation: responses need to be tailored to the geographic area.

3.3.1. Establishment of technical rules

Local regulators cannot be limited to adapting international standards to local conditions. International standards are only recommendations, or guidelines. Unless they are incorporated in a treaty or a binding agreement, they have no binding impact. Consequently, local regulators should establish regulations that prioritise the promotion of interests in the sectors they regulate within their domestic remit, interests giving pride of place safety and security.

One country with considerable work to do in this area is China. The body of rules governing financial regulation in China needs to be reviewed. As it stands, financial legislation in China is too imprecise, if not downright ambiguous. Considering that China does not have a tradition of case law which might serve as a benchmark, the law is exactly what needs to be clarified. Otherwise, regulatory authorities are given too much leeway in the decision-making process.

Recommendation No. 5: In China, further clarify the rules of financial regulation in the law to ensure a more equitable application.

Many countries have specifically adapted their domestic institutional structure in an effort to strengthen the process for creating and applying standards on financial and banking regulation.

Inset 3: Adaptation of international rules to the Colombian environment: the Financial Regulation Unit (URF)

Created by Decree in November 2011 and operational two years later, the *Unidad de Proyección Normativa y Estudios de Regulación Financiera* (URF) (Financial Regulation and Financial Studies Unit) provides strategic intelligence to support the Government in the decision-making process. The URF develops standards to adapt regulation of monetary policy, foreign exchange and credit, and in general to regulate and intervene in the banking, market and insurance sectors. Its structure was modified by Decree in October 2016.

The URF ensures that Colombian financial regulation measures up to international standards. Colombia sees this compliance as a competitive edge it must earn to gain the trust of investors.

3.3.2. Supervision

Oversight of compliance is a deeply local function that cannot be accomplished by an international organisation because only local regulators have the necessary access to conduct effective oversight.

Once again, China is a case study for identifiable measures calling for implementation. One of China's biggest concerns lies in the relatively poor quality of data collection and sharing, much too poor in fact to allow market operators to be properly supervised. There are many examples of unbalanced information as well as overlaps in data research between the different regulatory bodies. Regular exchanges of information need to be organised between these bodies.

One way to achieve the goal of improving data collection and sharing would be to create a separate agency in charge of collecting information from financial institutions and then distributing this information to the appropriate regulatory authority(ies) in a timely manner. This agency might also be tasked with breaking up the various categories of data in order to assess the security of the financial system as a whole. It could establish a comprehensive statistical dashboard used to monitor potential risks and recommend emergency measures at the right time in the event it detects the warning signs of financial instability.

While this would mean creating a new government entity – a decision that should always be taken with precaution – this new agency would be sure to cut down the cost of running a regulation system split into three separate entities, and would improve its efficiency.

Recommendation No. 6: Create a separate agency in China responsible for collecting information from financial institutions and transmitting it to the regulatory authorities.

3.3.3. Penalties for violations

Imposing penalties for violations is also a local matter, as dictated by the principle of subsidiarity. In the absence of an international organisation entrusted with recognised enforcement authority – which is not in danger of happening in the near future³⁵ (see Above), local regulators alone have the power to issue penalties when rules are broken.

³⁵ Finance is not the only sector where the prospect of a supranational enforcement authority is a hollow one indeed, as demonstrated by the all-too limited success of the International Court of Justice.

Could sanctions be replaced by compliance? This question requires some context: compliance hails from the United States.

The US has a solid tradition and culture of regulatory compliance, especially when it comes to financial regulation. Large corporations and small businesses alike have very elaborate compliance mechanisms and their own compliance officers. Employees regularly receive training in regulatory compliance. Regulatory compliance is undoubtedly a good form of corporate governance, but **there is a reason it is specifically American: the threat of private lawsuits** against banks or other companies by their shareholders and depositors, never mind the risk of regulators applying regulations.

We can therefore clearly expect to see a twofold structure in the future, where compliance and penalties coincide. An effective regulation system calls for both of these upstream/downstream elements to be in place. Compliance officers should or will work directly with the regulatory authorities.

Furthermore, non-compliance has consequences that go beyond the risk of regulatory sanctions and compensation payments. It generates **reputational risk** and, insofar as the regulatory framework is designed to ensure safety and security while minimising risks, companies may end up going out of business if found guilty of non-compliance. Take Lehman Brothers, for instance.

In any event, to guide countries not steeped in a culture of compliance like the United States, it would be useful for bodies such as the G20 to discuss the matter and formulate guidelines that would serve as a How-To Guide. Instilling a culture of compliance in a traditional system of regulations/sanctions takes some thought and cannot be rushed.

Recommendation No. 7: Make the issue of compliance an international talking point. France, which has extensively developed compliance in close collaboration between financial institutions and regulators – even though compliance is not part of its culture – could provide valuable insights to countries developing their own compliance system.

3.4. Improve regional coherence and opportunities for regulatory intervention

Even though no major international financial crisis has arisen since the subprime crisis, in light of the arguments above on the procrastination of public authorities when faced with the first signs of trouble in the financial system, Governments would do well to come together and discuss the right time for action. This is a topic that needs to be addressed separately by international organisations.

Recommendation No. 8: Have international organisations address the issue of time consistency in the prevention and management of financial crises. International organisations are overly focused on technical standards: the political economy of interventionism should also be discussed and subject to guidelines.

3.5. Dispel systemic risk, notably by cutting ties between banks that are “too big to fail and shadow banking, without creating “shadow shadow banking”

Given the multiple interdependencies between institutions, the fragility of the entire system is dictated by the vulnerability of its weakest links – weakest, that is, despite being massive banks, such as Germany's Deutsche Bank and Italy's Banca Monte dei Paschi di Siena, the latter bailed out in summer 2017. In the event of systemic stress, the largest banks (many of which can be found in Europe, as the sector is more consolidated in other areas of the world) have much higher capital requirements than those set by regulations, due in large part to their derivatives activities.

A true structural reform of systemic banks, which would help cut the incestuous ties they maintain with the shadow banking industry and drastically reduce the implicit subsidies they are still receiving, making their resolution credible, is a solution that could shelter the economies in question from a financial, economic and social cataclysm brought about by shadow banking activities and made possible by systemic banks.

Recommendation No. 9: Reform the structure of systemic banks to cut their ties with shadow banking, a cradle for systemic risk.

To this end, Europe should use as its guide the European Commission's green paper on shadow banking³⁶ and clarify the European tools used to assess and supervise the shadow banking industry.

As of summer 2016, the European Systemic Risk Board (ESRB) has been in charge of the macroprudential supervision of all shadow banking activities, including asset management, as currently done by the Financial Stability Board. The ESRB published its first report on shadow banking in July 2016³⁷, followed by a methodological paper³⁸. It specifically reviews what it refers to as market-based financing (MBF) in the shadow banking system. MBF is defined as a combination of risks arising from entities (securitisation vehicles, financial corporations engaged in lending carrying out factoring activities, real estate loans, consumer loans and financial leasing, non-securitisation special-purpose entities, investment funds including money market funds, hedge funds and bond funds) and activities (derivatives, repos, securities lending).

The ESRB identifies as a source of systemic risk the use of leverage by investment funds, and particularly hedge funds, the interconnections between money market funds and the banking sector, and finally, the risks generated by maturity and liquidity transformation with certain types of investment funds.

In addition to mapping out risks, it is worth considering giving the ESRB a more proactive role in supervising the shadow banking industry, by equipping it with investigative tools and even empowering it to levy appropriate penalties.

Recommendation No. 10: At the European level, increase the ESRB's powers in terms of macroprudential supervision of shadow banking.

Even though regulation leads to its circumvention and it is important not to pave the way for “shadow shadow banking”, a measured regulatory response is in order.

³⁶ Green Paper, *Shadow Banking*, European Commission, 19 March 2012.

³⁷ *EU Shadow Banking Monitor* No. 1, July 2016.

³⁸ *Assessing shadow banking – non-bank financial intermediation in Europe* (No. 10/July 2016).

The FSB has developed some leads resulting in a series of recommendations. Five working groups, organised by risk factors identified during the financial crisis, are working on them:

- the interconnection of shadow banking entities and banking sector entities;
- money market funds and the risks associated with sudden, massive redemptions by investors;
- securitisation;
- repos and securities lending/borrowing;
- risks to financial stability posed by other shadow banking activities and entities.

In addition, the ESRB has come out in favour of eliminating Constant Net Asset Value (CNAV) money market funds and strengthening liquidity requirements³⁹.

It took four years for the European money market fund reform, initiated by a draft regulation published by the European Commission in September 2013, to move forward⁴⁰. In May 2017, the Council adopted a regulation to ensure the smooth operation of the short-term financing market. This regulation set standards to ensure stability in the structure of money market funds, to guarantee that they invest in well-diversified assets of a good credit quality, and to increase the liquidity of money market funds, to ensure that they can face sudden redemption requests.

Given the systemic importance of shadow banking, now that money market funds have been addressed, **the European Union should adopt appropriate legislation on the other risks identified by the FSB.**

Recommendation No. 11: At the European level, encourage the quick adoption of shadow banking legislation expanding on the May 2017 regulation on money market funds.

3.6. Invest fully in the field of bilateral financial diplomacy

No country can conduct a national regulatory review without considering the role of the United States in the financial sector. Prevailing uncertainties call for a concerted effort to communicate with the Trump Administration on the matter, and to develop scenario planning-based responses depending on the options possibly chosen.

Recommendation No. 12: In France, as in all other countries, invest in diplomatic relations with the United States on the issue of financial regulation, and define scenarios based on possible futures. This project could also be undertaken at the European level.

The other major area of intra-European uncertainty, i.e. the consequences of Brexit, should also be addressed head-on.

This is not the first time the intensity of financial regulation has been a sticking point in Europe. In the past, the UK financial regulation authorities (the FCA and the PRA) have chosen not to abide by European regulatory guidelines: for example, British regulators refused to apply

³⁹ ESRB Recommendation of 20 December 2012 on money market funds.

⁴⁰ It notably set obligations on the management of their liquidity, allowing them to reimburse investors wishing to withdraw funds in the short term, alongside specific capital requirements for CNAV money market funds.

the European Banking Authority's Guidelines on Sound Remuneration Policy⁴¹, perceived as too strict and disproportionate.

Today, Brexit has created the risk of a “prisoner's dilemma”-type scenario. This scenario can be avoided, however, provided that the stakeholders (the UK, the EU and the 27 individual member states) communicate with one another. One issue that might give the UK pause on deregulation is the importance it places on its reputation as a trusted financial hub. It may also be held back, in its vague hopes of deregulation, by the question of equivalence and reciprocity. Nor will it wish to remove itself from international forums for discussion on financial deregulation. There are several cards that can be played.

This is where the next few months and years could prove to be a very tricky balancing act: trust, an eminently volatile commodity, lies at the very core of game theory. It is absolutely critical to avoid a war of deregulatory one-upmanship, which would be worse than a zero-sum game – a real lose-lose disaster that would ultimately very certainly benefit Wall Street.

Recommendation No. 13: Convene the European Council to address the consequences of Brexit on financial regulation, to avoid the impasse of game theory and the prisoner's dilemma.

3.7. Disseminate macroprudential supervision in order to slow and defuse systemic risks

Wherever the macroprudential supervision of systemic risk is lacking, it needs to be established.

It is also important to keep a vigilant eye on all the young systems in the process of being established. While President Jinping's July 2017 announcement that the PBoC would be taking on such a role is a step in the right direction, doubts may yet surface as to its direct operationality. After all, it does nothing to resolve the over-compartmentalisation of financial regulation and lacks coordination mechanisms.

Furthermore, besides creating new umbrella organisations, it is necessary to ensure good coordination between microprudential regulation institutions. Right now, coordination between the three financial regulation bodies in China takes place via an inter-agency conference, and much more needs to be done to clarify the distribution of responsibilities to address not only the flaws but also the overlaps in terms of regulatory authority. Coordination between agencies should not be restricted to “crisis-only” situations: rather they should coordinate regularly and qualitatively during periods of stability.

Recommendation No. 14: Institutionalise systematic inter-agency cooperation in China in periods of stability as well as crisis.

Recommendation No. 15: Encourage all countries, and especially emerging countries, to establish a macroprudential supervisory institution. For each country with such an institution, have the G20 review the progress of its work.

⁴¹ EBA/GL/2015/22, 27 June 2016

3.8. Settle the debate on the Glass-Steagall Act?

Despite the many assertions that the Glass-Steagall Act is making a comeback, the fact is that all the countries that have seized on the issue did so only very timidly, by compartmentalising rather than actually ring-fencing deposit activities.

Should we go further and settle this debate? If so, to avoid banks taking flight, it needs to be done through an international consensus undertaken by the G20.

Especially as, at first glance, and even though it was the subject of criticism for some time, the separation of functions that took place in the United States between 1933 and 1999 owing to the Glass-Steagall Act (over 60 years!) may in fact have been less harmful than beneficial. During this period, growth was relatively robust; financial innovation was not curbed; US companies dominated the global financial markets; and financial crises were avoided by-and-large, since the 2007-2008 crisis was the worst since 1929. With the elimination of segregation, the rapid emergence of financial conglomerates coincided with many problems, however, including a series of financial scandals in which these behemoths served as catalysts, financial innovation intended to circumvent regulation, the formation of market bubbles in new technologies and real estate, slower growth, and finally a financial crisis of considerable magnitude and lasting impacts.

To champion this principle at the international level will take no small amount of political courage, given the shields the banking sector will predictably raise.

Recommendation No. 16: Take the issue of restoring strict separation between deposit and investment activities to the international negotiation table, and promote this principle as long as a consensus is reached.

3.9. Do not curb financial innovation if it is positive for the real economy

Financial innovation is not exclusively synonymous with imbalances, economic destabilisation and regulatory circumvention. It can be a boon for segments of the economy poorly served by the traditional financial system. In fact, that's what it is supposed to do.

In the UK, to encourage the introduction of innovative financial products and services on the market, the FCA created an innovation hub, which includes a “regulatory sandbox” where companies can test out innovative financial services in a safe environment, without danger of infringing regulatory requirements.

Recommendation No. 17: In France, adopt the UK model encouraging and guiding positive financial innovation by creating an innovation hub in the AMF.

SUMMARY OF RECOMMENDATIONS

Recommendation No. 1: Restore international strategic momentum to 2009 levels. France could spearhead this movement.

Recommendation No. 2: Finalise Basel III and restore a reasonable level playing field by having an international discussion of the harmful effects of any cavalier strategy in terms of financial (de)regulation.

Recommendation No. 3: On the diplomatic front, do not promote the creation of a World Finance Organisation.

Recommendation No. 4: Revisit the work done by the Joint Forum of Financial Market Regulators and expand its scope to at least include all the member countries of the Basel Committee, IOSCO and the IAIS.

Recommendation No. 5: In China, further clarify the rules of financial regulation in the law to ensure a more equitable application.

Recommendation No. 6: Create a separate agency in China responsible for collecting information from financial institutions and transmitting it to the regulatory authorities.

Recommendation No. 7: Make the issue of compliance an international talking point. France, which has extensively developed compliance in close collaboration between financial institutions and regulators – even though compliance is not part of its culture – could provide valuable insights to countries developing their own compliance system.

Recommendation No. 8: Have international organisations address the issue of time consistency in the prevention and management of financial crises. International organisations are overly focused on technical standards: the political economy of interventionism should also be discussed and subject to guidelines.

Recommendation No. 9: Reform the structure of systemic banks to cut their ties with shadow banking, a cradle for systemic risk.

Recommendation No. 10: At the European level, increase the ESRB's powers in terms of macroprudential supervision of shadow banking.

Recommendation No. 11: At the European level, encourage the quick adoption of shadow banking legislation expanding on the May 2017 regulation on money market funds.

Recommendation No. 12: In France, as in all other countries, invest in diplomatic relations with the United States on the issue of financial regulation, and define scenarios based on possible futures. This project could also be undertaken at the European level.

Recommendation No. 13: Convene the European Council to address the consequences of Brexit on financial regulation, to avoid the impasse of game theory and the prisoner's dilemma.

Recommendation No. 14: Institutionalise systematic inter-agency cooperation in China in periods of stability as well as crisis.

Recommendation No. 15: Encourage all countries, and especially emerging countries, to establish a macroprudential supervisory institution. For each country with such an institution, have the G20 review the progress of its work.

Recommendation No. 16: Take the issue of restoring strict separation between deposit and investment activities to the international negotiation table, and promote this principle as long as a consensus is reached.

Recommendation No. 17: In France, adopt the UK model encouraging and guiding positive financial innovation by creating an innovation hub in the AMF.

Appendix 1:

IBER Dashboard

DASHBOARD

0. Preliminary questions

→ **Why regulate? What are the purposes of regulation in your country? What are the underlying theoretical foundations?** (e.g. neoclassic belief in the optimal nature of pure, pristine competition)

I. Who regulates?

1.1. On the power to regulate the economy

→ **Does your country have separate regulatory authorities** or is the legislative and/or executive branch responsible for regulating the economy?

If you have regulatory authorities:

1.2. On the independence of regulatory authorities

→ What is their **legal status**?

→ What is their **degree of independence** from the executive branch?

→ How are the members of their decision-making bodies **appointed**?

→ How long is a member's **term of office**?

→ Can the executive branch **reform** a decision taken by a regulatory authority (does it have the “last word”)?

→ Are there **organic links** between the regulatory authorities and the executive, legislative and judicial branches?

1.3. On the choice of the geographic level of authority

→ Does regulation take place at the **national** level? at the **local** level? at the **supranational** level? at the **cross-border** level? Does the level of geographic authority depend on the sector?

→ How do the various geographic levels interconnect? Is there a principle of **subsidiarity** (see rules of geographic distribution by relevance) and if so, how is it applied? Can one power impose its views in the event of conflicting views?

1.4. On the degree of operational transparency of the regulatory authorities

- Do existing **procedures** within these authorities ensure adequate transparency?
- How are **investigations** conducted?
- Do companies have a **whistleblowing** procedure?
- Are the **principles** governing democratic court proceedings also applied to procedures before agencies (**publication** of discussions, **the right to defence**, **the right to not incriminate oneself**, **adversarial system of justice**)?

1.5. On the expertise and credibility of regulatory authorities

- Where is the boundary between **expertise and politics** within regulatory authorities?
- Are members **recruited** on the basis of objective criteria of expertise?

II. What is regulated?

2.1. On the interaction of cross-functional and sector regulation

- Do cross-functional regulatory agencies **coexist** with sector regulation agencies?
- If so, **how do they interact** (formal dialogue such as the obligation to request opinions, as well as informal dialogue; prevalence of one over the other; interferences; the power to impose one view over another)?
- How are **boundaries between sectors determined**? For example, is there a major regulatory authority in charge of network industries? Has Energy been divided into independently regulated sub-sectors?

2.2. On the liberalisation of the economy

- To what **level of detail** are sectors regulated? Does it depend on the sector?
- How are **market weaknesses** identified?
- Are **prices** regulated, capped? What falls under the definition of **anti-competitive practices**?
- How does **anti-trust legislation** work? Are consolidations supervised (if at all) before or after the fact?

2.3. On the regulation of the economy and the public interest

- How is the **mandate** of a regulatory authority defined? Is it defined in a legislative standard?
- Does a regulatory authority's mandate **take higher interests into consideration**? The public interest? Legal security? (stability of standards, stability of case law, economic operators' to anticipate events)? Interactions with other sectors?
- Is there a **dialogue between regulatory and non-economic authorities**? (authorities

like the CNIL in France)

III. Who ensures that regulations are applied?

3.1. On the production of standards and regulations

→ Who **produces standards** on regulation? Do agencies share this power with democratic representation?

→ How is this power distributed?

3.2. On the tools available to regulatory authorities

→ Are the decisions taken by regulatory authorities **legally binding**?

→ Do the regulatory authorities have **standard-setting power**? **regulatory power**?

→ Do the regulatory authorities have the **power to issue sanctions or penalties**?

→ What are their **powers of investigation**?

→ Do they have a **power of injunction**? **prohibitory power**? **the power to compel**?

→ Can they **impose structural and/or behavioural commitments**? With what immediacy?

→ Do they have **transactional power**?

→ Can they **act on their own initiative**?

IV. Does regulation take place in a democratic framework? Does it protect businesses?

4.1. On avenues of appeal

→ Is there an **informal or formal appeals process**? Is it necessary to address the regulatory authority or the executive branch?

→ Can the decision of a regulatory authority be disputed **before the courts**? Are there any restrictions on this avenue of appeal?

→ **What types of decisions** may be disputed before the courts? Only final sanction decisions? Certain **isolated acts** such as the decision to waive business secrecy?

4.2. On the effectiveness of appeals

→ **How much control** do the courts exercise over the decisions of regulatory authorities? Is this control limited to external legality? Does it extend to internal legality and, if so, to what extent (control over the manifest error of assessment or normal control)?

→ What percentage of disputes are settled through **arbitration** or **transaction**?

→ What is the cost of administrative procedures, of compliance?

→ Are **protective measures/emergency measures** taken?

→ What is the **cost and duration**, on average and in terms of standard deviation, of **court proceedings**?

4.3. On the protection of business interests and “legal security”

→ Is the **law** on sector regulation **stable**?

→ Does **soft law** (i.e. recommendations, guidelines, codes of conduct, etc.) play a major role in sector regulation? Is it stable? Do regulatory authorities have to argue, for example, for the “reversal” of their soft law?

→ How does the issue of the protection and waiving of business secrecy work in administrative and court proceedings?

→ Is **case law** on regulation **clear**? annotated?

→ Is **case law** on regulation stable? How is case law reversed? Can the effects of reversals be adjusted over time or are they retroactive? Do arguments have to be made to reverse case law?

→ Do the courts **incorporate the concept of public interest** in their decisions?

V. Who assesses the quality of regulation?

→ Is there a **democratic process for assessing** the quality of regulation? Is it exercised at the **national or supranational** level?

→ Is this assessment conducted **periodically**?

→ Have the regulatory system and its operation been subject to major **reforms** in recent years? What impacts have these reforms had?

VI. Preliminary elements of analysis

→ **In your view, what are the distinctive features of the regulatory system in your country?**

→ **In your view, what are the pros and cons of your regulatory system? What are its strengths and weaknesses?**

→ **In this questionnaire, are there any concepts that have no equivalent in your own legal and economic system?** Did you have any problems with some of the questions in this regard? If so, please explain. Conversely, are there any concepts that exist in your country that did not appear in this questionnaire?

Appendix 2:

Members of the International Board of Economic Regulations

1. Panel

Jean-Michel Darrois, Chairman

Country of citizenship: France

A graduate of Sciences Po (Paris Institute of Political Studies) and of the Panthéon-Assas University (Paris II), Jean-Michel Darrois is a business lawyer. Formerly a member of the Attali Commission on French growth, he is currently head of the law firm Darrois Villey Maillot Brochier, which he founded in 1987.



Francisco Müssnich

Country of citizenship: Brazil

A graduate of Harvard Law School and of the Catholic University of Rio de Janeiro,

Francisco Müssnich is a business lawyer. He is a senior partner at the Barbosa Müssnich & Aragão law firm, which he also founded. He has worked both in Brazil and internationally.



Paul C. Saunders

Country of citizenship: United States

A graduate of Georgetown University, Paul C. Saunders was a partner at Cravath law firm until 2010. From 2010-2014 he was legal counsel to the firm's litigation department. He is currently Chair of the New York State Judicial Institute on Professionalism in the Law, a member of several working groups and committees, and he also teaches at Georgetown University.



Robert Safari Zihahirwa

Country of citizenship: Democratic Republic of Congo/Responsible for the West Africa Region

A graduate of Kinshasa University's Faculty of Law, Robert Safari Zihahirwa is a judge by profession. He was successively a member of the prosecuting authority, a Judge at the Regional Court, a Judge at the Commercial Court, Presiding Judge of the Kinshasa Commercial Courts and Judge of the Court of Appeal. Elected as a Judge of the Common Court of Justice and Arbitration of the Organisation for the Harmonization of Business Law in Africa (OHADA) by the 38th session of the Council of Ministers of that organisation, he is currently serving a seven-year, non-renewable, term with that court, which is headquartered in Abidjan in the Republic of Côte d'Ivoire.



Gabriel Hawawini

Country of citizenship: France/Responsible for economic gains and cost of regulation

A graduate of the University of New York, where he studied economics, Gabriel Hawawini is a Professor of Finance at INSEAD Business School. He has taught most notably at the University of New York and Columbia University, and at the Wharton School of the University of Pennsylvania. At the same time, he sits on the boards of several companies and advises companies on management.



Hua Li

Country of citizenship: China

Hua Li is a partner with the law firm Squire Patton Boggs. She formerly worked for the Ministry of Foreign Trade and Economic Cooperation, before becoming Vice-Director of Foreign Trade at the State Commission for the Economy and Trade.



Graham Gibb

Country of citizenship: United Kingdom

A graduate of the University of Glasgow, Graham Gibb is a business lawyer. He is a partner at the London firm Macfarlanes LLP and chairs its International Committee.



Gloria Isabel Ortiz Castaneda

Country of citizenship: Columbia

A graduate of Panthéon-Assas University (Paris 2) with a Master's in General Private Law and a Master's in Comparative European Law, specialising in Chinese, Japanese and Arab law, and of the Externado University of Colombia, Gloria Isabel Ortiz Castaneda is a member of the Macondo Association for the development of exchanges between French and Columbian legal professionals. She is currently Coordinator of Product Security and Market Supervision for Consumer Protection at Columbia's Superintendency of Industry and Commerce.



Nasser Wahbi

Country of citizenship: Syria

Nasser Wahbi is a legal advisor to Affaki Avocats and an economic and legal affairs researcher at the Qatar Embassy in Paris. He is also a member of the *Cercle des économistes arabes*. He graduated from Paris II University with a Master's in Business Law and a PhD in Financial Market Law. He also holds degrees in public law and international law from Damas University.



2. Special consultants

Paulo Ceppas Figueiredo, Partner at the BMA law firm

Adam Koffi Drissa, Doctoral student in private law at the University of Bouaké in the Republic of Côte d'Ivoire

Ana Carolina de Oliveira Malta, Partner at the BMA law firm

Dominique B. Walter, Partner at the BMA law firm

3. General Rapporteur: **Angélique Delorme**, Head of petitions at the *Conseil d'Etat*

The Board is also supported by the Civil Law Initiative, and particularly by its President, **Jean-François Dubos** and Managing Director, **Laure Bélanger**.

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