The present paper discusses global financial standards and their relevance as part of the regulatory reforms initiated in the aftermath of the financial turmoil. In a first – precursory – part, it provides more clarity on the notion and role of “soft” law instruments, which have become an eminent pillar for the regulation of global finance. The essay likewise highlights the financial sector specific division of labor between the different international bodies, fora, and organizations in charge of global agenda-/standard setting. In the main – analytical – part, the article will turn to the sweeping reforms triggered by the experiences in the financial crisis. Emphasis is put on standards aimed at preventing systemic risk in the field of capital adequacy, prudential supervision, and accounting. The analysis of the reform efforts reveals specific deficiencies, which raise doubts as to their effectiveness to deal with a crisis comparable to the one in 2008 et seqq. In the final – concluding – chapter, the key findings for the study of global financial standard setting and crisis reforms will be briefly summarized.

I. Introduction

1. Global regulatory reform and standard setting

Since the global financial crisis, bold steps have been undertaken to reform the global financial system and the regulatory framework. Amongst the most important regulatory reform focus areas was a strengthening of capital requirements and the introduction of both liquidity standards and a leverage ratio requirement for international banks, which were recognized by the Group of 20 (G20) upon proposal by the Basel Committee on Banking Supervision (BCBS) during the Summit in Seoul (2010). This has been complemented by a tightening of prudential supervisory standards issued by the BCBS. Moreover, the International Accounting Standards Board (IASB) has embraced new accounting principles that aim to inhibit financial instability in falling markets. Other areas of reform range from improving the regulation of over-the-counter (OTC) derivatives or advanced standards addressing credit rating agencies (CRA) to the measures taken to tackle the risks posed by “Systemically Important Financial Institutions” – the list could easily be expanded.1 Additionally, there was a broad consensus among political leaders that a more intensified international cooperation and coordination of regulatory efforts was indispensable so as to ensure consistent formulation and implementation of reforms.2 It was stressed that the strengthening of global financial standards (GFS) and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting financial stability.3

The present paper examines GFS and the endeavors of the international regulatory community to prevent cross-border systemic risk and financial instability. At the outset, the main features of GFS as

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well as the actors and processes relevant to global agenda-/standard setting are briefly illustrated (I). The main part provides an overview of the international regulatory responses following the financial crisis (II) and outlines critical considerations regarding the global reforms (III). Finally, the key conclusions and insights will be summarized (IV).

2. “Soft law” standards in financial law

Global financial standards can be defined as the minimum requirements applied globally to prevent systemic risk. The most well-known GFS are the Basel Committee’s capital adequacy standards, which will require banks to hold minimum common equity tier one capital (primarily common shares and retained earnings) in the amount of 7% of their assets. GFS may come in various phenotypes – depending on their specificity – as good principles, practices, or guidelines and can be categorized by their scope in either functional or sectoral standards. From the legal viewpoint, global financial standards per se are not binding, i.e. they do not qualify as a source of public international law (under Art. 38 ICJ-Statute). As a consequence, neither the regulatory reform agenda nor related standards can be enforced through courts. Instead, the GFS belong to the category of rules, which it has become customary to designate as soft law. In the most basic sense the term “soft law” refers to international promises, obligations, or commitments that are not binding under international law. More specifically, soft law standards have been defined as “international obligations that, while not legally binding themselves, are created with the expectation that they will be given some indirect legal effect through related binding obligations under either international or domestic law.”

To help shed light on the thicket of standards, the FSB has designated 14 GFS under 12 policy areas as “key” for sound financial systems and indicated that those standards are most likely to make the greatest contribution to reducing vulnerabilities and strengthening the resilience of financial systems. The FSB list of key standards encompasses standards in areas as disparate as monetary and financial policy, fiscal transparency, data dissemination, banking supervision, securities regulation and insurance supervision, insolvency, corporate governance, accounting, auditing, payment and settlement, and market integrity. The FSB list of key standards wholly coincides with the IMF and World Bank endorsement of internationally recognized standards.

However, it is important to note that the “soft” legal character does not necessarily affect the effectiveness of GFS as the various jurisdictions may well be (and indeed often have been) persuaded to incorporate these standards into their domestic legislative and regulatory frameworks either as a matter of self-interest or bolstered through other mechanisms. In fact, markets may have a function in disciplining national regulatory compliance. This is due to the fact that financial firms domiciled in countries that do not adhere to GFS may have to pay a risk premium when refinancing at the capital markets. Additionally, states, international organizations, International Financial Institutions (IFIs) and regulatory networks have set up various structures and arrangements of a more institutionalized nature, which they apply to discipline national compliance. Examples include peer review mechanisms, loan conditionalities, market access restrictions, or IFI monitoring programs.

11 For a thorough review of these mechanisms see Stefan A. Wandel, International Regulatory Cooperation: An Analy-
As one can infer from the table below, various GFS have undergone revisions in the aftermath of the crisis reflecting some of their perceived deficiencies.

<table>
<thead>
<tr>
<th>Subject Area</th>
<th>Key Standard</th>
<th>Issuing Body</th>
</tr>
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<tbody>
<tr>
<td>Macroeconomic policy and data transparency</td>
<td>Code of Good Practices on Transparency in Monetary and Financial Policies (Sep 1999)</td>
<td>IMF</td>
</tr>
<tr>
<td>Data dissemination</td>
<td>Special Data Dissemination Standard (Mar 1999)/General Data Dissemination System (Dec 1997)</td>
<td>IMF</td>
</tr>
<tr>
<td>Banking Supervision</td>
<td>Core Principles for Effective Banking Supervision (Sep 2012)</td>
<td>BCBS</td>
</tr>
<tr>
<td>Securities Regulation</td>
<td>Objectives and Principles of Securities Regulation (Jun 2010)</td>
<td>IOSCO</td>
</tr>
<tr>
<td>Crisis resolution and deposit insurance</td>
<td>Core Principles for Effective Deposit Insurance Systems (last rev Nov 2014)</td>
<td>BCBS/IADI</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>Principles of Corporate Governance (2006 rev Sep 2015)</td>
<td>OECD</td>
</tr>
<tr>
<td>Accounting</td>
<td>International Financial Reporting Standards (ongoing)</td>
<td>IASB</td>
</tr>
<tr>
<td>Auditing</td>
<td>International Standards on Auditing (ongoing)</td>
<td>IAASB</td>
</tr>
<tr>
<td>Payment, clearing and settlement</td>
<td>Principles for Financial Market Infrastructures (Apr 2012)</td>
<td>CPSS/IOSCO</td>
</tr>
<tr>
<td>Market integrity</td>
<td>FATF Recommendations on Combating Money Laundering and the Financing of Terrorism &amp; Proliferation (last rev Feb 2012)</td>
<td>FATF</td>
</tr>
</tbody>
</table>

Source: Author’s illustration.

3. The agenda-/standard setting process

The global agenda-/standard setting process relies on a multi-level structure.\(^{12}\) At the first – top – level there is agenda setting, a process primarily carried out by the G20. This rather political gathering is the prime forum for cooperation on reform of the global financial system at the head of state level. In practice, the G20 specifies the regulatory reform agenda in particular areas where reform is most needed, e.g. OTC derivatives reforms or banking capital requirements. Also at the top level, the Financial Stability Board (FSB), a semi-political body, amongst others made up of finance ministry officials and central bank governors is responsible for coordinating national and international standard-setters in the transposition of the regulatory reform agenda. Aply both bodies have been termed the “soft decision-making bodies” for financial regulatory reform.\(^{13}\)

At the second – medium – level is standard setting. This level entails the specific regulatory groundwork of negotiating and developing of GFS based on the regulatory reform agenda provided by the G20. Concretization through more detailed guidance is necessary because the G20’s agenda presettings are mostly rather broadly formulated. The standard-setting bodies are therefore promulgating more specific guidance, which is then made available for national implementation. More specifically, GFS for the banking sector are worked out by the BCBS, a forum for banking supervisory cooperation made up of central bank governors. GFS for the insurance sector are worked out by the IAIS, an organization of insurance supervisors and regulators. Moreover, GFS for the se-


\(^{13}\) See ibid., at 70 et seqq. for a more detailed discourse and further references.
The securities sector are developed by IOSCO, an association of organizations that regulate the world’s securities and futures markets. Contrary to international organizations, all of these institutions are informally structured.\(^\text{14}\)

At the third - lower - level is the domestic implementation of GFS. National legislators and regulatory authorities are supposed to adjust their local legal and regulatory frameworks on the basis of the GFS that have been adopted at the level of the international standard setters. National implementation efforts are overseen by the IFIs, which have set up monitoring (or “surveillance”) programs, such as the Financial Sector Assessment Program and the related Reports on the Observance of Standards and Codes. IFIs play only a minor, supporting role in developing regulatory standards for the international financial markets but their monitoring programs have a global outreach.

II. The evolution of global financial standards in the wake of the crisis

1. Capital adequacy standards

The first-ever genuinely prudential GFS – adopted by more than 100 countries – is the Capital Requirements Framework or Accord developed by the BCBS as Basel I in 1988 and revised as Basel II in 2004. The most important pillar of the Basel Accord are the minimum capital requirements. The regulatory capital requirements are expressed as a ratio and are composed of three elements: (i) the numerator of the ratio defines regulatory capital; (ii) the denominator of the ratio defines risk weighted assets (RWA); (iii) the ratio must at a minimum be at a level of 8%\(^\text{15}\).

It has turned out in the crisis that many banks held insufficient capital to cover the substantial trading book losses incurred and that many banks’ liquidity situation as a result of adverse market scenarios was inadequate. The BCBS, therefore, initiated a substantial effort to revise its existing Basel I/II capital adequacy framework. The resultant Basel III capital adequacy framework, which was published in September 2010 (and modified in 2011), bolsters capital and liquidity requirements for banks.\(^\text{16}\) The centerpiece of the new agreement is a greater focus on common equity. Under Basel III the minimum regulatory

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\(^\text{16}\) Cf. BCBS (n. 5), at 2, 8.
capital will remain at 8% but the portion of capital of the highest quality that can fully absorb losses (Common Equity Tier 1 or CET1) has been increased from 2% to 4.5% of RWA. An additional “conservation buffer” to be built up in times of strong economic growth, and consisting of common equity of 2.5% of RWA, has also been introduced. This will bring the total common equity standard to 7%. If a bank should fail to satisfy the conservation buffer it may not be allowed to pay dividends. Applicable in 2015, the minimum Tier 1 capital will increase from 4% (under Basel II) to 6% of RWA. The largest banks also need additional loss absorbency capital ranging from 1% to 2.5%, depending on the systemic importance. A countercyclical buffer consisting of common equity of up to 2.5% may be introduced at the discretion of national regulators to prevent the build up of an excessive credit growth. Moreover, two liquidity ratios were introduced. The Liquidity Coverage Ratio requires banks to hold high-quality liquid assets that would meet its liquidity needs for a 30 calendar day liquidity stress scenario and a Net Stable Funding Ratio was introduced to meet any mismatches in a firm’s liquidity profile over a one-year extended stress period.

2. Banking supervisory standards

The Basel Core Principles for Effective Banking Supervision (BCP) are the de facto minimum standard for sound prudential supervision of banks. The BCP have originally been published by the BCBS in 1997 (revised in 2006) and their purpose is to serve as a benchmark for assessing the quality of domestic supervisory systems. In 2012, the BCBS has issued a revised version of its BCP. The latest round of revisions reflects significant developments in the global financial markets and regulatory landscape since 2006 including post-crisis lessons. Specifically, the reform of the BCP addresses shortcomings in the following areas:

- **Macroprudential issues and systemic risk:** The BCP require supervisors to analyze risk in a broader context which includes the macroeconomic environment, business trends, as well as a build-up of risk across the banking sector. Relevant authorities should also have the capabilities to take pre-emptive action to address systemic risks.

- **Systemically important banks (SIB):** The BCP do not contain a stand-alone principle but set out in rather general terms that the expectations on supervisors will need to be of a higher order for SIBs corresponding to their risk profile and systemic importance.

- **Crisis management, recovery and resolution:** According to the BCP, banking supervision should be designed to reduce the probability (and impact) of bank failures but does not need to strive for a complete prevention of such failures. In this regard, it may be necessary to develop resolution plans by regulators; as well as contingency funding plans and recovery plans by the banks themselves. In a crisis situation, home supervisors should collaborate with their counterparts in host jurisdictions.

- **Corporate governance:** The existing corporate governance criteria contained in various sections of earlier BCP have been brought together to create a separate new principle, which reflects the significance of governance structures for institutional and systemic stability.

3. Accounting standards

The International Financial Reporting Standards (IFRS) developed by the IASB is the globally recognized standard in the accounting area. IFRS require capital-market oriented companies to disclose comparable information about their financial and earnings situation to investors, lenders and other creditors. One of the key valuation methods of the IFRS (and its predecessor International Accounting Standards or IAS) is the so-called Fair Value (FV) approach. FV accounting means that a company’s assets or lia-

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17 Wandel (n. 11), at 35.
19 Cf. European Commission (n. 15), at 60, 69.
21 Ibid., at 6.
22 Ibid., at 5.
23 Ibid., at 6 et seq.
24 Ibid., at 7.
25 Wandel (n. 11), at 41.
ilities must be accounted based on the current market price or on another objectively assessable “fair” value.\textsuperscript{26} Thereby FV accounting, as promoted by the IFRS standard setter, should enhance transparency by providing a “true and fair view” of the company’s accounts.\textsuperscript{27}

Accounting standards have come to be seen as market volatility-enhancing and procyclical in the crisis.\textsuperscript{28} The IASB had recognized under IAS 39 that financial assets and liabilities be measured at fair value. As a result, in boom times, FV allows banks to increase their leverage when asset values are rising (and vice versa in recessions), which makes the financial system more vulnerable and financial crises more severe.\textsuperscript{29} The adjustment of the fair value may also impair the regulatory capital of banks so they have to sell assets at a price below the fundamental value. Moreover, falling prices can (and did in the crisis) activate margin calls and sale triggers that are components of risk management criteria, contributing further to the downward trend.\textsuperscript{30}

The IASB has addressed this problem by issuing a new standard IFRS 9 (gradually replacing IAS 39), which will be fully applicable from January 1\textsuperscript{st}, 2018. The reform package introduces two basic measurement methods for financial instruments: amortised cost (AC) and FV. Essentially, financial assets will be measured at AC if the asset is held within a business model whose objective is to collect contractual cash flows rather than have the objective to sell the Instrument before its contractual maturity to realise its fair value changes (business model test), and the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest (cash flow characteristics test).\textsuperscript{31} These reforms are significant since – from a financial stability perspective – AC accounting is less susceptible to market fluctuations. As a consequence of the new rules, non-financial institutions that hold financial assets for the longer term, or financial institutions that undertake traditional banking activities of taking deposits and making loans, would rather apply AC instead of FV thereby smoothing potential procyclical swings.

### III. A critical reflection of global regulatory reforms

#### 1. Capital adequacy standards

According to former BCBS Chairman Nout Wellink, the Basel III regime will significantly reduce the probability and severity of banking crises in the future.\textsuperscript{32} However, the new capital framework has also been criticized on the ground that the capital requirements are simply not high enough to ensure that banks withstand a substantial external shock such as a fully-fledged financial crisis.\textsuperscript{33} This problem is particularly accentuated in Switzerland with its two major banks (and their relative size to the GDP) and it is also the reason why legislators and regulators have proposed strict new rules, which will require more and higher quality additional capital from UBS Group and Credit Suisse Group.\textsuperscript{34} The main argument of proponents of capital regulation is that it is an effective tool for maintaining the stability of the financial system and that equity is not expensive for banks. Therefore, they advocate for higher equity capital ratios.\textsuperscript{35} Some postulate bank equity capital as

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\textsuperscript{28} Ibid., at 7.


\textsuperscript{30} Novoa et al. (n. 26), at 3, 27.


\textsuperscript{32} Eernisse (n. 9), at 255 with references.


\textsuperscript{34} For details of the proposed Swiss capital regime see FINMA, Swiss “too big to fail regime” significantly strengthened, Press Release (21 October 2015), retrievable from FINMA website.

high as 20% or 30% on an un-weighted basis, whereas others consider 16% to 20% an optimal capital ratio. On the contrary, observers fear higher capital requirements since demanding more capital may induce them to take more risk (as a substitute for the lesser yield on capital) or charge more for their services, which would cause a customer drain. Critics also argue that if banks need to retain more capital and liquidity then the lending capacity will diminish. However, the negative impact on economic growth has never been proven. In any case, banks need to be healthy – from a capital perspective – to deal in credits thereby enabling economic growth. As can be seen in Japan (but also elsewhere), weak banks that fail to issue fresh equity to enhance their capital positions may develop to “zombies” of little use to the real economy. Additionally, banks do not have problems complying with Basel III as they have already strengthened their capital positions. In fact, at the global level, the world’s largest banks now have $500bn more capital than they used to have before the crisis. Nevertheless, there is a risk that strict banking capital standards will crowd out certain activities from the regulated parts of the financial system to the unregulated parts – the shadow banking system –, which have so far not been comparably addressed by capital regulation.

2. Banking supervisory standards

The revised BCP set out the key prerequisites for an effective system of banking supervision considering the experience of the crisis. However, two critical aspects of the BCBS’s reforms need to be highlighted. Whereas the BCP require governments to put in place arrangements for crisis management and to define the roles and mandates of banking supervisors, finance ministries, central banks and resolution authorities, they do not contain concrete provisions on how to cope with bank failures including how to resolve banks in an orderly manner and in particular on the procedural conditions of international supervisory cooperation in a crisis situation. This may be problematic since communications and crisis management protocols are essential and need to be crafted in advance, as there may be intense time pressure in times of crisis. Moreover, various resolution strategies covering potential eventualities should be pre-defined. The BCP should set out clear procedural requirements for resolution options, crisis management protocols and international information-sharing so that potential crisis eventualities are covered.

Albeit the fact that the BCP touch upon systemic importance of banks, the BCBS refrained from adopting an independent provision that would be applicable to SIBs. Here, too, the question is whether it would not have been better to adopt a separate SIB prudential provision in the BCP due to the differences between individual jurisdictions’ regulatory approaches and the fact that the size of these institutions may compel home and host supervisors to bail them out.

3. Accounting standards

The promulgation of IFRS 9 will bring new requirements for classifying and measuring financial assets. However, the effectiveness of the revised standard to mitigate market conditions needs to be critically questioned. One issue of concern is that IFRS 9 (and its predecessor) is based on a mixed measurement model: some financial instruments are generally measured at FV whereas others are measured at AC.

38 Eurnisse (n. 9), at 259 with further references.
39 Id., at 260.
41 Id.
42 See Admati et al. (n. 36), at 57.
43 See the further reaching FSB umbrella standard on resolution regimes for financial institutions (Key Attributes of Effective Resolution Regimes for Financial Institutions (revised version 15 October 2014) 66) and corresponding draft guidance (Guidance on Cooperation and Information Sharing with Host Authorities of Jurisdictions Not Represented on CMGs where a G-SIFI has a Systemic Presence (17 October 2014) 4 et seqq.; both retrievable from FSB website.
44 Id.
Only debt instruments (e.g. bonds, loans) that meet both the cash flow and business model test can be measured at AC. Equity instruments and derivatives need to be measured at FV. There have also been concerns that the classification attributes were too strict, which in effect would prompt the reporting of financial instruments at FV instead of – the more suitable – AC. Moreover, the potential target group for the FV option (as shown above) is severely restricted. An overly stringent definition of qualification criteria for AC reporting and the fact that only debt instruments can be measured at AC as well as the limited application may hamper the positive effects to attenuate market movements in a crisis scenario.

IV. Conclusion

A plethora of GFS have revamped international financial markets since the set up of the ambitious reform agenda by the G20 in 2008. This was done in recognition that the risks caused by the activities in the banking and financial services sector impinged upon global financial stability and that the existing regulatory frameworks at the international/global level were far from effective to deal with these challenges. But despite the multitude of GFS promulgated in recent years, regulatory reform efforts have had their drawbacks. This paper has shown that in some instances GFS may be flawed in a way that causes doubts about their effectiveness to prevent systemic risk and financial instability. It is doubtful whether the broad-based capital reforms under Basel III will be sufficient to prevent another crisis of the kind of 2008 because the capital requirements simply do not go far enough and national governments may again have to initiate bailouts to restore the stability of the financial system. Notwithstanding their swift and extensive (almost worldwide) endorsement, the BCP neglect the risks of institutions that are “too big to fail” and missed an opportunity to incorporate procedural principles for crisis management and international cooperation. Moreover, the effectiveness of accounting reforms could be seen critical as new standards only partially address the effect of market fluctuations and eventually procyclicality.

To sum up, the GFS are indispensable instruments for coordination and cooperation among national regulators with a view to regulating global financial markets. The conceptual limits of GFS should nevertheless be acknowledged as there is an inherent risk that global standard setters agree on erroneous standards. Ultimately, the dissemination of common standards by the international financial community does not constitute a panacea to prevent financial crises and, thus, cannot be regarded as a substitute for sound financial regulation and supervisory practices at national level.