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**The Financial Stability Board**

*The G20's answer to the Global Financial Crisis*

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## I Introduction

The collapse of the United States sub-prime mortgage and housing market in 2008 led to the largest financial crisis in modern history. It was described by Dominique Strauss-Kahn, the then Managing Director and Chair of the Executive Board of the International Monetary Fund (IMF) as the “worst economic slowdown since the Great Depression.”<sup>1</sup> Large private banking institutions fostered a culture of low interest lending, encouraged by competitive market interest rate swaps and complex derivatives, leading to increased borrowing and subsequent default. As a result, 2008 also saw an 81 per cent increase in home foreclosures on the previous year<sup>2</sup> as well as the bankruptcy of one of the U.S.’ largest investment banks, Lehman Brothers Holdings Incorporated. With US\$639 billion dollars in assets and US\$619 billion dollars in debt, the bankruptcy of the Lehman Brothers Empire is the largest recorded in U.S. history to date.<sup>3</sup> While tempered to some degree, the effects of the Global Financial Crisis (GFC) can still be felt today.

With a litany of varying factors contributing to the eventuality of the GFC, a variety of international organisations acting as regulatory agencies, such as the World Trade Organisation (WTO), the IMF, and the World Bank appeared to have had little effect in preventing its occurrence. Of particular significance was the Financial Stability Forum (FSF), consisting of major national financial authorities and international financial institutions, a subset of the Group of Seven (G7) and predecessor to the Financial Stability Board (FSB), which was brought into existence in 1999 to promote international financial stability. Soon after the 2008 market crash, and as a result of the 2009 G-20 London summit, the FSF was rebranded, given an increase in membership, established new aims and priorities and provided with a wider mandate to increase the accountability of its member states, with particular focus on their adherence to its new objectives.

The FSB was in part the G20's response to the GFC. As well as outlining its functions and structure, the focus of this paper will assess the role of the FSB in light of the global governance regime. Although limited, the literature available on the FSB suggests that while vast improvements have been made to make the institution more democratically inclusive, they are far from satisfactory. It is instead suggested that the FSB acts as the G20's executive branch, fulfilling its objectives, while circumventing accountability, transparency and public participation through its constitutional framework and documentation.

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<sup>1</sup> International Monetary Fund *Annual Report 2009* (International Monetary Fund, Annual Report, 2009) at 4.

<sup>2</sup> Les Christie “Foreclosures up a record 81% in 2008” (15 January 2009 <money.cnn.com>).

<sup>3</sup> *In re: Lehman Brothers Holdings Inc., et al.* Chapter 11 Case No. 08-13555 (JMP) (Jointly Administered) Debtors’ Disclosure Statement for Third Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. And its Affiliated Debtors Pursuant to Section 1125 of the Bankruptcy Code. United States Bankruptcy Court Southern District of New York.

## II *Overview of the FSB*

### A *Role of the FSB*

According to its mandate, the FSB is responsible for coordinating national financial authorities and international standard-setting bodies, such as the Basel Committee, the International Accounting Standards Board (IASB) and the International Organization of Securities Commissions (IOSCO), in order to facilitate the development of strong regulatory, supervisory and financial sector policies. The FSB presents itself as acting in a facilitatory role, promoting international financial stability by working with stakeholders to strengthen financial systems. In order to achieve these ends, the FSB has outlined nine key reasons the agency was established, which are to:<sup>4</sup>

- assess vulnerabilities affecting the global financial system as well as to identify and review, on a timely and ongoing basis within a macroprudential perspective, the regulatory, supervisory and related actions needed to address these vulnerabilities, and their outcomes
- promote coordination and information exchange among authorities
- monitor and advise on market developments and their implications for regulatory policy
- monitor and advise with regard to best practice in meeting regulatory standards
- undertake joint strategic reviews of the international standard setting bodies and coordinate their respective policy development work to ensure this work is timely, coordinated, focused on priorities and addresses gaps
- set guidelines for establishing and supporting supervisory colleges
- support contingency planning for cross-border crisis management, particularly with regard to systemically important firms
- collaborate with the International Monetary Fund (IMF) to conduct Early Warning Exercises
- promote member jurisdictions' implementation of agreed commitments, standards and policy recommendations, through monitoring of implementation, peer review and disclosure.

Other than the G20's blessing the FSB has no inherent authority and only gained some legal form as an association (Verein) under Swiss law in 2013.<sup>5</sup> Vereins have become a popular form of loose merging between law firms, circumventing the onerous reconciliation of conflicting jurisdictional tax regimes all the while maintaining separate accountability, one office not being liable for the other.<sup>6</sup> Unlike other legal entities, a Swiss Verein does not require registration in order to have a

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<sup>4</sup> Financial Stability Board "Our Mandate" (April 2018) Financial Stability Board: About Us, <[www.fsb.org/about/](http://www.fsb.org/about/)>.

<sup>5</sup> Financial Stability Board *4<sup>th</sup> Annual Report: 1 April 2016 – 31 March 2017* (Financial Stability Board, Annual Report, 27 December 2017) cl 1.1 at 27.

<sup>6</sup> Robin Sparkman "In House" *The American Lawyer* (online ed, New York, February 2011) at 8.

separate legal personality,<sup>7</sup> however must do if it conducts a commercial operation or is subject to an audit requirement.<sup>8</sup> Given the FSB has no assets or liabilities nor generates any revenue; there is no mandatory requirement for it to register.<sup>9</sup>

Another polarising feature of the FSB is that it in practice forms a centralised regulatory body that monitors compliance on a state and regional basis. As well as making policy recommendations to states, the FSB works alongside the IMF, aiming to detect potential financial instability in acting as an early warning system. While described by the former U.S. Secretary of State, Timothy Geithner as “in effect the fourth pillar to the architecture of cooperation we established after the Second World War”<sup>10</sup> the FSB has come under serious scrutiny by the U.S. Congress’ House Committee on Financial Services (the Committee) for lacking transparency, accountability and stakeholder participation.

A hearing was convened in September 2016 in order for the Committee to examine the FSB’s effects on the financial services industry’s ability to perform effectively for customers, compete internationally, and contribute to a sound financial system.<sup>11</sup> The Chairman, Mr Jeb Hensarling, in delivering the decision of the Committee raised particular concerns around the impact the FSB’s recommendations could have on domestic policy, given the FSB’s members were not democratically elected. Mr Hensarling went on to find:<sup>12</sup>

It is very troubling that American regulators would relinquish any regulatory authority to unelected European bureaucrats who meet behind closed doors in a secretive fashion to determine the fate of the U.S. financial institutions. Because very little is known about the FSB, I have very serious concerns about the arbitrary decision-making process used to formulate policy that is devoid of any and all public participation.

While the Committee concluded that the FSB’s decisions and recommendations were not binding on its members (in particular the U.S.), the FSB has otherwise accepted that it operates by ‘moral suasion’ and ‘peer pressure’ in order to ensure member states are upholding minimum standards. Members appear to subject themselves to voluntary peer reviews, using internal and external standards such as the IMF/World Bank public Financial Sector Assessment (FSAP) reports to gauge

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<sup>7</sup> Drew Hasselback “More on the Swiss Verein System” (online ed, Toronto, 16 November 2010).

<sup>8</sup> Swiss Civil Code 1907, Art 61.

<sup>9</sup> Financial Stability Board *4<sup>th</sup> Annual Report: 1 April 2016 – 31 March 2017* (Financial Stability Board, Annual Report, 27 December 2017) cl 2.5.2 at 29.

<sup>10</sup> Eric Helleiner “Did the Financial Crisis Generate a Fourth Pillar of Global Economic Architecture?” (2013) 19 SPSR 558 at 558 *see also* U.S. Department of the Treasury “Press Briefing by Treasury Secretary Tim Geithner on the G20 Meeting Pittsburgh Convention Centre” (24 September 2009) Press Center <[www.treasury.gov](http://www.treasury.gov)>.

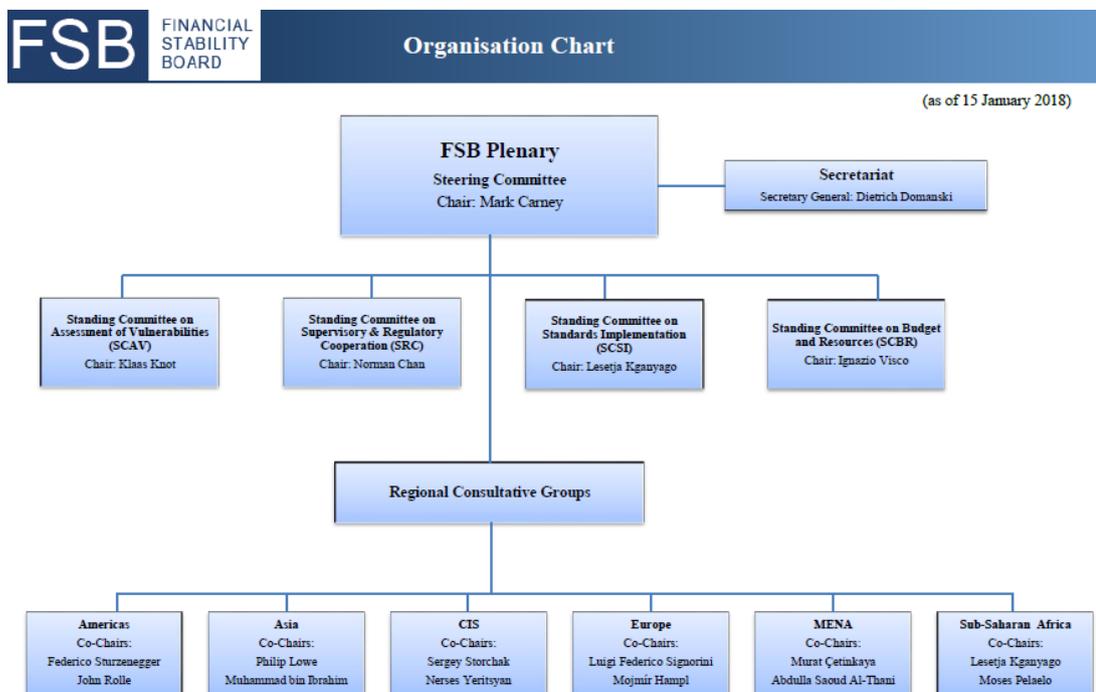
<sup>11</sup> United States House of Representatives: Committee on Financial Services *Memorandum* 20 September 2016.

<sup>12</sup> Hearing before the Subcommittee on Monetary Policy and Trade of the Committee on Financial Services U.S. House of Representatives One Hundred Fourteenth Congress Second Session *The Financial Stability Board’s Implications for U.S. Growth and Competitiveness* (Serial No. 114-106, 27 September 2016) at 8.

compliance. Given the lack of enforceability of its decisions or recommendations, the FSB's overall structure and modus operandi is called into question.

### B Structure of the FSB

The FSB is made up of 71 member institutions, representing 25 states and 13 international organisations and standard-setting bodies. Mark Carney, Governor, Bank of England assumed the role of Chair of the FSB Plenary in 2011 and is the current and second only Chair to occupy the position since its inception in 2009. As Chair, Mr Carney is the principal spokesperson for the FSB representing it externally as well as convening and chairing meetings of the Plenary and the Steering Committee as well as maintaining oversight of the FSB Secretariat. An FSB's organisational chart, as at 15 January 2018, is depicted below:<sup>13</sup>



The Plenary is the sole decision-making body of the FSB and consists of representatives of all its members. As the decision making-body, the Plenary is responsible for adopting reports, principles, standards, recommendations and guidance developed by the FSB as well as establishing standing committees and working groups. The Plenary also decides on membership, assignments to various positions within the FSB and compositions of the various Committees as well as having oversight of the work programme and budget.

<sup>13</sup> Financial Stability Board "Organisation Chart" (15 January 2018) Financial Stability Board <[www.fsb.org/wp-content/uploads/FSB-Organisation-Chart.pdf](http://www.fsb.org/wp-content/uploads/FSB-Organisation-Chart.pdf)>.

## 1 Funding

The FSB is majority funded by the Bank for International Settlements (BIS) under a five year agreement, which was recently renewed in January 2018 and extended to 2023. In order to carry out its activities the FSB, to the financial year end 31 March 2017 disclosed CHF 13,403,000 (circa USD \$13m at present rates) in operating costs for its 33 permanent staff. Over 92% of that funding being provided by the BIS, the remaining 8% shared by the IMF, World Bank and one undisclosed national regulator.<sup>14</sup> The FSB's operating expenses include salary and allowances, health and accident insurance, post-employment benefits and other personnel-related costs such as travel, meeting costs and subscriptions.<sup>15</sup> The FSB's registered address is the BIS' headquarters located in Basel Switzerland.

Unsurprisingly, the BIS' provision of premises and administrative support are provided free of charge and not included as an expense in the FSB's statement of activities.<sup>16</sup> Poignantly, the aims of the BIS closely align with the purposes of the FSB, in its mission to serve central banks in their pursuit of monetary and financial stability and to foster international cooperation in those areas and acting as a bank for central banks.<sup>17</sup> The BIS is owned by its 60 central bank members, which includes the Reserve Banks, or their equivalent, of Australia, Canada, the U.S. and New Zealand. To this end and beyond its physical locale, the FSB appears to be an extension of the BIS, pursuing in part the aims and objectives of its primary financial investor.

## 2 Procedure

The FSB is governed by its Charter,<sup>18</sup> Articles of Association<sup>19</sup> and Procedural Guidelines<sup>20</sup> promoting itself as being a member-driven organisation where decisions are taken by consensus. The FSB's Charter outlines its objectives and mandate as discussed above and also outlines its organisational structure, and the responsibilities of its seven established roles. Each Committee or Group has a wide

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<sup>14</sup> Financial Stability Board *4<sup>th</sup> Annual Report: 1 April 2016 – 31 March 2017* (Financial Stability Board, Annual Report, 27 December 2017) cl 2.6 at 29-30.

<sup>15</sup> At cl 2.7.

<sup>16</sup> At cl 2.7.

<sup>17</sup> Bank for International Settlements *The BIS: Promoting Global Monetary and Financial Stability* (BIS, Profile Brochure (June 2017)).

<sup>18</sup> Financial Stability Board *Charter of Financial Stability Board* (Financial Stability Board, Charter, June 2012) ("Charter").

<sup>19</sup> Financial Stability Board *Articles of Association of the Financial Stability Board (FSB)* (Financial Stability Board, Articles of Association, 28 January 2013) ("Articles").

<sup>20</sup> Financial Stability Board *FSB Procedural Guidelines* (Financial Stability Board, Procedural Guidelines, 1 February 2013 as amended on 21 July 2016) ("Guidelines").

discretionary ambit to include non FSB-Members into ad-hoc working groups<sup>21</sup> in addition to the Chairs' ability to extend invitations to non FSB-Members to the whole or part of their meetings as they see fit.<sup>22</sup> According to the Charter, the Chair of the FSB is selected from the representatives of the Plenary and appointed for a term of three years renewable once.<sup>23</sup> Given Mr Carney's appointment to the Chair in 2011, his second three year term expired in 2017 however; he remains in the position seemingly uncontested. Domenico Lombardi's Report, known as the Brookings Issue Paper, was a review of the Governance of the FSB which relevantly found that owing to the central banking culture of discretion and informality that permeated the institution, there appeared to be no set of rules for the selection process of the Chair.<sup>24</sup>

The Brookings Issue Paper led to a series of reforms in 2012 which were in part implemented. While the Chair must have recognised expertise and standing in the international policy arena, there does not appear to be any other objective standards on which to assess the Chair's suitability for the role.<sup>25</sup> Mr Carney's term as Chair was recently extended until December 2018. This extension in term is over and beyond the permissible maximum six year tenure and therefore undermines the integrity of the Charter.<sup>26</sup> The integrity of which is already brought into question given Article 23 provides that the Charter is not intended to create any legal rights or obligations on its members or staff. While Charters and Codes need not be legally enforceable in order to provide effective governance, they do require adherence. Frankel suggests that there are three types of professional codes that institutions will adopt in order to legitimise themselves.<sup>27</sup> Along the continuum are aspirational, educational and regulatory codes, the latter normally consisting of a set of detailed rules which govern professional conduct and serve as the basis for adjudicating grievances.

The FSB's Charter is aspirational at best. A well-intended aspirational code will enshrine a statement of ideals to which actors strive towards upholding.<sup>28</sup> Given its wide discretionary powers, limited requirements for fulfilling positions and lack of legal recognition or enforceability combined with a lack of adherence to its own

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<sup>21</sup> Charter at art 19.

<sup>22</sup> At art 18(4).

<sup>23</sup> At art 21.

<sup>24</sup> Domenico Lombardi *The Governance of the Financial Stability Board* (Global Economy and Development at Brookings, Issues Paper, September 2011).

<sup>25</sup> Charter at art 21(2).

<sup>26</sup> Financial Stability Board "FSB Governance" (6 October 2017) Financial Stability Board <[www.fsb.org/2017/10/fsb-discusses-2018-workplan-and-next-steps-on-evaluations-of-effects-of-reforms](http://www.fsb.org/2017/10/fsb-discusses-2018-workplan-and-next-steps-on-evaluations-of-effects-of-reforms)>.

<sup>27</sup> Frankel, MS "Professional Codes: Why, How and with What Impact?" (1989) 8(2/3) JBE 109 as cited in David Spencer and Michael Brogan *Mediation Law and Practice* (1<sup>st</sup> ed, Cambridge University Press, New York, 2006) at 216.

<sup>28</sup> At 216.

rules, the FSB's Charter exists more in form than in substance. The same can be said of the FSB's procedural guidelines which further reiterate the various roles of the FSB as discussed in its Charter. The FSB's Guidelines seek to improve transparency and consistency of practice in its operational activity as set out in its Charter.<sup>29</sup> However, the Guidelines appear to be nothing more than a list of timeframes, assignments of actors to various groups and qualified recommendations.

Under the Selection and Appointment Processes, Part D of the Charter, there is no mandatory requirement that the process for selecting and appointing a Chair to any of its Committees be open or transparent, instead each requirement is prefaced with the discretionary licence of 'should'. The selection process *should* be open and transparent, *should* be completed before the expiry of the term of the existing incumbent and the Nomination Committee *should* explain the process and outcome of the process to the Plenary.<sup>30</sup> While it is possible these steps are taken to the letter, there is no provision under any of FSB's structural framework documentation for dispute resolution or remedies in the event of breach. The High-Level Panel involved in the production of the Brookings Issue Paper made 12 recommendations for strengthening the FSB's governance, credibility and understanding of its purpose. Importantly, the Panel recommended that the FSB should articulate the conditions under which the Chair can or must be removed from office due to malfeasance, conflict of interest negligence.<sup>31</sup> No provision is made under the FSB's current framework for such an outcome. Instead, and at the Plenary's discretion, Mr Carney's term as Chair has been extended with no indication as to why or how such a decision was reached.

### C *Self-Assessment*

In the wake of the United Kingdom's decision to leave to the European Union and downward revisions in anticipated returns, Mr Carney, in an open letter to the G20 Finance Ministers and Central Bank Governors, outlined that due to the partial implementation of the G20 reforms, the global economy and financial markets were better able to weather events which led to uncertainty and risk aversion.<sup>32</sup> The letter outlined the progress the FSB had made to date in advancing the goals and reforms recommended by the G20 with a commitment to fully implement the remaining recommendations by the end of 2016. Unsurprisingly, the G20 reforms were not concerned with the internal structure or governance of the FSB itself and instead focused on addressing the structural vulnerabilities in some aspects of market-based

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<sup>29</sup> Guidelines at Preamble.

<sup>30</sup> At pt D.1.

<sup>31</sup> Domenico Lombardi *Recommendations from the High-Level Panel on the Governance of the Financial Stability Board* (Global Economy and Development at Brookings, Recommendations, September 2011).

<sup>32</sup> Mark Carney (Chairman of the FSB) to G20 Finance Ministers and Central Bank Governors regarding implementation of G20 reforms (19 July 2016).

finance. Somewhat ironically, a top priority for the FSB in 2016 was to build an open and resilient global financial system by promoting resilient sources of market-based finance while remaining closed as to its own internal processes.

This is not to say that the efforts of the FSB to reduce economic uncertainty are not well-intended, prevention of a widespread economic recession being in the interest of most global economies. However, it is the place of the FSB as policy advisor and financial expert to powerful states that raises concern. In January 2017, the FSB published an updated version of proposed policy recommendations addressing the financial stability risks posed by asset management companies and intermediaries.<sup>33</sup> Again, the first policy recommendation suggested increasing information sharing and transparency, albeit related to addressing liquidity mismatches between fund investments assets and redemption terms and conditions for fund units.<sup>34</sup> The self-proclaimed commendable efforts of the FSB were again reiterated in a speech given by Mr Carney, in his capacity as Chair of the FSB and as Governor of the Bank of England, to the Institute of International Finance's Washington Policy Summit in April 2017.<sup>35</sup>

According to Mr Carney in his address, there has been widespread acceptance of the FSB's recommendations noting that international minimum standards (standards from over ten international organisations, including the IMF, World Bank and OECD compiled and centralised by the FSB)<sup>36</sup> have by and large been consistently and promptly implemented in G20 jurisdictions. A decade on, Mr Carney advises that the broad goals the FSB was charged with in light of the GFC had largely been achieved by: creating more resilient banks (increasing capital and in turn liquidity), ending the too-big-to-fail mentality, transforming shadow banking (the use of credit lines outside of the regular banking system) and making the derivatives market safe. As a result, Mr Carney claimed the global financial system was safer, simpler and fairer but also recognised there was no room for complacency and that there was still work to be done. Mr Carney concluded his speech with a call to the global community to recognise that due to the increasing risks to financial stability there was a need to continue working together to identify emerging vulnerabilities in a timely and consistent manner.

Accepting for a moment that the work of the FSB over the last decade has achieved the objectives it has claims to have achieved, weathering market spikes, assisting

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<sup>33</sup> Financial Stability Board *Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities* (Financial Stability Board, Policy Recommendations, 12 January 2017).

<sup>34</sup> At Annex 1: Recommendation 1.

<sup>35</sup> Mark Carney, Governor of the Bank of England & Chair of the Financial Stability Board "What a Difference a Decade Makes" (Remarks at Institute of International Finance's Washington Policy Summit, the Regan Centre, Washington DC, 20 April 2017).

<sup>36</sup> Financial Stability Board "Table of Key Standards for Sound Financial Systems" (2018) Financial Stability Board <[www.fsb.org/what-we-do/about-the-compendium-of-standards/key\\_standards/table-of-key-standards-for-sound-financial-systems](http://www.fsb.org/what-we-do/about-the-compendium-of-standards/key_standards/table-of-key-standards-for-sound-financial-systems)>.

financial institutions increase capital and significantly preventing a global economic downturn, it could be argued that the FSB is actually doing what it is set out to do, in facilitating the development of strong regulatory, supervisory and financial sector policies. However, these outcomes appear to be at odds with the views of powerful domestic governments such as the U.S. suggesting that domestic regulators should be slow to relinquish power and be dubious of the closed-door practices of international organisations with heavy-weight affiliates. Nanz and Steffek would suggest that such sentiments stem from an inherent distrust of powerful elites, who may very well possess the expertise you would expect to see in the areas they govern, but lack a public voice<sup>37</sup>

...an expression of distrust regarding the role of experts and diplomats as protagonists on international governance. In the eyes of many stakeholders and affected citizens, elite expertise and bureaucratic deliberation alone do not suffice to make international organizations legitimate.

While the FSB has been busy fulfilling its mandate to ensure market stability of the world's most powerful economies, it appears to have given little or no real attention to improving its internal processes or structure. While implementing the recommendations of the G20 and concerning itself in the important work of ensuring the regulatory work of states is compliant with international standard-setting bodies, lip service has been given to the recommendations made in the Brookings Issues Paper to increase procedural transparency, accountability and public participation.

### *III Competing views*

A reoccurring theme in the literature is that little academic attention has been given to the organisational structure, role and emergence of the FSB. This is particularly striking given its central status as a coordinator and standard setting-body of many powerful financial institutions and domestic regulators. This section of the paper canvasses three opinions published over the decade of the FSB's existence and assesses their relative usefulness in assessing the FSB's transparency, accountability and mechanisms for public participation. Each author provides an alternative view in considering the role and position the FSB occupies under the auspices of international financial regulation institutions.

Stavros Gadinis, Professor of Law at Berkley, University of California, highlights the significance of political involvement in global financial regulation facilitated by the FSB, noting that such a forum provides politicians with a voice they previously

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<sup>37</sup> Patrizia Nanz and Jens Steffek "Global Governance, Participation and the Public Sphere" (2004) 39 Gov. Oppos. 314 at 320.

lacked on the international stage.<sup>38</sup> Warren Clarke, Post-Doctoral Fellow at McMaster University, Hamilton Canada, provides a view imploring scholars to seriously consider the role of the FSB as it operates within institutionally dense spaces<sup>39</sup> while Camilo Soto Crespo, Mexican Delegate to the Youth 20 Dialogue 2017 and LL.M. candidate at New York University provides an explanation as to why the FSB must operate through a series of “soft-law” practices.<sup>40</sup>

#### A *The New Politics of International Financial Regulation*

In support of the FSB's utility, Gadinis argues that both the proponents and critics of the FSB have severely underestimated one of its key attributes, that of its deeply political character. While occupying seats at the FSB's Plenary and Steering Committee does not fall under any official domestic role expectation as Banking Regulators or Finance and Securities Ministers, Gadinis suggests that their respective presence in these forums means that politicians are now responsible for some of the most momentous decisions in a financial institution's life, such as determining whether or not to extend credit to it. This, Gadinis heralds, is an innovative step in warranting elected politicians avenues to shape and influence international financial regulation in ways not available to them in the past. Accordingly, the FSB has become the G20's executive branch in implementing its recommendations and overseeing compliance of its members to its standards.

In support of his position, Gadinis proposes three ways in which the governments represented by the G20 intervene in international financial regulation: through promoting specific amendments in international rule maker's existing standards, through setting entirely new policymaking initiatives, and through intensifying efforts to monitor compliance with international rules at the domestic level.<sup>41</sup> Gadinis recognises that due to the FSB's inability to enforce sanctions for non-compliance it is reliant on soft-law mechanisms such as peer pressure and the voluntary adoption of international standards at the domestic level. Such mechanisms are criticised for being dependent on state legal institutions for enforcement and therefore legitimacy.<sup>42</sup> These soft law mechanisms, Gadinis' suggests are often the product of transnational regulatory networks, which scholars

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<sup>38</sup> Stavros Gadinis “The Financial Stability Board: The New Politics of International Financial Regulation” (2013) 48 *Tex. Int'l L.J.* 157.

<sup>39</sup> Warren Clarke “Creating the Financial Stability Forum: What Role for Existing Institutions?” (2014) 28 *Glob. Soc.* 195.

<sup>40</sup> Camilo Soto Crespo “Explaining the Financial Stability Board, Path Dependency and Zealous Regulatory Apprehension” (2017) 5 *JLIA* 302

<sup>41</sup> Stavros Gadinis, above n 38 at 160.

<sup>42</sup> Rodney Bruce Hall & Thomas J. Biersteker (ed) *The Emergence of Private Authority in Global Governance* (1st ed, Cambridge University Press, Cambridge, 2002) at 3.

have found to cut across the seemingly arbitrary confines of the state in order to achieve its outcomes.<sup>43</sup>

While tempered with reservation concerning the involvement of domestic politicians acting on the international stage, in a seemingly loosely arranged organisation, Gadinis' point concerning the significance of political involvement in these forums is brought to light when compared with other large non-state organisations such as the International Accounting Standards Board (IASB) or the International Swaps and Derivatives Association (ISDA).<sup>44</sup> The IASB and ISDA operate on a world scale influencing state and domestic policy in less than democratically elected ways. Annelise Riles' anthropological piece on the day-to-day workings of the ISDA highlighted how the ISDA would achieve its objectives through aggressive lobbying at state level or by circumventing domestic law altogether by electing which jurisdiction's law would prevail in the event of a dispute between two international parties.<sup>45</sup>

Gadinis notes here that the priorities and implementation strategies of these networks, such as the IASB and ISDA, reflect the preferences of the participating regulatory officials, with little to no input from their elected governments.<sup>46</sup> While recognising the support for the separation of politics from financial regulation in addressing global challenges, Gadinis is quick to point out that a system run purely by industry experts, fails to take into account any biased perspectives they may possess coupled with a lack of accountability to the general public.<sup>47</sup> Here, Gadinis suggests that the FSB is the first serious attempt at bringing some order to a decentralised policy making sphere, remedying any suggestion of democratic deficiency by having elected officials represented in the G20, with its aims being executed by the FSB.

While state representation of the G20 governs 85% of the world most powerful economies, there is no recognition of the remaining 15% of nations that make up the rest of the world's economy, or how these marginalised countries contribute to their economies through trade and services. Consideration of the world's economies can apparently be boiled down to representation by 20 powerful nations and the elite membership of FSB. Perhaps this what Gadinis meant when suggesting that in creating the FSB the governments of the most *important* jurisdictions in the world

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<sup>43</sup> Anne-Marie Slaughter "The Real New World Order" (1997) 76 *Foreign Aff.* 183.

<sup>44</sup> Stavros Gadinis, above n 38 at 162.

<sup>45</sup> Annelise Riles "Private Global Governance, Legal Knowledge, and the Legitimacy of the State" (2008) 56 *Am J Comp Law* 605 at 606.

<sup>46</sup> Stavros Gadinis, above n 38 at 162.

<sup>47</sup> At 163.

have sent a strong signal about the future of international financial regulation.<sup>48</sup> While Gadinis' assesses the relative usefulness of a centralised regulatory institution like the FSB, operating in conjunction with the G20 as "executive coordinators" in harmonising the various standard setting bodies with relevant ease, he also finds no fault within the organisational structure of the FSB itself.

When comparing the FSB with its predecessor the FSF, Gadinis notes that the FSB has two main institutional advantages, an expanded membership warranting wider international influence and a tighter governance structure.<sup>49</sup> Significantly, he finds that due to its institutional mechanisms, the FSB gives politicians an important role in shaping the reform agenda and determining the priorities of international standard-setters. Gadinis notes that the FSB is not a passive entity operating in a proactive fashion, in asking international standard-setters to develop rules in a specific direction, either in response to a G20 request or of its own initiative. Gadinis finds that due to the composition and powers of the Plenary in allowing politicians to gather first-hand information about how countries are implementing rules, means that they are able to intervene where certain rules will pose a risk to global financial system.

Finally, Gadinis suggests in relation the continuous information sharing between the G20, FSB, international standard-setters, domestic regulators and politicians, that such information gathering could add to the "sense of accountability and commitment to a common cause as standard-setters and individual states present their progress of their setbacks to the Plenary."<sup>50</sup> Reference is again made to the fact that the FSB's recommendations are non-binding, but faith in membership accountability is high fostered by an elevated sense of institutionalised peer pressure, in providing information to other governments about each member's progress in implementing agreed standards. The relevance of which could equate to the sharing of a disappointing report card, without any threat of detention or being grounded. Gadinis continues to discuss the relationship of the FSB with the G20 in great detail which ultimately comes together in the conclusion that the FSB is the new and improved executive arm of the G20, far outweighing the usefulness of its predecessor due to its expanded membership and scope.

### *B What Role for Existing Institutions?*

Warren Clarke's piece on the emergence of the FSF provides a useful insight into the context in which the FSF was formed. While theoretical explanations are provided

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<sup>48</sup> At 175.

<sup>49</sup> At 166.

<sup>50</sup> At 167.

to understand its function and purpose, Clarke finds that these only answer some of the questions that surround the existence of yet another financial regulatory body, particularly given the FSF's unusual creation, evolution and design.<sup>51</sup> Clarke notes that at the time of the FSB's creation, several financial institutions already existed, with expertise and mandates similar to the FSB's today, such as the IMF, BIS and World Bank. As noted, the FSF was established under similar circumstances as the creation of the FSB, soon after the 1994 Mexican Peso Crisis and the 1997-1999 Asian Financial Crisis.<sup>52</sup> Clarke canvasses power-based, soft law and neo-liberal theories in assessing the rationale for the existence of the FSF in light of the densely populated arena of financial regulation institutions.

Accordingly, the power-based theory, applied in this context, suggests that powerful states and institutions created the FSF as a vehicle for realising their own preferences, so as to legitimise internationally recognised financial standards and codes.<sup>53</sup> This theory aligns with observations made above that the FSB exists in part as the executive extension of the G20 and BIS. To this end the FSF was seen by developing countries as a means of allowing powerful economic states like the U.S. and E.U. to lobby together and leverage against its capital in the market place to ensure compliance with standards that reflected their interests were introduced and upheld by the FSF. However, concerns over the FSF's legitimacy were not limited to the developing nations but also senior politicians, such as the then Finance Minister of Canada, Paul Martin, noting that it was a mistake to limit the FSF to exclusive and powerful states.<sup>54</sup>

While the FSF commenced with great promise, the standards endorsed by it appeared to reflect the domestic regulatory practices of the U.S. and to some extent the E.U.<sup>55</sup> This factor combined with the voluntary nature of the programmes overseen by the FSF led to systemic failures of compliance by the U.S of its standards in the lead up to the GFC. The FSF lacked any ability to monitor or enforce compliance of its members and its ability to influence dissipated as a result.<sup>56</sup> Furthermore, FSF meetings were later described as a 'chore' and officials quickly regarded them as repetitive and lacking clear direction.<sup>57</sup> While these factors

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<sup>51</sup> Warren Clarke, above n 39 at 195.

<sup>52</sup> Randall Germaine "The Financial Stability Board" in Thomas Hale and David Held (eds.) *Hand-book of Transnational Governance* (Malden, Polity, 2011).

<sup>53</sup> Warren Clarke, above n 39 at 200.

<sup>54</sup> Strauss-Kahn cited in Ngaire Woods "Who Should Govern the World Economy: The Challenges of Globalization and Governance" (2011) 9 *Renewal* 75 as cited in Warren Clarke, above n 39, at 198.

<sup>55</sup> Warren Clarke, above n 39 at 198.

<sup>56</sup> Eric Hellenier "What Role for the New Financial Stability Board? The Politics of International Standards after the Crisis" (2010) 1 *Global Policy* 283 as cited in Warren Clarke, above n 39 at 198.

<sup>57</sup> Paul Blustein "How Global Watchdogs Missed a World of Trouble" (2012) CIGI Papers, No. 5 at 14 as cited in Warren Clarke, above n 39, at 199.

go some way in explaining the revitalisation of the FSF in the form of the FSB in 2009, they do not address or explain, as Clarke indicates, the advent of an additional regulatory forum in amongst a myriad of other international bodies that already exist with largely the same purpose as the FSB. These concerns were raised by a group representing the IMF at the time of the FSF's creation and suggested "strengthening existing instruments of international cooperation appears to be the best way of proceeding, instead of experimenting with new institutional modalities".<sup>58</sup>

Clarke concludes by noting that the circumstances in which the FSB's predecessor was created provides some reasoning as to its existence, but ultimately finds that they are unsatisfactory.<sup>59</sup> Given the unique role the FSB occupies as a central forum for financial regulatory governance, more attention from scholars of international institutions is required as accounts available to date only provide accounts of the FSB's functionality. This is evidenced in Gadinis' article above. In light of the lack of academic scrutiny on the FSB, Clarke is only able to rationalise its existence in the context of the existing institutional environment in which it emerged. The implication here being, but for the resources and imperatives of the IMF and BIS, the FSB would cease to exist.

### *C Path Dependency and Zealous Regulatory Apprehension*

Clarke's explanation of the FSF's failings combined with Gadinis' suggestion that the FSB is more politically inclusive can be seen in Soto Crespo's finding that the FSF's move from elite membership to the FSB's wider membership is more democratic. This, Soto Crespo suggests, indicates a positive step forward taken by the national financial regulators to increase democratic involvement.<sup>60</sup> While limited insight has been provided in the literature or through the institutional material itself as to the rationale for the organisational structure and operation of the FSB, Soto Crespo suggests that the FSB operates effectively through informal international soft law practices. While outlining the arguments for and against this type of legal structure, Soto Crespo then attempts to answer the question as to why the FSB operates under these conditions concluding that regulators are reluctant to relinquish state power and there is a path-dependency which leaves the FSB without an international legal personality or ability to making legally binding instruments.

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<sup>58</sup> International Monetary Fund "Developing Country Ministers call for Comprehensive Reforms of International Monetary System" *IMF Survey* (Washington, 10 May 1999) at 153.

<sup>59</sup> Warren Clarke, above n 39, at 215.

<sup>60</sup> Camilo Soto Crespo "Explaining the Financial Stability Board, Path Dependency and Zealous Regulatory Apprehension" (2047) 5 *JLIA* 302 at 307.

In order to explain the concept of path-dependency, Soto Crespo poses the question of why states turn to international organisations in seeking recourse to disputes. International organisations are a literal and figurative space used by states to resolve their coordination problems,<sup>61</sup> noting that in more traditional international law arrangements, differences can be resolved through the treaties the agreements are based on.<sup>62</sup> International organisations are also another mechanism for states to legitimise their adherence to rule-making processes. This reliance on soft-law mechanisms to international law by states is becoming more attractive given that national regulators “can retain the ability to wield the rules of the international financial game through soft-law standards that conform to their points of view, and which countervail the need for achieving consensus with more stakeholders that formal venues and treaty-making would require.”<sup>63</sup>

While the ability to use soft-law instruments is attractive due to its flexibility and non-binding nature, it raises issues of procedural fairness and democratic legitimacy by being able to circumvent the rigours of due process. Furthermore, Soto Crespo suggests that the attraction towards soft-law instruments is in part maintained by state regulatory agents’ reluctance to relinquish state power. To this end Soto Crespo elevates the role of national regulators above that of elected politicians and suggests that given their expertise they are the most important actors in the financial legal arena. Not only are national regulators involved in forums where other state regulators meet, they inject their own technocratic expertise into the discussion contributing to the rule making process at the international level.<sup>64</sup>

As noted by Soto Crespo, the FSB would be considered by Vabulas and Snidal as an informal international intergovernmental organization (IIGO), being distinguished from the more formal international organisation as something less than due to its informal processes, lack of international legal presence, non-binding recommendations and informal origins. While less than, in terms of traditional international law arrangement, states will still choose these types of forums when it is in their interests to:<sup>65</sup>

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<sup>61</sup> Jan Wouters & Jed Odermatt “Comparing the ‘Four Pillars’ of Global Economic Governance: A Critical Analysis of the Institutional Design of the FSB, IMF, World Bank and WTO (2014) 17 J. Int’l Econ. L 49 as cited in Camilo Soto Crespo, above n 60 at 319.

<sup>62</sup> Jose Alvarez, International Organisations as Law-Makers 48 (2005) as cited in Camilo Soto Crespo above n 60 at 319.

<sup>63</sup> Camilo Soto Crespo, above n 60 at 307.

<sup>64</sup> At 324.

<sup>65</sup> Felicity Vabulas & Duncan Snidal “Organization without delegation: Informal intergovernmental organizations (IIGOs) and the spectrum of intergovernmental arrangements” (2013) 8 Rev. Int. Org. 193 at 219 as cited in Camilo Soto Crespo, above n 60 at 310.

States opt for less formality by using IIGOs when the advantages of lower sovereignty and negotiations costs, flexibility and speed outweigh the need for enforcement commitment, consensus, and the bureaucratic centralization.

Soto Crespo's article considers the external factors impacting on the FSB's informal nature, suggesting that the FSB will remain an IIGO. This, upon reflection, ties in with the underlying objectives of its creation in being a facilitator and coordinator of varying international standard-setting bodies. It also aligns with the G20's vision that the FSB should be nothing more than a coordinator, explicitly denying it warrant to become an independent legal personality.<sup>66</sup>

#### *IV Theoretical Overview*

While international organisations suffer criticism for dependency on state power for legitimacy and authority, much can be done to increase their standing as transparent and responsible international citizens. Accordingly, Grant and Keohane provide mechanisms in which institutions can employ to increase their accountability and therefore legitimacy. While the FSB monitors compliance of its members in a supervisory role, there is a lack of supervision or monitoring of the FSB itself, and it is for those reasons Grant and Keohane's accountability mechanisms fall short with respect to the FSB. Nanz and Steffek on the other hand, provide a useful commentary on how international organisations can increase transparency and accountability through increased public participation and the release of internal policy documents. However, due to the FSB's make-up, elusive legal presence and lack of procedural framework, these mechanisms again fall short of holding the FSB to account.

#### *A Accountability*

Given the proliferation of international originations that operate on the world stage, coupled with the absence of any form of global democracy, Grant and Keohane suggest that mechanisms should be implemented in order to improve accountability to limit abuses of power in world politics. Not only do they suggest reform, but also helpfully identify seven examples of accountability mechanisms in order to identify opportunities for improving protections against abuses of power at the global level.<sup>67</sup> Importantly, the authors recognise that improved accountability mechanisms will not resolve abuses of power without general agreement on what accountability entails.<sup>68</sup> The authors define accountability as a term that allows

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<sup>66</sup> At 326.

<sup>67</sup> Ruth W. Grant & Robert O. Keohane "Accountability and Abuses of Power in World Politics" (2005) 99 *Am. Political Sci. Rev.* 29.

<sup>68</sup> At 29.

actors the right to hold other actors to a set of standards and to judge whether they have fulfilled their responsibilities in light of the standards, they further state:<sup>69</sup>

Accountability presupposes a relationship between power-wielders and those holding them accountable where there is a general recognition of the legitimacy of (1) the operative standards for accountability and (2) the authority of the parties to the relationship (on to exercise particular powers and the other to hold them to account).

The authors further note that such a relationship forms an obligation between the parties to act in ways which are consistent with accepted standards of behaviour in fear of sanctions for failing to comply. The FSB's model does not sit easily under this definition. While holding no legal authority itself, the FSB does monitor the compliance of member states financial bodies to international national standards without any mechanism for sanction in the event of breach. However, when considering the accountability of the FSB itself, the relationship shifts. The FSB only ever answers to the G20 under an informal memorandum of understanding, providing the board of the G20 with an annual report, outlining its various projects (as dictated by the G20) and expenses, funding of which comes from a separate entity altogether. The mischief, if any, appears to be in the FSB's facilitation of powerful regulatory agents coming together to determine what standards best serve their individual interests. Without any internationally recognised legal presence, or significant power to duly, or more importantly, unduly inflict on member states, the FSB by in large escapes calls to account.

Conversely, in applying the FSB's model to Grant and Keohane's Supervisory model of accountability, internal governance and accountability can be seen at work. The FSB's member states and institutions would be the relevant "accountability holders", the FSB's Plenary being its executive board, comprising of state representatives that make policies with ad-hoc sub-committees formed with the sole purpose of ensuring members are complying with those polices. Grant and Keohane suggest that supervisory relationships are more or less democratic as states are more or less democratic,<sup>70</sup> however such parallels cannot be easily drawn in relation to the FSB where they suggest it is states that supervise the body in question where here it is the reverse in that the FSB is supervising state compliance. While Gadinis would agree with the supervisory model being democratic, involving politicians in the rule-making process, that relates to member compliance and no the compliance of the FSB itself.

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<sup>69</sup> At 29.

<sup>70</sup> At 36.

Grant and Keohane's fiscal accountability model may hold some relevance to the FSB model. The authors suggest that funding agencies can demand reports from and ultimately sanction agencies that are recipients of funding.<sup>71</sup> While such a model can be more readily applied between truly independent bodies, the FSB's funding arrangement is not clear. While references are made in the annual reports to an extended funding agreement between the BIS and FSB,<sup>72</sup> there is no provision of that agreement available for review and it is therefore difficult to assess whether or not the FSB can be sanctioned or have its funding pulled. Such a decision will undoubtedly rest with the BIS, however so long as the FSB fulfils the aims and goals of the BIS, G20 and IMF, it is difficult to imagine circumstances in which the FSB would be sanctioned, particularly given its close association with each of these entities.

The peer accountability model of the FSB relates to the compliance of its member states with international standards, as coordinated and regulated by the FSB Plenary, Steering-Committee and ad-hoc sub-committees. Grant and Keohane's peer accountability model relates to the mutual evaluation of organisations by their counterparts.<sup>73</sup> While the FSB has a peer review mechanism; it is not used to determine the FSB's compliance with international standards compared to its peers. The difficulty here is identifying the relevant organisational equivalent of the FSB, given its existence as a subset of the G20 and fiscal recipient of the BIS. Given the FSB's informal legal composition and non-profit model, Grant and Keohane's market and legal models of accountability fall short here as well.

## *B Public Participation and Transparency*

While international organisations can operate effectively through transnational networks, cutting across the arbitrary confines of bureaucratic processes,<sup>74</sup> they have often been criticised as being democratically deficient.<sup>75</sup> Democracy at the international level is understood by Nanz and Steffek as a "framework of social and institutional conditions that facilitate the expression of citizens' concerns and ensures the responsiveness of political power."<sup>76</sup> They say that democracy in this sense has the ability of increasing legitimacy by ensuring the conditions for high

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<sup>71</sup> At 36.

<sup>72</sup> Financial Stability Board *4<sup>th</sup> Annual Report: 1 April 2016 – 31 March 2017* (Financial Stability Board, Annual Report, 27 December 2017) cl 2.6 at 29-30.

<sup>73</sup> Ruth W. Grant & Robert O. Keohane "Accountability and Abuses of Power in World Politics" (2005) 99 *Am. Political Sci. Rev.* 29 at 37.

<sup>74</sup> Annelise Riles "Private Global Governance, Legal Knowledge, and the Legitimacy of the State" (2008) 56 *Am J Comp Law* 605 at 606.

<sup>75</sup> Eyal Benvenisti *The Law of Global Governance* (1<sup>st</sup> ed, Hague Academy of International Law, Holland, 2014) at 17.

<sup>76</sup> Patrizia Nanz and Jens Steffek "Global Governance, Participation and the Public Sphere" (2004) 39 *Gov. Oppos.* 314 at 318.

quality decision-making includes access to affected citizens (or elected officials) in this process. While public access to policy making at the domestic level can easily be reduced to voting in periodic elections, the authors note that citizens are also active at state level through involvement in political parties, interest groups, social movements and civil society associations.<sup>77</sup>

In elevating the import of the global citizen, Nanz and Steffek argue that democratic legitimacy at the global level must ultimately depend on the creation of an appropriate public sphere.<sup>78</sup> In recognising the rather technocratic environment of global governance (political elites and experts), the authors do not envisage any transnational public sphere as a distinct or overarching realm but rather a model of functional decision-making and meaningful participation in deliberate forums of governance arrangements.<sup>79</sup> Accordingly, in order for 'deliberate democracy' to work it must ensure citizens' concerns feed into the policy-making process and are actually taken into account when decisions are made with binding effect.<sup>80</sup> In addressing some of the practical limitations to coordinating the public voice at the international level, the authors suggest that the process need not ensure that everyone participates but rather organisations ensure the public opinion is formed from reliable information gathering sources and considered with appropriate weight in the decision-making process.

The authors demonstrate their theoretical approach to the democratisation of global governance by applying it to the processes of the WTO. They find that while steps have been taken by the WTO to become more transparent, by making policy and other relevant documents publicly available, these changes would not have come about expect for the efforts of and sustained campaigns by civil society, in particular activist Non-Governments Organisations (NGO).<sup>81</sup> They suggest that moves towards transparency would be expedited and facilitated by the creation and maintenance of a public sphere, the communicative space where arguments on the merits and defects of international governance are generated and negotiated.<sup>82</sup> Given the FSB's function to regulate and monitor market risk, there is an underestimated and somewhat unconscious public interest. It is suggested that such mechanisms, if applied to the context surrounding the FSB, would bring the FSB out of the shadows and into the public sphere, available for public scrutiny.

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<sup>77</sup> At 317.

<sup>78</sup> At 315.

<sup>79</sup> Stijin Smismans "The European Economic and Social Committee: towards Deliberative Democracy via a Functional Assembly" (2002) 4 ELoP 12 as cited in Patrizia Nanz and Jens Steffek, above n 76 at 315.

<sup>80</sup> At 320.

<sup>81</sup> At 327.

<sup>82</sup> At 333.

While Gadinis and Crespo Soto would suggest that the FSB is more democratically evolved than its predecessor, involving elected officials at its plenary meetings, Nanz and Steffek recognise that involvement of these officials is a highly indirect one, arising out of the national government they represent as opposed to the collectively of world citizens.<sup>83</sup> With that in mind, a healthy level of scepticism should be applied when considering the FSB's self-acclaimed obligations to public consultation and accountability. According to article 3 of its' Charter, the FSB's requirement to consult, extends to its Members, stakeholders and Regional Consultative Groups.<sup>84</sup> Encouragingly, subsection (2) also provides for a structured process for public consultation on policy proposals. However, much like its procedural guidelines, article 3 is qualified with discretionary solace of 'should'.

While the FSB makes mention of these consolatory requirements, they are in essence only recommendatory without any mandatory requirement to ensure the public is in fact consulted. The FSB's accountability provision at article 4 of its Charter is even more perverse stating:<sup>85</sup>

The FSB will discharge its accountability, beyond its members, through publication of reports and, in particular, through periodical reporting of progress in its work to the Finance Ministers and Central Bank Governors of the Group of Twenty, and to Heads of State and Governments of the Group of Twenty.

While honourable mention is made to the public provision of reports and further reporting on its work to its relevant stakeholders, there does not appear to be any objective standard with which to measure whether the FSB truly discharge its obligations of accountability. The FSB's affirmative stance on discharging its accountability obligations combined with the discretionary requirements to consult is self-serving and lacking in substance. To this end, and in line with Nanz and Steffek's empirical findings with respect to the WTO, what matters is the availability of comprehensible information for all those that seek it.<sup>86</sup> The FSB could do more enhance transparency by providing better access to information concerning its structural arrangement and relationship with its parent entities.

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<sup>83</sup> Patrizia Nanz and Jens Steffek "Global Governance, Participation and the Public Sphere" (2004) 39 Gov. Oppos. 314 at 314.

<sup>84</sup> Financial Stability Board *Charter of Financial Stability Board* (Financial Stability Board, Charter, June 2012) ("Charter") at art 3.

<sup>85</sup> At art 4.

<sup>86</sup> At 329.

## V Conclusion

The FSB occupies a fascinating space within the global governance environment. It was borne in part out of a desire to remedy the shortcomings of its predecessor while maintaining its main function as a financial market watchdog. The FSB acts as a centralised regulatory forum for ensuring member compliance with relevant international standards. Given its illusory legal presence, it achieves its objectives through soft-law mechanisms such as peer pressure and reputational risk.<sup>87</sup> Due to its inability to sanction members or enforce decisions the FSB's legitimacy is called in question, however, given the G20's instruction that the FSB be nothing more than a coordinator, it is somewhat unsurprising that it lacks international legal personality. To this end, the FSB is in effect the G20's executive branch, fulfilling its objectives by facilitating a forum for its members to consider policy and standards to be applied across the financial landscape.

The literature suggests that while vast improvements have been made to make the institution more democratically inclusive, this should be considered in light of its predecessor, which had limited mandate and lacked stakeholder interest. It is suggested that given the FSB's presence as a central coordinator of regulatory frameworks and financial standards, there is a striking absence of theoretically commentary on the FSB's place in the global governance regime. While the FSB's Charter and Guidelines are publicly available, they are riddled with discretionary qualification and are easily manipulated, as evidenced by the recent term extension of its Chair. The good work of the FSB, if any, is undermined by its elusive framework for decision making, and lack of transparency, public participation and accountability.

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<sup>87</sup> At 326.

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