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INTERNATIONAL REGULATION OF GLOBAL SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

In the wake of the financial crisis, the U.S. and the EU have taken steps to provide for the resolution of systemically important financial institutions to limit the consequences of their failure. But the lack of a formal mechanism to ensure cooperation, the author argues, could perpetuate the problems of systemic risk because the response to a failing institution is likely to be fractured. What is needed, he believes, are binding cross-border agreements between key home and host country regulators.

By Edward F. Greene *

The financial crisis that hit us in 2008 highlighted that financial markets are currently so global and interconnected that the failure of a systemically significant financial institution engaged in cross-border activity, such as Lehman Brothers, can wreak havoc on markets outside its home country.

The Group of Seven countries (the “G-7”)¹ responded. It decided first that an effective global response, which all agreed was necessary, would require expansion of the G-7 to the Group of Twenty (the “G-20”).² The G-20 quickly came to the conclusion that reform of the financial markets was critical. In its view, the existing regulatory structure was imperfect both in identifying activities and entities that posed systemic

risk to global financial markets, as well as with respect to the structure in place for supervising and resolving global systemically important financial institutions, which I will call “G-SIFIs.” These are institutions whose failure would affect global markets, not just their home markets. It was also recognized that there were key linkages to overseeing G-SIFIs that if coordinated would reinforce regulatory effectiveness: enhanced supervision on a coordinated basis between home and host country regulators; revised capital standards that would have greater loss-absorbency, as well as eliminating the perceived cyclicality created by Basel II; reduced risks of interconnectivity among financial institutions; and coordinated cross-border resolution of failed or failing G-SIFIs through enhanced and flexible powers to wind up financial institutions, so-called resolution powers.

THE STATUS OF GLOBAL STANDARDS

In Pittsburgh in 2009, the G-20 identified key areas that would require implementation by each member of

¹ The G-7 includes Canada, France, Germany, Italy, Japan, the U.K., and the U.S.

² The G-20 includes (in addition to G-7 members) Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, and the EU.

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