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Book Review

Systemic Risk, Institutional Design, and the Regulation of Financial Markets,
Anita Anand, ed. (Oxford, UK: Oxford University Press, 2016) 221 pp. C \$80

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This book is a collection of papers written by some of the leading academics in the field of financial regulation from around the globe. The various chapters effectively explore “the related concepts of systemic risk and institutional design of financial markets”.¹ This book is broad in its scope as it “addresses both domestic and international approaches to regulation”.²

According to the authors, the book is geared towards a narrow audience of academic experts. The preface states that this book “will be useful for academic law researchers who study financial system design and systemic risk. For those involved in policy-making, the book will be informative given the increased focus on macroprudential regulation as the broad policy framework within which systemic risk is to be addressed.”³ However, this book should also be of interest to lawyers practicing in the fields of financial law and banking law, financial regulators, policy-makers and economists.

In Chapter 1, “Institutional Design and New Systemic Risk in Banking Crises”, Professors Anita Anand, Michael Trebilcock, and Mr. Michael Rosenstock examine “banking crises with regards to both commercial and other financial institutions”.⁴ They note that “[s]ystemic risk has also developed to extend well beyond the formal commercial banking sector to include shadow banking and the cross-border dimensions of the phenomenon”.⁵ They conveniently refer to this as the “new systemic risk” (NSR).⁶

*332 The authors “argue for more integration and coordination among institutions charged with systemic risk oversight and regulation, both domestically and internationally, recognizing that the existing set of institutions developed at a time when a more restricted conception of systemic risk prevailed.”⁷ They “argue for greater emphasis on coordination among domestic financial regulators”⁸ through the “increasing use of memoranda of understanding (MOU)”⁹ to monitor, manage and enforce regulatory oversight of the NSR. For example, they correctly note that “there is little agreement among countries regarding harmonizing the regulation of cross-border [over-the-counter] OTC derivative transactions”.¹⁰ They also note that credit rating agencies are not adequately regulated by new legislation.

In conclusion, the authors argue that at the domestic level

the objectives-based approach is the most likely to facilitate the coordination necessary to mitigate NSR while allowing uncompromised prudential and business conduct regulation ... At the

international level, [they] propose an expanded use of soft law including MOUs among countries to bind them to a system of monitoring and managing the NSR”.¹¹

In Chapter 2, “Perspectives on Regulating Systemic Risk”, Professor Steven L. Schwarcz focuses on trying to prevent excessive corporate risk-taking by arguing that regulation should target managers in their personal capacity instead of imposing firm-level liability. The author correctly notes that “[a]nother reason why systemic shocks are inevitable is that the financial system is constantly changing. As a result, systemic risk regulation will often lag financial reality.”¹²

Professor Schwarcz convincingly argues that managers of systemically important firms should owe a duty to the public.

Because corporate risk-taking can impact the public in addition to impacting investors, one way of controlling excessive risk-taking would be to require the managers of a systemically important firm to run the firm as agents not merely for the investors but also for the public. To that extent, such managers would not only have a private corporate governance duty to investors but also a “public governance duty” to society not to engage in excessive risk-taking that could systemically harm the public.¹³

Overall, he concludes that since systemic shocks are inevitable, “regulation should therefore be aimed at protecting the financial system from the impact of those shocks.”¹⁴

*333 In Chapter 3, “Law, Financial Instability, and the Institutional Structure of Financial Regulation”, Professor Dan Awrey tries to provide an answer to the fundamental question: “what role, if any, does institutional structure play in advancing the objectives of financial regulation?”¹⁵ The author notes that “the law is an important and often neglected part of the story. By paying closer attention to contractual, legislative, and regulatory frameworks which together comprise the structure of the financial system, we may therefore be able to better understand the causes of financial stability.”¹⁶

Professor Awrey highlights that the “regulatory authorities on both sides of the Atlantic failed to adopt a coordinated approach toward the identification, monitoring, and response to potential threats to financial stability.”¹⁷ In line with the observations made by the other authors in this book, he notes that “in an increasingly globalized and interconnected financial system, the institutional structure of financial regulation at the domestic level may be less important than an effective global regulatory architecture.”¹⁸

In Chapter 4, “Further Assessment of the Iron Law of Financial Regulation: A Postscript to Regulating in the Dark”, Professor Roberta Romano provides a very dark account of the failures of the *Dodd-Frank Act*. This chapter leaves a bitter after-taste that uses a tone that does not gel well with the rest of the book. Professor Romano notes that “we would appear to have learned very little from the recent crisis.”¹⁹ She uses a part of this chapter to launch personal attacks against Barney Frank by calling him a “poorly informed and highly partisan political actor.”²⁰

She also criticizes the creation of the Consumer Financial Protection Bureau (CFPB) for being an administrative agency that is “formally insulated from political accountability.”²¹ She argues that the “most troubling aspect of the CFPB's

unique insulation from congressional oversight, however, is that it has facilitated policy-making that evades democratic accountability and that, on occasion, has been of questionable lawfulness.”²²

However, in order to provide a more balanced approach, Romano should have highlighted some of the major achievements of the CFPB in protecting retail consumers since it was created. These include, *inter alia*, the \$1 billion fine imposed on Wells Fargo related to auto loans and the guidance issued to consumers about the risks of investing in crypto-currencies.

***334** As the CFPB is an administrative agency that is entirely independent of the executive branch and placed entirely within the Federal Reserve System, Romano has highlighted that congressional committees are unable to impose budgetary restrictions on the CFPB. However, Romano does not stress that consumer protection is an important goal, and it appears that the CFPB was intentionally set up this way so that Congress could not strip it of its budget, which is a real risk under the current administration in the US. Ultimately, Romano argues that CFPB should have been a sunset agency so that Congress could revisit its authorization in the future.

In Chapter 5, “Reflections on Financial Crises, Regulation and Sunsetting”, Professor Edward M. Iacobucci responds to Professor Romano's arguments on including sunset provisions in new legislation. He critiques her position and argues that it is unnecessary to include sunset provisions in crisis legislation because “crisis legislation is better informed than pre-crisis legislation, and thus from a Bayesian perspective is at least presumptively better.”²³ Therefore, he favours permanent legislation over temporary legislation.

In Chapter 6, “China's Long March to Dismantling the Financial Great Wall: RMB Internationalization and Macroprudential Policy”, Dr. Weitseng Chen has argued that by internationalizing the RMB without adopting macroprudential policies, China has underestimated the dangers posed by systemic risk. He argues that the RMB cannot become an international reserve currency until it becomes “freely convertible”,²⁴ which China plans for the year 2020. However, he notes that lifting capital controls could increase investment bubbles. Consequently, he argues that systemic risk could be triggered by the rapid pace of the RMB's internationalization. “Until the domestic banking and financial industries are overhauled, systemic risk will continue to grow unchecked in China.”²⁵

Dr. Chen also notes that shadow banking has liberalized China's financial sector; however, there are serious concerns with respect to systemic risk when complex products and services are being offered to the public. Furthermore, the size of the shadow banking industry is estimated to be RMB 25 trillion as of the end of 2013 (approximately 43% of China's GDP). Therefore, the Chinese government has to keep a close eye on these developments. He concludes that “China's financial industry as a whole has become ‘too-big-to-fail’, and this is not only a problem for Chinese regulators but also its trading partners around the world.”²⁶

In Chapter 7, “Emergency Liquidity Assistance and Systemic Risk”, Professor Rosa Maria Lastra adopts a comparative perspective in the analysis of the emergency liquidity assistance/lender of last resort facility (ELA/LOLR) ***335** and discusses this instrument in the prevention and containment of systemic risk. She argues that “the interconnectedness of financial markets has rendered financial stability as a ‘national, regional and international goal.’ This makes it a global public good that ‘does not stop at national borders’.”²⁷ Furthermore, she makes a critical point that “the central bank should not lend to insolvent institutions though, of course, it is difficult to define insolvency.”²⁸

Finally, she concludes that a clear legal framework is needed that “sets out LOLR policies and procedures in advance *ex ante*, but leaves ample discretion to act and establishes adequate accountability *ex post*. Flexibility and speed are essential.”²⁹ She observes that

[t]oday's interconnectedness of financial institutions and markets and the nature of funding markets suggest that support should be granted without unnecessary restrictions against collateral to solvent financial institutions to counteract the risk of contagion ... We need to think outside the boundaries of national law to find solutions to the challenges we face.”³⁰

Overall, this book is unique because it provides divergent opinions and sometimes conflicting views on how to best regulate the international financial system and contain systemic risk. It is an enjoyable and informative read that I would recommend to anyone who is interested in expanding their knowledge on financial regulation and systemic risk from a legal perspective.

Footnotes

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- 1 Anita Anand, ed., *Systemic Risk, Institutional Design, and the Regulation of Financial Markets* (Oxford, UK: Oxford University Press, 2016) at vii (preface).
- 2 *Ibid.* at vii (preface).
- 3 *Ibid.* at x (preface).
- 4 *Ibid.* at 2.
- 5 *Ibid.*
- 6 *Ibid.*
- 7 *Ibid.* at 5.
- 8 *Ibid.* at 6.
- 9 *Ibid.* at 6.
- 10 *Ibid.* at 13.
- 11 *Ibid.* at 37.
- 12 *Ibid.* at 42.
- 13 *Ibid.* at 54.
- 14 *Ibid.* at 59.
- 15 *Ibid.* at 62.
- 16 *Ibid.* at 79.

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- 17 *Ibid.* at 79
18 *Ibid.* at 96.
19 *Ibid.* at 100.
20 *Ibid.* at 106.
21 *Ibid.* at 118
22 *Ibid.* at 119.
23 *Ibid.* at 136.
24 *Ibid.* at 146.
25 *Ibid.* at 161.
26 *Ibid.* at 174.
27 *Ibid.* at 180.
28 *Ibid.* at 185.
29 *Ibid.* at 205.
30 *Ibid.* at 205-206.

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