ABSTRACTS

‘Corporate Governance in the European Union: The Day after tomorrow’

Stelios Andreadakis
Oxford Brookes University

Following the wave of scandals and collapses in both the United States and Europe, corporate governance became the most popular item for discussion in the agenda. Hundreds of pages have been written and several opinions have been expressed about the optimal form of regulation, but we are still far from reaching consensus. The Sarbanes-Oxley Act was the American response to the voices asking for strict rules and severe penalties. The European Union adopted a more cautious and liberal approach, choosing the path of harmonisation and convergence. The Action Plan represents the roadmap for the future, but it is still not clear what will be exactly the corporate regulation in the European Union in the following years.

The vexed issue of Short Sales regulation
Why Prohibition is Inefficient and Disclosure Insufficient

Dr Emilios Avgouleas
University of Manchester

In September 2008, in the middle of precipitous market price falls and of an impending financial catastrophe most developed market regulators declared a nearly worldwide ban on short sales in financial sector stocks. The ban was in accord with a widespread belief that has long regarded short selling as aggressive speculation that destabilizes financial markets and raises concerns about their economic and moral foundations. However, many empirical studies indicate that short sales are, in fact, a beneficial source of market liquidity and information efficiency. This view is confirmed by studies on the September 2008 ban in the US and the UK, which show that the ban did not yield any concrete welfare benefits, especially in terms of reduction of price volatility. On the contrary, it had an adverse impact on liquidity. The market abuse rationale, offered as the main justification for the September 2008 ban, is also unconvincing. Furthermore, US and European regulatory orders to ban short-sales revealed how disparate are the regimes governing cross-border securities trading in international securities markets including the EU markets. This paper argues that the best way to regulate short sales is through a dual strategy of disclosure and downward price limits, so-called circuit breakers, which lead to a temporary halt in trading rather than a prohibition or an uptick rule. The combination of disclosure and circuit breaker short trading halts preserves liquidity enhancing short sales and the valuable information that these trades carry, while it checks downward price pressures, due to market irrationality and herding. Arguably,
the FSA’s and the SEC’s recent proposals to amend their rules on short selling are in the right direction, yet they remain incomplete. In the same mode, IOSCO’s draft principles, which are supposed to eliminate inconsistent national regulatory regimes that impede cross-border trading, are so high level that they cannot close the gaps. Therefore, the endorsement of the two prong regulatory strategy proposed in the paper could provide the foundations of a global framework for the regulation of short sales, since its implementation would lead to rather compatible national regulatory regimes.

‘What makes a director fit? - An analysis of the workings of section 17 of the Company Directors Disqualification Act 1986’

Professor Alice Belcher, University of Dundee

Under the Company Directors Disqualification Act 1986 (CDDA 1986) a director can be found to be “… unfit to be concerned in the management of a company.” However, the Act also permits a disqualified director to apply to the court for leave nevertheless to act as a director. This article explores the concept of director “fitness” in the context of recent corporate governance developments and by analysing some of the cases brought under section 17 of the CDDA 1986. It concludes that the a court’s decision to grant leave to serve as a director whilst disqualified is not just a matter protecting creditors or the public, which can be argued in relation to the disqualification itself, rather the granting of leave must also be an ongoing governance matter. There is a mismatch of the standards applied in section 17 cases and recent corporate governance developments.

‘What Future for Principles Based Regulation?’

Professor Julia Black
London School of Economics and Political Science

Two years ago, principles based regulation (PBR) was being heralded by policy makers on both sides of the Atlantic as ‘the’ regulatory solution. But in the wake of the credit crisis, the attraction of principles based regulation has been severely dented. PBR has been ousted from the FSA’s lexicon. For, in Hector Sants’ memorable phrase ‘Principles based regulation cannot work for people who have no principles’. Instead, the FSA has ditched the PBR strapline in favour of ‘outcomes based regulation’ and ‘intensive supervision’.

Indeed, the FSA had invested so much reputational capital in the idea of PBR since early 2007 that it in effect had to choose but to withdraw that product from the market, in effect, and to have a re-launch. But is this the same product under a different, more austere label, or have there been real changes which mean that it is in effect a different product? In other words, is this the end of PBR, or just a modification of it? Moreover, moving beyond financial services, what are the implications of the tarnishing of the PBR brand for regulatory approaches in other regulatory domains? Has the reputation of PBR been so sullied that no self-respecting regulator can now advocate it as a responsible approach to regulation? If so, what does this tell us about the relevance of the impact of the broader political context on the
approach that independent regulatory agencies take. We have been told that firms need a ‘social’ licence to operate; do regulators need a similar ‘political licence’?

The paper explores the different forms of PBR, its inherent paradoxes, and evaluates the apparent shift in the FSA’s regulatory approach in the wake of the crisis.

---

Systemic Risk and Derivatives: The Limitations of Bankruptcy
Robert Bliss
Wake Forest University

Derivative contracts enjoy three key protections in bankruptcy. There are 1) the ability to net exposures between counterparties, 2) the ability to unilaterally terminate contracts under certain events of default, and 3) the ability to liquidate collateral. While netting of other contracts is supported in some jurisdictions and not in others, termination is an exception to stay imposed on most other contracts, as is the liquidation of collateral without judicial approval. These carveouts were motivated by arguments that they were necessary to reduce systemic risk in derivatives markets. Ironically, these protections also led to the creation of a highly concentrated dealer market—that is, to the creation of systemically important firms. Large derivatives dealers are systemically important because they are counterparties to hundreds of thousands of contracts that would all need to be replace simultaneously if a dealer failed, due to the protection of closeout rights. Staying closeout rights would be even more disruptive as counterparties are locked in positions of rapidly changing values with no ability to manage their exposures. The events have shown that guaranteeing or bailing out derivatives contracts and/or major market participants is frequently necessary, as the orderly determination and allocation of losses through bankruptcy proceedings is impossible.

---

‘Corporate Governance in China: The Derivative Action Dimension’
Dr Qingxiu Bu
School of Law Queen's University, Belfast

China’s expanding economy has steadily integrated with Western sophisticated market economies and capital market, which are bound together in a complex web spanning multiple jurisdictions. The prospective financial failure is, to some extent, a matter of international concern. The administrative and criminal sanctions prove inadequate against the pervasive financial irregularities. With the enactment of Company Law 2006, a derivative action scheme enshrined in Article 152 has been introduced to make up for deficiencies of the current supervision and regulation. The paper examines to what extent the new three-pillar regulatory mechanism will reshape the development of China’s corporate governance with a particular emphasis on shareholder’s remedies.

The paper starts with defining contexts where the regulatory machine is run including, among other things, the culture, shareholding structure and other political and social settings. Second part goes to why the administrative and criminal sanctions fail to serve its deterrent functions with substantial changes of China’s capital market. The key issue as to why the civil remedial tool through derivative litigation is indispensable is highlighted in the paper, followed by an analysis of challenges China faces to integrate it into an efficient enforcement system. Last but not the least, a hypothesised optimum regulatory regime is to be explored prior to a tentative conclusion.
‘Insiders-Outsiders, Transparency and the Value of the Ticker’

Dr Giovanni Cespa
Queen Mar, University of London

We consider a multi-period rational expectations model in which risk-averse investors differ in their information on past transaction prices (the ticker). Some investors (insiders) observe prices in real-time whereas other investors (outsiders) observe prices with a delay. Hence, the level of transparency is higher when more investors are insiders. While a higher level of transparency always promotes informational efficiency, full transparency is never socially optimal. Rather, the Pareto optimal market structure is either fully opaque or has limited transparency (that is, both insiders and outsiders coexist in the market). We also show how a market for price information can implement the socially optimal level of transparency. In this market, the price of price information acts as a Pigovian tax, in that it is set optimally high to curb excessive acquisition of ticker information.

Steroid Hormones and trader risk preferences

Dr John Coates
University of Cambridge

Alan Greenspan has lamented that economics will never have a perfect model of risk. The problem, he said, is that economists cannot fathom the will-o-the-wisp of market sentiment. Yet today neuroscience and endocrinology may help us understand these troublesome spirits. For the waves of irrational exuberance and pessimism that destabilise the financial markets may be driven by naturally produced steroid hormones.

‘Can the Opaque be Made Transparent? A Study of Complex Toxic Financial Products’

Professor M.A.H. Dempster, University of Cambridge,
Dr E.A. Medova, University of Cambridge and
Professor Dr J. Roberts, University of Munich

It has been said that thirty per cent of derivatives are "bought" and seventy per cent are "sold" -- meaning that the smaller percentage is exchanged between professionals able to make sophisticated assessments of the risks involved, while the remainder are sold to people and institutions who have no idea what they are purchasing. This paper is based on an analysis of over seventy cases of complex fixed income and foreign exchange derivative products recently sold to wealthy individual investors, local authorities and firms by major continental banks with little or no indication to the client of the risks entailed. All these
underlying cases now involve potential or actual litigation. In this paper we will abstract from the underlying specific cases in order to characterize the nature of the products, categorize common seller misbehaviour and make suggestions as to what should have been conveyed to the client before purchase. Some of these suggestions could appropriately be incorporated into buyer protection legislation and future regulation guidelines for banks.

‘Chance, corruption or capture? ‘Credit crunch’, regulators & democracy’

Professor Nicholas Dorn
Erasmus University, Rotterdam

This paper considers three approaches to analysis of the circumstances leading up to systemic instability in financial markets: rational choice, ‘bad apples’ and institutional capture of financial regulation by the markets. Rational choice analysis, focusing on legitimate market players, suggests how ‘risk appetite’ and innovation shifted the boundaries of commercial practice, evading regulation and eventually undermining markets. ‘Bad apple’ perspectives, which locate market irregularities and corrupt practices primarily in a small minority of market players, nevertheless raise questions about continuities between financial market innovation and fraud. Regulatory capture provides a meta-narrative on ‘what went wrong’, by providing insights on the dominance, within regulatory thinking, of rational choice and bad apple theories – which together go some way to explain regulatory compromise and quietism and the emergence of the crisis. The paper argues against an exclusionary notion of regulation that would make it a matter of discussion and coordination conducted solely between those possessing technical expertise, separated off from moral questions, public politics and debate amongst citizens. Equally the paper argues against the exclusion of normative issues that characterises much of the literature on socio-cultural bases of markets. It is proposed that the literature on security governance and ‘public goods’ might be deployed to open up public debate on financial regulation, reversing regulatory capture.

‘A European Perspective on Consumer Loans and the Role of Credit Registries: the Reconciliation between Data Protection, Risk-Management, Enhanced Efficiency, and a Better Prudential Supervision of the Financial System’

Dr Federico Ferretti,
Brunel Law School

The paper examines the role of Credit Registries in the context of European consumer credit markets. It attempts to show the institutional challenges relating to some competing rights and interests among consumers, financial institutions, and the need for a strengthened prudential supervision of the financial system as evidenced by the recent crisis whose effects have spread into the global economy. In particular, it shows that there is a conflict between the right to data protection of consumers, the risk-management interests of lenders, and the prudential supervision of the credit system. The ultimate goal is to show some weaknesses of the current arrangements and to put forward a proposal that is probably controversial but that is intended to stimulate a debate on the topic.
‘Lessons from Japan’s Banking Crisis, 1991-2005’

Professor Mariko Fujii
RCAST, University of Tokyo
(joint work with Masahiro Kawai, Asian Development Bank Institute)

The Japanese government failed to tackle the financial crisis in the 1990s promptly because of the slow development of the crisis, underestimation of the severity of the crisis, optimistic expectations of growth, and lack of domestic and external constraints. A comprehensive framework for bank resolution established after the 1997–98 systemic crisis was more decisive. The related problems were eventually mitigated by a series of policies since that period, aided by an export-led economic recovery.

Japan’s economic history suggests that it is vital for the government to devise new ideas about providing adequate incentives to banks, or even to tighten regulatory measures, as was done in Japan in 2002. Economic stagnation would cause new NPLs (nonperforming loans) to emerge rapidly, and may virtually deplete bank capital. If the authorities cannot address the banking sector problem promptly, then the crisis will prolong and economic recovery will be substantially delayed.

‘Regulation and the Role of Law in Economic Crisis’

Dr Ioannis Glinavos,
Kingston University

This paper contributes to the current debate as to responses to the crisis and the role of law in paving a way out of recession, by highlighting the persistence of market centred theories that defined the state market relationship before the crisis. The paper begins by discussing the concept of regulation itself and discusses the extent to which the credit crunch has shaken belief in modern capitalism. The paper then offers a discussion on the relationship of deregulation to financial crisis, arguing that there is a direct link between the receding reach of the state and market instability, drawing analogies with previous instances of market failure, like the Great Depression. On the basis of this connection, a theoretical portrayal of perceptions of the role of law in modern capitalism is attempted, where the main message is that dominant modern perceptions of the state market relationship allow a role for regulation but still do not recognise the state as the legitimate author of such regulation, showing a preference for market-led solutions. The paper then tests these findings against state actions in response to the credit crunch and concludes by offering the suggestion that while the current financial crisis has shown the limitations of modern capitalism, and while it is possible that a fundamental rethink of the role of the state in the market may take place as a consequence, this rethink has not yet materialised in policy proclamations and government aspirations on a global scale.

‘Law reform or flexible regulation? The case for reforming insurance contract law’
Several key principles of insurance law were developed in the nineteenth century, and codified in the Marine Insurance Act 1906. There is a consensus that these principles are unsuited to a mass consumer market. However, the insurance industry has long opposed reform. Instead it has relied on successive layers of self-regulation, FSA rules and ombudsman guidance.

This paper examines and rejects the arguments for "soft law" in this area. It sets out the reasons why the English and Scottish Law Commissions believe that Parliament should now reform the 1906 Act, rather than continue to rely on FSA rules and Financial Ombudsman Service discretion. The Commissions intend to publish a draft Bill on consumer insurance law by the end of the year.

---

'Three Models Of Derivatives Regulations Some Thoughts On The Entanglement Between The Economic Theory And The Evolution Of Law'

Dr Mariusz J. Golecki, Ph.D., LL.M. Cantab. Cambridge University & University of Łódź

The paper aims at scrutinising whether the evolution of options, futures and other derivatives is an effect of a wider impact of the evolution of financial market and economic theories upon legal system. This constitutes, however, a part of a wider topic, namely the legal approach to risk, uncertainty and speculation. Thus it is crucial to examine whether recent regulation of financial markets and exempting such transactions as options, futures or swaps, performed by set-off from existing anti-speculative regulation (or abolishing of the majority of anti-speculative rules) may have a wider impact on the notion of risk in private law. The theory of efficiency of common law will also be scrutinised from this point of view, accordingly with the “origin of law” hypothesis (La Porta et. al 2008) and the “incompleteness of law” theory (Pistor & Xu 2002, 2003). These characteristics should include the examination of the existing legal regulations in reference to the Coase theorem and the assumptions purported by transaction costs economics. The prima facie thesis is that recognition of risk-shifting legal instruments may be a next step on a long way of the immanent evolution of this system toward higher efficiency.

The final part of the paper will concentrate on the notion of evolution of law as a process induced by the change of the economic theory (in light of the previous scrutiny on the relation between legal theory and regulation and underlying economic theory and policy recommendations concerning derivatives and in a broader sense the speculation as a kind of market activity). The brief look at the American deregulatory reform justifies some skepticism toward any theory of linear legal evolution, especially in a form of the “incomplete law theory”. It seems that there is no determinism as far as the alleged evolution of the financial regulations is concerned. Additionally the dynamic growth of financial
innovation does not facilitate the regulatory task. The question remains how to combine innovation with security under the conditions of uncertainty (the normative uncertainty hypothesis). The normative theory of regulation would favor “dynamic efficiency” and the capability to adopt the regulation to changing circumstances rather than fixed regulatory approach, concentrated on one particular purpose. The future regulatory frameworks will have to be responsive and multi-purposive. Three different kinds of regulatory frameworks could possibly be distinguished: transaction-oriented regulation, institution oriented regulation and market oriented regulation. It seems that the evolution of the regulatory regimes could usefully be analyzed against this analytical framework. The market oriented model of regulation has not accidentally been adopted by the European Commission (MiFID 2006) and many other jurisdictions including Germany, France and Poland. Additionally the move in the same direction has already been announced by the US Secretary of the Treasury, Timothy F. Geithner.
"Unusual and Exigent Circumstances"
‘The Role of the U.S. Federal Reserve in the Recent Financial Crisis’

Professor Christian A. Johnson
University of Utah College of Law

The U.S. Federal Reserve has committed hundreds of billions of dollars in unprecedented lending activities over the past fifteen months based upon its interpretation of an untested clause in the Federal Reserve Act. This expansion of authority exercised by the Federal Reserve not only has significance in today's financial crisis but also sets a precedent for future Federal Reserve actions.

This paper/presentation will analyze the Federal Reserve's lending and intervention in the U.S. and international capital markets based on its interpretation of the "unusual and exigent circumstances" clause of Section 13(3) of the Federal Reserve Act. Section 13(3) provides that:

In unusual and exigent circumstances, the Board of Governors of The Federal Reserve System, . . . may authorize any Federal reserve bank, . . . to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange . . . provided, That . . . the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions.

The Federal Reserve has relied on that authority to authorize the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Commercial Paper Funding Facility, Money Market Investor Funding Facility, Primary Dealer Credit Facility and the Term Asset-Backed Security Loan Facility. Each of these represent a significant divergence from the traditional lending activities performed by the Federal Reserve.

Based on the analysis of Section 13(3) and the newly authorized programs and facilities, the paper will critique or support the Federal Reserve's aggressive actions based on Section 13(3). In addition to the legislative and regulatory research on Section 13(3), the paper will provide an in depth analysis of the specific actions taken by the Federal Reserve programs and how they differ from past responses.

‘Legal Governance of Global Financial Markets: The Experience of Asia’

Dr Takeshi Kawana
Kokugakuin University, Japan

The financial crisis which originated from the U.S. subprime loan problems expanded and did harm globally in an instant. Europe has severely suffered from the problems because many financial institutions purchased a lot of securities products like CDOs which involved the above loans. Though Japan had less influence from the crisis at first because only a few financial institutions were concerned in the securities products, the economy has severe damage due to its reliance on the U.S. economy. Asian countries such as China and India had also strong damage in spite of the decoupling theory, but their recent economic conditions
and stock exchange indices are getting better than the developed countries’. This reflects the expectation to Asian countries’ potential growth.

However, even though the influence of the current financial crisis to Asian countries is relatively smaller than the developed countries, it cannot be ignored completely because developing and developed countries are not divided in the global markets as the decoupling theory says. Therefore, developing countries should be involved in legal regulatory framework as well as political and economic dialogue in order to establish global financial market governance robustly.

On the basis of the above ideas, this article discusses three issues: 1) how the current financial crisis influenced Asian countries or not, and what measures the governments/central banks take to tackle the crisis; 2) What schemes were constructed in Asian region after 1997 Asian financial crisis to prevent the future crises; 3) how Asian countries should be involved to global financial market governance like G20, International Monetary Fund, Financial Stability Board, etc.

‘The Financial Reporting Review Panel’

Bill Knight,
Chairman, Financial Reporting Review Panel

This paper gives an account of the operation of the Financial Reporting Review Panel, the UK regulator aiming to enforce compliance with the law relating to accounts and with accounting standards.

The Panel is one of the most experienced accounting enforcers in the world. Its closest counterpart is the SEC. Unlike the SEC however the Panel operates a system of peer review and aims to operate on the basis of agreement with the companies whose accounts it reviews.

The Panel was founded in 1991. It has the power, delegated from the Secretary of State for Business Innovation and Skills, to apply to the court for an order requiring directors to re-issue the accounts or the directors’ report. It has not yet taken a case to court.

This is the London approach to accounting enforcement. The paper gives an account of the methods used by the Panel for selecting accounts for review and the way in which a case will proceed. It discusses the issues which the Panel believes to be important – confidentiality, operation by consensus and a reluctance to substitute its judgment for the judgment of a properly informed board of directors. The paper concludes by referring to current issues, including the extension of the Panel’s remit to cover narrative reporting.

‘Taking a Reform of Capital Market Law Seriously: A Turkish Example’

F. Banu Kring
Izmir University of Economics, Turkey

Today, there is worldwide competition not only between the capital markets, but also between their legal regulations, which is compelling national lawmakers to update and develop their systems, in order to be able to understand and withstand the crisis of the financial markets. At 40%, Turkey’s foreign investor participation rate in the capital market is very high and continuously increasing. In order to encourage the foreign direct investment
in Turkey, the reformation of an effective financial law system is *conditio sine qua non*. As a European Union Membership Candidate, Turkey has shown regulatory evolution of its financial systems similar to that of European countries. Since the first law in the late 1920s, Turkey has continued to experience statutory regulation in financial markets, which was formerly French-German dominated, and now Anglo-American dominated. From a statutory regulation based on a bank dominated financial system towards a reform of Capital Market Law based on Anglo-American capital-market dominated system, the analysis of Turkish and European regulations can be enlightening for all compared law systems. The present paper critically examines the legal regulatory similarities and differences in a broader context and argues that aspects of maturity and essentiality of such capital market law reform are both convincing. Comparing the way these legal systems were regulated in the world’s leading capital markets in the past, the outcomes of the research have implications for the efforts of the Turkish Lawmaking body in regulating the capital market law, in terms of the future orientation and levels of support for such regulations.

‘*Whose Mortgage Is It Anyway? Producers, Consumers and The Law in the UK Mortgage Market*’

**Professor Patrick McAuslan**  
**Birkbeck College, University of London**

A paper on the subject of mortgages with the above title covers the following topics:

- A survey of the public law of mortgages: Financial Services Authority (FSA) and Consumer Credit Act;
- A survey of the financial and economic context of mortgages with particular reference to securitisation of mortgages and the Crosby and Miles Reports on mortgages commissioned by the Treasury in 2004 and 2008;
- A more detailed discussion of the problems in the current law and regulatory framework of mortgages with particular reference to defaults and repossessions
- Suggestions for changes in law and practice including new forms of mortgages and new regulatory provisions.

‘*How to Fund UK Deposit Protection: The Future for the FSCS*’

**Catriona McCollam**  
**Nottingham Law School**

This paper examines deposit protection offered to UK consumers. It focuses on the potential future organisation of the Financial Services Compensation Scheme in the light of some of the weaknesses that have been highlighted by the credit crunch of the scheme.

This paper offers a normative perspective on deposit protection funding, ignoring EC law requirements that mandate particular methods of funding. The paper considers the need for deposit protection and evaluates how best to fund such protection drawing on the rationales that underpin deposit protection, international experiences and academic commentary. The paper considers the arrangement of the scheme prior to the run on Northern Rock, the
changes made in response to the crisis and possible methods for funding the scheme in the future. Finally, the paper concludes by offering a suggestion for the future funding of the FSCS.

Bank Failure and Deposit Protection in Offshore Britain: The Case of Guernsey

PE Morris and L Lawton
University of Lancaster

Purpose - The global financial turmoil of 2008 spilled over into the British Isles offshore jurisdictions of Guernsey and the Isle of Man resulting in the collapse of two local subsidiaries of major Icelandic banking groups and consequent depositors’ losses. This paper contrasts the sharply differing reactions of the insular authorities and critically evaluates Guernsey’s recently enacted deposit protection scheme.

Design/ Methodology/ Approach - The paper outlines the nature of the Guernsey jurisdiction, its offshore development and policy issues in deposit protection. Legislation establishing Guernsey’s deposit protection scheme is described and critically evaluated.

Findings - Guernsey’s scheme is a rushed legislative reaction dominated by finance centre reputational concerns. The legislation is clear and comprehensive but the long-term robustness of its funding model is unclear.

Originality/value - The analysis contained in this paper highlights the ramifications of international bank instability in small offshore jurisdictions and the regulatory problems this poses. Discussion of the legislative basis of the deposit protection scheme clarifies its nature and limitations as an investor protection technique, which is timely given the status of deposit protection as a key theme in the United Kingdom government’s initiated Foot Review of nine offshore jurisdictions.

Key Words - Banks, Guernsey, Isle of Man, offshore finance centres, deposit protection, legislation

Paper type - Research paper


Dr Dieter Pesendorfer
Queen’s University, Belfast

The monumental crisis of global financial markets since 2007 and the subsequent economic downturn have led to a fundamental change in debates about financial and economic regulation. Many critics of Neoliberalism hope that this ‘policy window’ will result in a paradigm shift and a completely new system based on a ‘New (Green) Deal’, on tight regulation within a new global financial architecture and a revival of Keynesian state intervention. This paper focuses on two core areas – the debates about ‘financial innovation’ and about the EU draft Directive on Alternative Investment Fund Managers – to explore specific problems of highly complex areas within the financial sector. In both cases, experts from the private sector, public authorities and academics are warning about possible
problems and huge negative effects of overriding regulation and emphasis the importance of innovation in financial markets and of private equity and hedge funds in dealing with certain risks. Without them regulators would risk reducing future economic growth significantly. In this paper I will argue that without linking the overall debate with discussions about a precautionary approach in risk regulation and the future of economic growth under the overall paradigm of sustainable development it will be unlikely to expect any radical policy change. Unfortunately, it is argued, these discourses are not linked systematically up to now and we already see watered-down proposals for new regulation.

‘Harmonization, International Standards and the new Financial Order’

Priya Pooran

The past 12-18 months has produced a range of challenges and lessons for financial institutions throughout the global financial system. Questions have arisen in all sectors as to what has caused the regulatory problems and why, why these were not foreseen and what could have been done to prevent these. This has presented national regulators and frameworks with an urgency to question the basic efficacy, continuing validity and effectiveness of the current framework and model for regulating the financial markets and the cross-border business transactions in the international financial sector.

The crisis has unleashed a myriad regulatory concerns on both sides of the Atlantic, produced many valuable lessons for the regulatory approach but more importantly, it has brought into question the issue of whether the current approach for regulation of financial institutions is appropriate in the current environment. Among the issues arising from the crisis are questions as to the quality of assets being securitized and the nature of risk transfer, the efficacy of current approaches to risk management as well as the broader issues of the use and supervision of new structures and techniques which are constantly evolving and with which national regulators often fail to keep pace.

The crisis has undermined the confidence of investors in the global economy but has also brought into question the degree to which the international regulatory architecture effectively responds to and has kept pace with the scope and pace of growth and innovations in the development of new products and cross-border transactions.

It has highlighted the need to re-examine the role and importance of harmonization, in particular harmonized regulatory regimes, in providing a more reliable, consistent and effective framework for regulating the global financial sector. A model based on national or single jurisdiction dominance is outdated¹ and cannot respond effectively to this. Harmonization is central to the new regulatory response to support the level of innovation in the markets and the pace² of development in the international financial markets.

As a prelude, let me discuss what I mean by “harmonization” here. I am referring to the extent to which greater consistency in regulatory regimes within federal systems and more importantly on a cross-border, cross-jurisdictional basis would provide a more reliable basis

---

¹ Increasing complexity of financial products, need to keep pace with growth and innovation in types of financial instruments, financial products and risk management techniques and cross-border international transactions. A rules based approach cannot cater to the constantly changing nature of the markets and the innovations in risk transfer. It means an inefficient regulatory framework because it will by necessity be a step behind the markets and not a good indicator of possible failure of give good warning signs.

² The pace of development means that the instruments and techniques in the financial markets are constantly changing.
for regulation of the banking and non-banking sectors. It will examine different regulatory models based on greater standardization of regulations, increased recognition of the regulatory regimes of foreign jurisdictions and greater reliance on international standards in financial regulation and supervision. This will include increased provision and exchange of information among supervisory authorities, the power of regulators to have access to information relevant to the financial condition of entities no matter where located and heavier reliance on a principles-based approach instead of rules-based frameworks for governance.

‘The Crash that Launched A Thousand Fixes: Regulation of Consumer Credit after the Lending Revolution and the Credit Crunch’

Professor Iain Ramsay and Professor Toni Williams
University of Kent

There have been many reforms of consumer credit and overindebtedness regulation during the past decade in both developed and developing countries. The first years of the 21st century in the UK were characterised by a flurry of inquiries, reports, task forces, legislation, regulation and soft law on consumer credit, overindebtedness and financial inclusion. The credit crunch which followed the “lending revolution” has stimulated fundamental reappraisals of consumer credit regulation and the UK government promises a White Paper which will “initiate a debate on the long term vision for consumer credit in the UK”. Key issues are the balance between availability and safety of credit and the relative role of private and public regulation. There remain differences between countries on these issues with contrasts drawn between “Anglo-Saxon” approaches to regulation which emphasise freedom to obtain credit and European jurisdictions such as France which are more likely to protect an individual from the credit market.

This paper explores an influential international model of consumer credit regulation, outlined in World Bank documents, which emphasises the importance of (a) positive credit reporting and credit scoring (b) truth in lending (c) financial literacy and (d) ombudsmen as central aspects of an efficient consumer credit market. These institutions are justified in terms of information failures on both the supply and demand sides of the market and enforcement costs. Measures such as interest rate ceilings or the use of market regulation to redistribute the costs of market transactions are rejected. The paper analyses the limits of this model both in terms of behavioural models of consumer behaviour and equitable goals of achieving affordable access to credit. The paper then discusses the role of ex ante public regulation of credit markets. Some US authors have proposed a consumer credit safety commission, as a supplement to existing regulation. The central features of this proposal resemble well-established regulatory techniques in the UK, namely the whole market licensing powers of the Office of Fair Trading and Financial Services Authority. The paper briefly examines recent regulatory actions and practices by the FSA in relation to sub-prime lending and payment protection insurance and reflects on the potential capacity of this model of public credit regulation.

---


4 See DBERR and “Building Britain’s Future (Treasury, Budget 2009).
Corporations’ collapses and financial scandals often lead governments to take legislative action aimed at restoring investors trust in financial markets. Generally, these reforms are characterized by a tendency to increase the accountability of management and the vigilance on corporate affairs. The influence of this trend can be easily recognized in the development of Irish companies’ legislation, especially in the evolution of provision regarding restriction or disqualification of directors, inspections powers, and reckless or fraudulent trading.

In this context, the enactment of the Company Law Enforcement Act, 2001,\(^5\) which introduces an independent statutory enforcement agency, can be seen as a natural step towards a more restrictive approach to company law. The CLEA, 2001 was introduced as a reaction to the damage made by corporate collapses, corporations’ financial problems, and abuses of company law to the reputation of Ireland as a safe place to do business.\(^6\) However, introducing new legislation in order to deal with public disquiet is not a unique phenomenon and it can easily be recognized in other jurisdictions as well.\(^7\)

However, empirical studies in the area of corporate law tend to correlate corporate law flexibility with positive investors perceptions.\(^8\) Given that, the question that arises is whether the policy implemented by the Irish legislators has the power to achieve its purposes and instill investors' trust in the financial market.

In order to answer this question, this research empirically analyses the effect of the CLEA, 2001 on the Irish stock market using event study methodology. Event studies have been regarded as among the most successful uses of econometrics in policy analysis. The methodology provides an anchor for measuring the impacts of an event on investor wealth and offers a fruitful means for evaluating the welfare implications of a given policy.\(^9\) Through this research, four linked events related to the enactment of the CLEA, 2001 were investigated for suspicious patterns. The results reveal that in contrast to the desired, the changes introduced by the CLEA, 2001 created statistically significant negative abnormal returns. In other words, the changes introduced had a negative effect on the perception of investors.

Given the results, the author concludes that intervention directed to achieve stability and trust in financial markets should be done with care. The tendency to use the traditional field of company law to achieve other regulatory purposes might lead to quite the opposite of company law as a framework for competitive business: more compulsory rules, heavier monitoring and enforcement regimes, and slower, more cumbersome and burdensome, procedures. Thus, combating fraud and abuse of companies should be carefully achieved without hindering the development and use of efficient company law structures and systems.

\(^5\) The Company Law Enforcement Act, 2005 (hereinafter: The CLEA 2001)
\(^6\) 523 Dáil Deb. col 1100 (Oct. 5, 2000).
\(^7\) See, for example, JS Baker Jr ‘Reforming Corporations through Threats of Federal Prosecutions’ 89 Cornell L Rev 310, 339, illustrating the American experience.
\(^8\) R Romano The Genius of American Corporate Law (The AEI Press Washington D.C. 1993)
‘The new shape of credit institutions in the future: implications on competition of the bail out plans in the European Union’

Dr Costanza Russo
University of Trento, Italy.

Since October 2008 European member States implemented recapitalisation and guarantee plans to support the banking sector. Such plans, although different, are based on common agreed principles at EcoFin level, stating that they should be limited in scope and time, that State involvement must be confined to the minimum, that shareholders should bear the consequences of interventions and that Governments should protect competition. In light of the special circumstances due to the current serious disturbance in the economy and in the financial sector, European Commission provided guidance as to the framework within which the State aid compatibility of the bail out plans could be assessed. The Commission recognised as compatible with State aid rules those plans that were: temporary, non discriminatory and that had a significant contribution from the private sector. In so far all the national plans have been considered compatible with art. 87 of the Treaty. However, it appears that a more correct analysis of the relevant EU decisions on this matter could only be conducted in a longer term perspective. Indeed, if we look at the main characteristics of the most important European measures, we could argue that the role of the State would be more than “temporary” and less than “profitable” for the taxpayers. Moreover serious moral hazard problems might arise. Eventually, it seems that those “compatibility decisions” might instead lead to a new financial market structure where competition would be seriously hindered.

‘Does Credit Expansion Matter for Growth? What the Data Show’

Professor Prabirjit Sarkar
Jadavpur University, Kolkata, India;
Visiting Fellow, CBR, University of Cambridge

This paper analyses the relationship between expansion of domestic credit to private sector relative to GDP and growth for a sample of 65 less developed countries over a long period, 1980-2006. Using causality tests at various lag-orders we find a strong evidence of mutual causation. We have used alternative dynamic panel data models such as mean group, pooled mean group and dynamic fixed effect. Hausman test suggests dynamic fixed effect model. While the mean group model suggests no relationship in either direction, the other two models show two opposite long-term relationships: credit-to-growth relationship is negative whereas growth-to-credit link is positive.
‘A market based approach to the identification and regulation of systemic risk’
Margarita Sweeney-Baird,
University of Birmingham

INTRODUCTION

Financial prudential regulation has traditionally focussed on micro-prudential regulation, which is the regulation of individual financial institutions. The assumption being that the financial soundness of each individual financial institution would ensure the financial soundness of the entire system. The current financial crisis has demonstrated that this assumption may be wrong and that financial prudential regulation has certainly failed. The failure in prudential financial regulation has been the result, in part, in the failure to understand the risks underlying many financial products and the incorrect valuation of those products. When defaults in the sub-prime mortgage market occurred losses extended far beyond the originators of the loans subject to the defaults and the systemic risks to financial institutions across the globe became apparent for all to see. To address the failure in prudential financial regulation fundamental reform is required and is under active consideration. The reform agenda recognises that relying on micro-prudential regulation is no longer sufficient and that it is wise to introduce macro-prudential regulation of systemic risks.

This paper examines the failure in prudential financial regulation and the proposed regulatory response to systemic risk regulation; firstly, by identifying the regulatory gaps in systemic risk regulation that have resulted in the failure of financial regulation and secondly, by exploring the theoretical justification for systemic risk regulation from a macroeconomist’s perspective.10

Then, thirdly the proposals for reform of systemic risk regulation by the G3011, G2012, the IMF13, the US14, the UK15, and the EU16 are considered. The difficulties in regulating the systemic risk of global financial institutions and institutions that are ‘too big to fail’ are also considered. These difficulties include: extraterritorial limitations on national supervisors, centralisation of risk management function, the extent of cross border activity, varying supervisory resources, the boundary problem of regulation, and the lack of an existing regulatory paradigm for systemic risk regulation.

Finally, drawing upon the theoretical justification for systemic risk regulation a market based approach to systemic risk regulation will be considered. This encompasses a disclosure based model of regulation that acquires information from the market participants and then provides disclosure of consolidated market information. The purpose of this is to allow the market to value systemic risk.17 There will be some consideration of the role of auditing and

12 The G20 London Summit, agreed statement and declarations; and, in particular the creation of the Financial Stability Board as a successor to the FSF and the relationship of the FSB to the rest of the global financial regulatory architecture including the proposed supervisory colleges.
14 The Department of the Treasury Blueprint and various US developments
15 The Turner Review and the FSA discussion paper, DP09/2
16 The De Larosiere report and various EU developments resulting from this initiative
17 A step in this direction has taken place in the amendment to DTR 5 from 1 June to extend the UK major shareholding regime to include disclosure of all long economic interests (The Disclosure and Transparency
accounting in this process and the need for a more extensive approach to risk management and systemic risk analysis through a ‘compliance auditor model’\textsuperscript{18}. The role of the various systemic risk regulators will then be considered and to what extent it is feasible for a national, regional and/or a global regulator to regulate the build up of systemic risk beyond the proposed ‘early warning system’.

This analysis will conclude with a consideration of the balance that will need to be struck in a market based approach to systemic risk analysis and the role of regulators in systemic risk regulation.

‘Re-assessing ‘sanctity’, reconfiguring ownership: conceptualizing an emergent framework of responsibility in sovereign debt’

Dania Thomas
Keele University

The legacy of the Argentine debt crisis continues to unfold, not least for its spectacular default. The eventual judge-mediated debt restructuring, the market-driven contract change and the increasing reliance on good faith as a market norm has on the one hand tempered creditor instincts to litigate and on the other made sovereigns litigation proof. With debt restructuring the preferred option, contemporary regulation dispels the view that there exists a private law doctrinal toolbox that can be used to resolve debt crises in the future. Thus, as far as the law is concerned this new post-Argentina regulatory environment is marked by uncertainty on several counts.

It is in this context that this paper maps the continuing (albeit marginal) relevance of the ‘sanctity of contract’ doctrine to enforceability. Secondly, as the marginal importance of sanctity shifts attention away from the contractual relationship between the debtor and the creditor to an incipient notion of property that ensures a creditors entitlement to participate in a debt workout, a new framework of creditor responsibility that spills over four corners of the bond contract emerges. This emergence questions the basis of recent calls for an international sovereign debt restructuring court and raises the issue of creditor responsibility for the social costs of a debt crisis.

‘Towards A New Corporate Governance:
Will the Financial Crisis change the World as we know it?’

Professor Roman Tomasic
University of Durham, Durham Law School

Two decades of corporate governance reform have not prepared the financial services sector to cope well with the pressures of the financial crisis. The collapse or near collapse of leading financial institutions in the United Kingdom and in other parts of the world has had a

\textsuperscript{18} The author has considered a potential role for a compliance auditor in providing a methodology for disclosure, see \url{http://www.voxeu.org/index.php?q=node/3266} and in a conference paper for the 7\textsuperscript{th} International conference on corporate governance on 29\textsuperscript{th} June 2009 and in a forthcoming article in the company lawyer.
number of causes; amongst the more important of these have been a lack of robustness in internal controls within banks and financial institutions. This may be described as a failure of corporate governance. Some of the variables that have affected the quality of corporate governance have been the role of the board, the capacities of gatekeepers, the nature of stakeholder governance and the presence of a robust corporate culture. The current crisis has illustrated the failure of key stakeholders such as boards, institutional investors and employees, to effectively contain rampant risk taking upon the part of the dominant management team. Voluntary corporate governance codes and the “comply or explain” self regulatory strategy of securing corporate accountability have also been called into question. Together, these failures suggest a broader structural failure in the fabric of corporate governance as it has evolved in recent decades; it also calls for a fundamental reappraisal of underlying strategies for achieving corporate accountability and control. This paper argues that more robust approaches to achieving good corporate governance will in future be necessary; amongst the most important of these is the embedding new values in the corporate culture of financial institutions, the creation of more effective internal monitoring structures, the strengthening of boards and a greater involvement of shareholders. This will not be easy as market actors will be tempted to minimise regulation and to return to discredited practices that they have been familiar with.

‘Of Corporations and Plumbers: Shareholder Voting Rights and Securities Clearing and Settlement in Europe’

Agata Waclawik-Wejman
Jagiellonian University, Cracow

In the recent years, the legal framework for cross-border voting in Europe in the intermediated securities environment is being developed, however in a fragmented and incomplete way. The problems with cross-border exercise of shareholder rights in Europe show that it is not possible to create an effective corporate governance framework without well-functioning capital markets infrastructure. While the EU Shareholder Rights Directive introduces measures improving issuer-shareholder communication and otherwise strengthening foreign shareholders’ voting rights, the core problems with cross-border voting are of a more technical nature and are related to the functioning of the securities clearing and settlement infrastructure. The fact that all shareholdings in listed companies across Europe are evidenced only as book entries on accounts maintained by intermediaries, results in the close relation of a sound cross-border securities clearing and settlement infrastructure – sometimes dubbed the plumbing of the capital markets – and the efficiency of the exercise of any rights vested in the shares, such as, most notably, the voting rights and rights to distributions (dividends, pre-emptive rights).

Thus, a significant link between company law and the law of book-entry securities exists. Three core issues are of relevance in this context: (i) the identification of the shareholder; (ii) the communication between the issuer and shareholders before, during and after the general meeting and (iii) third parties’ actions on behalf of the investor.

An effective and efficient cross-border exercise of shareholder rights is not possible without a sound legal framework for cross-border intermediated securities holdings. Consequently, the efficient exercise of shareholder rights in Europe will need to be a joint product of a number of European and international initiatives, both in company law (Shareholders Rights Directive), and securities law (The Legal Certainty Project and others). For example, the following legal solutions are still outstanding: (i) the EU-wide recognition
of cross-border multi-tiered intermediated securities holding systems, (ii) the regulation of duties of account providers with regard to corporate actions and voting. Those areas, covered by the recommendations of the Legal Certainty Group, are a necessary supplement to the measures already in place in the Shareholder Rights Directive.

Dr Michael Waibel
University of Cambridge

In recent years, sovereign debt crises have received much attention from the perspective of international public policy, but an effective legal solution to sovereign defaults has yet to coalesce within international law. Over the last two decades, private creditors have increasingly resorted to litigation in national courts, though without great success, in an effort to obtain payment on defaulted sovereign debt. Another, emerging option is arbitration—in particular, before the International Centre for Settlement of Investment Disputes (ICSID). Will ICSID be the new venue of choice for recovering on sovereign bonds? I conclude that such attempts to take defaulting countries to ICSID arbitration are unlikely to succeed.

‘Financial Crisis and Financial Market Globalisation – Is there a Case for Harmonisation of Securities Regulation?’

Susan Yin
Queen Mary, University of London

During the last two decades, financial markets have been globalising exponentially contributing to economic growth worldwide. However, the increase of market interconnectedness has led to a migration and amplification of risks, resulting in the global escalation of the financial crisis over the past two years. Securities markets have played an important part in the globalisation process, while securities market participants, investment banks and hedges funds in particular, have been blamed for the fall of the financial house of cards. Such has been the enormity of the current crisis that a re-thinking of the global governance framework is urgently needed alongside national law reforms. One of the central issues in global securities market governance (as this paper demonstrates) is whether and when there should be substantive harmonisation of securities regulation. The aim of the paper is to establish a prima facie case for harmonisation of rules and provide regulators with a general framework to analyse the issues for harmonisation.

The paper is divided into four parts. In part one, the globalisation of securities markets is described and global-level problems of securities regulation discussed with a view to demonstrate the inadequacies of the present governance regime based on national laws. In part two, the relevance of harmonisation for global market governance is explained through raising the research question. Part three examines the case for harmonisation using a methodology created on the basis of theories of economic regulation and real-world harmonisation. Finally, an analytical framework for harmonisation is laid down in part four before conclusions are drawn.
‘The Role of Law and Governance in Financial Market: The Case of Emerging Chinese Securities Market’

Dr Sanzhu Zhu
School of Law, SOAS, University of London

China’s securities market is a new and transitional market emerged in the process of China’s transformation from previous socialist and planned economy to a market economy. The paper examines the role of law and governance in the development of Chinese emerging securities market. After an introduction, Part II, in tracking the law, regulations and judicial rules in the regulation of securities market in China, examines the patterns of, and relationships between, the development of the legal, regulatory and judicial framework and procedures in China’s securities and futures market. Part III examines the role played by the law, regulations and judicial rules in shaping China’s commodity and financial futures market which had undergone a tortuous passage, as a prime example to show how important and crucial that an appropriate and balanced legal, regulatory and judicial framework should be put in place to ensure a healthy and sustainable development of a commodity and financial futures market in China. Part IV examines the role played by the people’s court in their dealing with investors’ civil compensation claims resulting from false statements made on the securities market, an area which demonstrates the importance that the regulation of China’s securities market and an effective tackling of securities fraud rely upon, in addition to other legal or administrative measures, a supportive and accommodating court with a set of appropriate judicial rules and procedures. Part V examines the way in which the role of law, the role of court, and the role of administrative authorities and their actions are entwined in the regulation of China’s securities market in the context of China’s overall administrative, economic, legal, social and political system. The paper submits that future development of China’s securities market calls for a further legal, regulatory and judicial reform in order to support for China’s securities market to move to a new level of scale and standards in compatible with China’s overall economic development and China’s establishment of the rule of law in the twenty-first century.