

The Independence of Domestic Financial Regulators: An Underestimated Structural Issue in International Financial Governance

Régis Bismuth*

Table of Contents

Abstract	94
A. Introduction	94
B. The Facets of Independence	96
C. The Risks of Independence	99
I. The Loss of State Unity on the International Stage	99
II. The Circumvention of National Democratic Processes	101
1. The Recognized Risk of Circumvention	101
2. The Unequal and Insufficient Democratization of Standard-Setting Procedures	102
III. The Circumvention of the European Democratic Process	105
1. Asymmetry: Domestic Regulators v. European Regulation	105
2. Comitology: European Regulators v. European Institutions	107
D. A Proposal: The Establishment of an International Standard- Setting Organization	108

* Ph.D. (Université Paris 1 Panthéon-Sorbonne), LL.M. (Columbia Law School, Harlan Fiske Stone Scholar). Research and Teaching Fellow in Public International Law, Université Paris 1 Panthéon-Sorbonne, Centre d'Étude et de Recherche en Droit International – CERDIN (since 2004). The author may be contacted at regis.bismuth@gmail.com.

Abstract

Among the myriad of institutions involved in the reshaping of the international financial system, several standard-setting bodies (the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the International Association of Insurance Supervisors) present the distinctive feature of being comprised of national independent regulatory authorities. The international activity of these independent authorities has complicated and blurred several aspects of the standard-setting process of the aforementioned international institutions. Despite being the product of a soft law process, international financial standards are in practice influential international rules. Given this *de facto* predominance, these standards result in a *fait accompli* for domestic or regional authorities which have no choice but to implement them, therefore bypassing the traditional democratic dimension of the law-making process. Although the standard-setting activities have progressively included consultation procedures, they have not completely corrected this flaw. Another problem stems from the presence of several domestic regulatory authorities representing the same state and rendering the decision-making process more complex at the international level. For these reasons, this article aims to demonstrate that the establishment of an international financial organization may correct these institutional gaps without necessarily call into question the soft law nature of the standard-setting process.

A. Introduction

While public attention following the recent financial unrest has mostly focused on the Group of Twenty (G20) summits, this latter collective action at the intergovernmental level should not eclipse the long-lasting normative activity of key standard-setting bodies such as the Basel Committee on Banking Supervision (the “Basel Committee”), the International Organization of Securities Commissions (“IOSCO”) and the International Association of Insurance Supervisors (“IAIS”). Among the myriad of institutions involved in international financial governance,¹ the distinctive feature of the

¹ For a brilliant and exhaustive overview, see, M. Giovanoli, ‘A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting’, in M. Giovanoli (ed.), *International Monetary Law – Issues for the New Millennium* (2000), 3-59.

Basel Committee, IOSCO and the IAIS is their membership, almost exclusively comprised of independent domestic financial regulatory authorities.

Occurring outside the customary diplomatic channels, these processes of cooperation have been described by some authors as “transnational” or “transgovernmental regulatory networks”². While raising some interesting issues of accountability, most of this literature has not precisely assessed the potential disruptive impact of the independence of domestic financial regulators on the effectiveness of international financial governance structures. Before discussing this issue in greater detail, the importance and influence of these standard-setting bodies shall be pointed out.

Despite remaining in the shadow of more notorious institutions, the Basel Committee, IOSCO and the IAIS have devised influential international financial standards favoring the harmonization and the mutual recognition of domestic regulations. In spite of their soft law nature, these standards have not only enjoyed wide implementation in domestic laws but have also been adopted or used as an assessment device by several international institutions such as the former Financial Stability Forum,³ the IMF and the World Bank,⁴ and the WTO.⁵ Reflecting this growing *de facto* influence, the G20 has recently invested the Financial Stability Board (FSB) – established as the successor to the Financial Stability Forum – with the mission of

² See, for instance, A.-M. Slaughter, ‘Governing the Global Economy Through Government Networks’, in M. Byers (ed.), *The Role of Law in International Politics – Essays in International Relations and International Law* (2000), 177-205; D. Zaring, ‘International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations’, 33 *Texas International Law Journal* (1998), 281-330; K. Raustiala, ‘The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law’, 43 *Virginia Journal of International Law* (2002), 1-92; P.-H. Verdier, ‘Transnational Regulatory Networks and Their Limits’, 34 *Yale Journal of International Law* (2009), 113-172.

³ R. Bismuth, ‘Le Système International de Prévention des Crises Financières. Réflexions Autour de la Structure en Réseau du Forum de Stabilité Financière’, 134 *Journal du Droit International* (2007), 57-83.

⁴ R. P. Delonis, ‘International Financial Standards and Codes: Mandatory Regulation Without Representation’, 36 *New York University Journal of International Law and Politics* (2004), 563-634.

⁵ R. Bismuth, ‘Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Financial Standards in WTO Law’, 44 *Journal of World Trade* (2010, forthcoming).

monitoring and coordinating the elaboration of international financial standards, including those of the Basel Committee, IOSCO and the IAIS.⁶

Actually, the soft law nature of these standards is incidental given the authority they unquestionably enjoy in practice. However, this unchallenged influence is not free from problems – some structural governance issues stemming from the international activity of independent regulators have arisen. The international impact of an ill-controlled separation of powers in national legal orders has indeed complicated, blurred and even made questionable several aspects of the standard-setting activity of the Basel Committee, IOSCO and the IAIS, the underlying issue being to what extent should these international norms be solely defined by independent experts.

Before pointing out the possible risks weighing on the legitimacy of these international normative processes (C.), it is necessary to highlight the scope of domestic financial regulators' independence and its institutional impact on standard-setting bodies (B.). These analyses will be used to suggest possible avenues for reform that have been overlooked by the G20 (D.).

B. The Facets of Independence

While it should be noted that financial regulators could not be classified in a single kind of public entity given the significant institutional differences between them,⁷ it is possible to highlight a similar status of independence to governmental authorities, although not of the same degree. In this respect, three dimensions of independence shall be pointed out: institutional, budgetary and regulatory.⁸

Institutional independence to the executive and legislative branches is generally ensured by the specific modalities of appointment of regulators' officials and the extremely narrow basis for their dismissal. For instance, in the United States, the members of the Board of Governors of the Federal

⁶ M. Giovanoli, 'The Reform of the International Financial Architecture After the Global Crisis', 42 *New York University Journal of International Law and Politics* (2010, forthcoming).

⁷ For example, see, C. Hadjiemmanuil, 'Institutional structure of financial regulation: A trend towards "Megaregulators"?' , *Yearbook of International Financial and Economic Law* (2000-2001), 127-190; D. Masciandaro (ed.), *Handbook of Central Banking and Financial Authorities in Europe. New Architectures in the Supervision of Financial Markets* (2005). More generally, see, M. Andenas *et al.* (eds), *Independent Administrative Authorities* (2004).

⁸ M. Quityn & M. W. Taylor, *Should Financial Sector Regulators Be Independent?* (2004), 6.

Reserve System,⁹ the commissioners of the Securities and Exchange Commission (SEC)¹⁰ and the Commodity Futures Trading Commission (CFTC),¹¹ the Acting Director of the Office of Thrift Supervision (OTS)¹² and the Comptroller of the Currency (OCC)¹³ are nominated by the President and confirmed by the Senate. Most of these appointments are made in such a way as to prevent the complete renewal of the regulators' executive board in one presidential term of office. Specific provisions also aim to ensure that regulators remain non-partisan: no more than three Commissioners (out of five) of the SEC and the CFTC may belong to the same political party.¹⁴ Moreover, these officials can be dismissed for serious misconduct only and never for political purposes. In a nutshell, as pointed out by the US Supreme Court in *Humphrey's Executor*, officials of such agencies "shall be independent of executive authority *except in its selection*, and free to exercise its judgment without the leave or hindrance of any other official or any department of the government."¹⁵ The institutional independence does not mean that financial regulatory authorities operate in complete insulation. They are all accountable, at some level, to the executive and legislative branches, notably through their annual reports.

Budgetary independence is based on the level of financial autonomy and depends "on the role of the executive or the legislative branch in determining the agency's budget and how it is used."¹⁶ Most of the financial regulators are funded through fees paid by entities subject to their supervision. It is the case for the French Autorité des Marchés Financiers (AMF),¹⁷ the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)¹⁸ or the British Financial Services Authority (FSA).¹⁹ Unlike these regulators, the

⁹ 12 U.S.C. § 241.

¹⁰ 15 U.S.C. § 78(d).

¹¹ 7 U.S.C. § 2(a)(2).

¹² 12 U.S.C. § 1462(a)(c).

¹³ 12 U.S.C. § 2.

¹⁴ Respectively, 15 U.S.C. § 78(d); 7 U.S.C. § 2(a)(2).

¹⁵ *Humphrey's Executor v. United States*, 295 U.S. 602, 625-626 (1935). (Italic emphasis in the original).

¹⁶ Quityn & Taylor, *supra* note 8, 8.

¹⁷ Code Monétaire et Financier, art. L. 621-5-2.

¹⁸ Gesetz über die Bundesanstalt für die Finanzdienstleistungsaufsicht (FinDAG), § 13(1).

¹⁹ Financial Services and Markets Act, Schedule 1, Part III, § 17.

budget of the SEC is not based on a levy on the regulated firms and is subject to the consent of Congress.²⁰

Regulatory independence reflects the political latitude of the regulator to adopt, implement and enforce adequate rules for the supervision and control of financial institutions, instruments and transactions. These missions are usually accomplished by authorities other than central banks. It is for instance the case for the British FSA,²¹ the French AMF²² and American financial markets and banking agencies.²³ In Germany, the regulatory power has been originally vested in the Federal Ministry of Finance but with the option to be delegated to the BaFin²⁴ and, in practice, the Ministry has regularly let the BaFin exercise this power, thus allowing an author to point out that the latter has “an important regulatory role to play.”²⁵

This multidimensional independence of domestic regulators has been justified by the necessity to insulate financial regulation from short term politics, supposedly inducing financial instability.²⁶ However, domestic regulators have not only enjoyed significant latitude at the domestic level, they have also exploited it at the international one.²⁷ While they have established cross-border relations with their foreign counterparts, this financial diplomacy has occurred outside customary diplomatic channels.

Financial regulators have undertaken bilateral agreements (known as Memoranda of Understanding) and have established permanent multilateral forums for cooperation such as the Basel Committee, the IOSCO and the IAIS. However, given that national regulators lack treaty-making power, these international agreements and the functioning of these institutions are not covered by international law.²⁸ This uncontrolled polycentrism has en-

²⁰ J. Seligman, ‘Self-funding for the Securities and Exchange Commission’, 28 *Nova Law Review* (2004), 233.

²¹ Financial Services and Markets Act, Part X, Chapter I.

²² Code Monétaire et Financier, art. L. 621-7.

²³ See for instance, 12 U.S.C. § 3907(a).

²⁴ Gesetz über den Wertpapierhandel (WpHG), §9(3), §9(4); Gesetz über das Kreditwesen (KWG), § 29(4); Gesetz über die Beaufsichtigung der Versicherungsunternehmen (VAG), Section 5(6)

²⁵ R. Grote, ‘The Liberalisation of Financial Markets: The Regulatory Response in Germany’, in R. Grote & T. Maruhn (eds), *The Regulation of International Financial Markets – Perspectives for reform* (2006), 75-94, 83.

²⁶ Quityn & Taylor, *supra* note 8, 3.

²⁷ For instance, see the interesting contribution of Stephan Handke to this volume, and especially the passage on the international activities of BaFin.

²⁸ For an overview of some issues stemming from the absence of an international law framework, see, C. Möllers, ‘Transnationale Behördenkooperation. Verfassungs- und

gendered various risks on the international stage, several regulators acting on the behalf of the same state and adopting international standards without legal authority to that purpose.

C. The Risks of Independence

Three types of problems can be identified: the potential loss of state unity on the international stage (I.), and the circumvention of domestic (II.) and regional (III.) democratic processes.

I. The Loss of State Unity on the International Stage

The risk weighing on state unity has been mostly exemplified in the context of federalism by the possible contradictions between the foreign policies of states (if any) and of the federal government.²⁹ This risk exists not only in the case of territorial divisions but can also manifest itself through governmental fragmentation when centralized government power has been distributed to multiple domestic regulatory authorities representing the same state on the international stage for a similar issue. Previous experiences have indeed shown that separation of powers between entities not necessarily sharing the same point of view on financial regulation renders the decision-making process more complex at the international level.

This has been the case within the framework of the negotiation of the Basel II agreement when divergences between the several US banking regulators members of the Basel Committee became obvious. The Federal Reserve Board strongly supported the new Basel regulatory framework, whereas the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) criticized the complexity of the new standard.³⁰ The same differences in points of view became apparent when US banking regulators were heard in Congress, leading one author to point out that “US negotiators at Basel speak for themselves, not the United States [...]”³¹

völkerrechtliche Probleme transnationaler administrativer Standardsetzung’, 65 *Zeitschrift für ausländisches Recht und Völkerrecht* (2005), 351-389.

²⁹ For instance, see, S. H. Cleveland, ‘Crosby and the “One-Voice” Myth in the US Foreign Relations’, 46 *Villanova Law Review* (2001), 975-1014.

³⁰ M. S. Barr & G. P. Miller, ‘Global Administrative Law: The View From Basel’, 17 *European Journal of International Law* (2006), 15-46, 32. See also, Verdier, *supra* note 2, 128.

³¹ Barr & Miller, *supra* note 30, 34-35.

A bill was presented before the US Congress in 2003 and 2005 in order to put an end to this conflict. Its objective was to establish “a mechanism for developing uniform United States positions on issues before the Basel Committee [...] [and] require a review on the most recent recommendation of the Basel Committee for an accord on capital standards, and for other purposes.”³² It planned to institute an inter-agency committee known as the “United States Financial Policy Committee” comprised of the Secretary of the Treasury (who would have served as the chairperson of the Committee), the Chairman of the Board of Governors of the Federal Reserve System, the OCC, the Chairperson of the FDIC and the Director of the Office of Thrift Supervision. Pursuant to this bill, this new committee would have met before any meeting of the Basel Committee and each of its members should have adhered to its positions in any negotiations. Moreover, if its members would have been “unable to agree on a uniform position on an issue, the position of the Secretary of the Treasury [should have been] determinative.”³³ By threatening to substitute the Secretary of the Treasury for the US banking regulators, this experience has highlighted the potential power of domestic parliaments to oversee the international activity of independent domestic regulators but has also demonstrated that the risk of loss of state unity on the international stage is not purely theoretical.

It could be argued that this issue is specific to the US regulatory regime given the complexity of its institutional design comprised of a half-dozen influential domestic regulators, not to mention the absence of federal regulation of the insurance sector.³⁴ To some extent, it is true given the current trend towards the “single regulator” model.³⁵ However, states that have adopted this model may find that what they gain in terms of unity and consistency is offset by losses in terms of domestic transparency. As pointed out by professors Barr and Miller, “[t]he division among regulators may enhance transparency, public engagement and dialogue, as well as accountability and rationality at the international level as compared with transnational regulation developed by monolithic regulators within each country.”³⁶ However, while the “multiple regulators” model may facilitate transparency,

³² See H.R. 2043, 108th Congress, 2003; H.R. 1226, 109th Congress, 2005 (*United States Financial Policy Committee for Fair Capital Standards Act*).

³³ *Id.*

³⁴ See *infra* note 74.

³⁵ Hadjiemmanuil, *supra* note 7, 127-190.

³⁶ Barr & Miller, *supra* note 30, 33.

it does not reduce the risk of circumvention of national democratic processes.

II. The Circumvention of National Democratic Processes

1. The Recognized Risk of Circumvention

As already pointed out, the normative activity of standard-setting bodies is not covered by international law and, as non-legally binding norms, the procedure under which international financial standards are adopted should not raise any issue. However, these standards are intended to be implemented in domestic legal orders, notably – but not exclusively – through the autonomous regulatory power of financial regulators.³⁷ Once adopted at the international level, they are presented to the private sector and national political authorities as a *fait accompli*.³⁸ It would be simplistic to put forward the non-binding character of these standards in order to shrug off this critical issue. In that respect, Professors Barr and Miller rightly noted that:

“Critics also contend that ‘home country enactment is simply a formality’. Thus, opponents of global regulation, in this view, cannot effectively challenge transnational regulation at the domestic level. International rule-making becomes a way of circumventing legislative oversight because Congress will not undo complex international agreements, and a way of bypassing real administrative rule-making because the domestic notice and comment rule-making will simply rubber stamp the decisions made by the regulators during their international negotiations.”³⁹

³⁷ Professor Stewart noted that “[i]mplementation at the domestic level of policies and measures agreed to by networks depends on and can generally be accomplished by the initiative of the relevant participating national officials, often through the exercise of their existing administrative authority”; R. B. Stewart, ‘US Administrative Law: A Model for Global Administrative Law’, 68 *Law & Contemporary Problems* (2005), 63-108, 68.

³⁸ D. Zaring, ‘Informal Procedure, Hard and Soft, in International Administration’, 5 *Chicago Journal of International Law* (2005), 547-603, 600; C. Bradley, ‘Private International Law-Making for the Financial Markets’, 29 *Fordham International Law Journal* (2005), 127-180, 155.

³⁹ Barr & Miller, *supra* note 30, 20-21.

As pointed out by these authors, this problem is not limited solely to the circumvention of congressional oversight, but also affects existing domestic administrative consultation procedures giving the private sector the opportunity to comment on proposed regulatory reforms. For instance, it has been demonstrated that the US banking authorities used the Basel Committee in 1988 to their own advantage in order to impose capital adequacy norms on domestic banks, which had expressed their reluctance to adhere to such standards.⁴⁰ Indeed, while the Basel I agreement had been adopted in July 1988, some US regulators released it for comments pursuant to the Administrative Procedure Act only in December 1988, it being understood that comments would concern only the domestic implementation of Basel I and not its content.⁴¹ Likewise, the confidential negotiations of the 1975 and 1983 Basel Concordats sparked off a fierce controversy in the US Congress.⁴²

2. The Unequal and Insufficient Democratization of Standard-Setting Procedures

In response to this lack of transparency, the practice of standard-setting procedures has progressively been democratized since the nineties in order to involve more actively and effectively private actors as well as public institutions. However, some important differences exist between the change in practice of the Basel Committee, IOSCO and the IAIS.

The Basel Committee has shown since the early nineties its willingness to make more open its standard-setting activity,⁴³ reflecting “a maturation of the Basel process” and “a possible movement towards increased pluralism”⁴⁴. The capital adequacy standards overhaul through the Basel II process best illustrates this trend. The Committee launched an extensive consultation process involving domestic regulators, financial institutions, professional associations and academics.⁴⁵ The 2004 Basel II agreement pointed out in that respect that “the Committee has benefited greatly from

⁴⁰ Zaring, *supra* note 38, 574.

⁴¹ *Id.*

⁴² E. B. Kapstein, *Governing the Global Economy – International Finance and the State* (1996), 50.

⁴³ D. Wood, *Governing Global Banking – The Basel Committee and the Politics of Financial Globalisation* (2005), 3.

⁴⁴ B. Matthews, ‘Capital Adequacy, Netting and Derivatives’, 2 *Stanford Journal of Law, Business and Finance* (1995), 167-191, 188.

⁴⁵ Barr & Miller, *supra* note 30, 25.

its frequent interactions with industry participants and looks forward to enhanced opportunities for dialogue.”⁴⁶ More importantly, it has also acknowledged during this negotiation “the importance of national rule-making processes underway in several jurisdictions, and that it will need to consider the outcome of these national processes within this timeframe,”⁴⁷ thereby demonstrating that the openness of the standard-setting procedure does not necessarily result in an increasing risk of regulatory capture by private interests. This broad openness to external actors has not been limited to capital adequacy standards. For instance, the consultative document issued by the Basel Committee within the framework of its “Core Principles for Effective Banking Supervision” noted that “[b]efore finalizing the text, the Committee conducted a broad consultation that was open to national supervisory authorities, central banks, international trade associations, academia and other interested parties.”⁴⁸ Basel II marks, however, a crucial turning point in the practice of the Committee given that, since then, it has always sought the comments of the international financial community on each of its projects.⁴⁹

Since the 2000s, IOSCO has also spontaneously launched consultations on ongoing projects.⁵⁰ The general implementation of this practice took place in 2005 when it adopted its “Consultation Policy and Procedure” through which the organization “encourages all interested parties to submit

⁴⁶ Basel Committee, *International Convergence of Capital Measurement and Capital Standards – A Revised Framework* (June 2004) para. 15, available at <http://www.bis.org/publ/bcbs107.pdf> (last visited 8 March 2010).

⁴⁷ Basel Committee, *Basel II: Significant Progress on Major Issues* (Press Release, 11 October 2003) available at <http://www.bis.org/press/p031011.htm> (last visited 8 March 2010).

⁴⁸ Basel Committee, *Core Principles for Effective Banking Supervision – Consultative Document* (April 2006) para. 4, available at <http://www.bis.org/publ/bcbs123.pdf> (last visited 8 March 2010).

⁴⁹ For a recent example, see, Basel Committee, *International Association of Deposit Insurers, Core Principles for Effective Deposit Insurance System – Consultative Document* (March 2009) available at <http://www.bis.org/publ/bcbs151.pdf> (last visited 8 March 2010).

⁵⁰ See, for instance, IOSCO, *Code of Conduct Fundamentals for Credit Rating Agencies – A Consultation Report of the Chairmen’s Task Force of the Technical Committee of IOSCO* (October 2004) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD173.pdf> (last visited 8 March 2010).

comments on its Consultation Reports.”⁵¹ The declared objectives of this instrument were, among others, “to benefit from the expertise of the international financial community”, “to increase transparency regarding IOSCO’s activities” and “to obtain information and views on the potential impact, benefits and costs of any proposed standards and principles.”⁵² Despite showing remarkable progress in terms of transparency, this approach, focusing on private actors, gives the impression that it aims more to take the place of domestic administrative consultation procedures⁵³ rather than to take into consideration national rule-making processes.

The democratization process undertaken by the IAIS remains the most questionable since the opportunity to comment on future standards is limited to institutions enjoying the status of observer. The IAIS bylaws were amended in 2004 and now provide that “[t]he Association will consult widely amongst its members and observers and make its consultation procedures transparent.”⁵⁴ In order to put into practice the principles laid down in the by-laws, the IAIS adopted in 2005 a “Policy Statement on the Scope of Observers’ Participation” which has surprisingly never been made public by it.⁵⁵ Despite the status of observer being accessible to a large category of public and private institutions,⁵⁶ the policy pursued by the IAIS makes the involvement of external actors in its consultation procedures dependent on

⁵¹ IOSCO, Consultation Policy and Procedure (April 2005) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD197.pdf> (last visited 8 March 2010).

⁵² *Id.*

⁵³ E. Fleishman, ‘Consult Nations’, *The Lawyer* (4 July 2005), 29.

⁵⁴ IAIS, International Association of Insurance Supervisors By-Laws (2008) art. 2(3), available at http://www.iaisweb.org/__temp/By-laws__2008_edition_.pdf (last visited 8 March 2010).

⁵⁵ Its existence is mentioned in two annual reports. See, IAIS, Annual Report 2005-2006 (2006) 2, available at http://www.iaisweb.org/__temp/2005-2006_Annual_Report.pdf (last visited 8 March 2010); IAIS, Annual Report 2004-2005 (2005) 14, available at http://www.iaisweb.org/__temp/2004-2005_Annual_Report.pdf (last visited 8 March 2010).

⁵⁶ The IAIS By-Laws (see, *supra* note 54, art. 7(1)) provide indeed that “[t]he following persons are eligible to be an observer: (a) an international, regional or national organisation, a component element of which has an interest in insurance and insurance supervision regardless of whether the organisation is directly responsible for insurance law or its administration; (b) any other person, entity, or organisation, private or public, with an interest in the business or supervision of insurance, and includes any company, association, educator, educational institution, or natural person.”

an onerous observership fee.⁵⁷ In this respect, it is noteworthy to mention that the observership fees account for about a third of the IAIS annual operating revenue,⁵⁸ thereby giving rise to the suspicion – legitimate or not – that this financial dependence increases the risk of regulatory capture by private interests and affects the democratic nature of its standard-setting activity.

Admittedly, the opportunity given by the Basel Committee and IOSCO to comment on the proposed international financial standards is a progress towards an increased transparency of standard-setting bodies. While it has improved the democratic nature of the standard-setting process, these consultation procedures, however, do not alone make them fully compliant with existing domestic democratic processes and have not corrected the democratic flaw from which these institutions initially suffer.

Before putting forward possible avenues for reform, assessing the impact of independent financial regulators at the European level is interesting in highlighting the potential normative influence of such actors in processes of regional integration.

III. The Circumvention of the European Democratic Process

1. Asymmetry: Domestic Regulators *v.* European Regulation

European community law constitutes the main source of development in financial laws in the Member States. Unlike the American model, where financial regulators involved in standard-setting bodies spatially coincide with domestic political authorities, the European financial regulation has introduced a spatial asymmetry between national financial authorities taking part in the international standard-setting activity on the one side, and European institutions having the authority to define and adopt financial regulations on the other. Given that the main European institutions are not directly involved in the standard-setting activity, they do not bear the moral obligation to implement the international financial standards when they fall within

⁵⁷ The observership fee for 2010 has been set to 14,500 Swiss Francs by the association. See, IAIS, Application for Observership (2010) available at <http://www.iaisweb.org/index.cfm?pageID=303> (last visited 8 March 2010).

⁵⁸ IAIS, Annual Report 2007-2008 (2008) 17, available at http://www.iaisweb.org/__temp/2007-2008_Annual_report.pdf (last visited 8 March 2010). This annual report shows that in 2007 the total amount of the observership fees collected was CHF 1,244,250 and the total operating revenue CHF 3,998,076.

the scope of their competence. This asymmetry gave European institutions a political asset allowing them to greatly influence the work of standard-setting bodies.

This influence manifested itself with regard to Basel II in the form of a regular monitoring of the negotiations of the agreement between banking regulators under the auspices of the Basel Committee. While European institutions have agreed to postpone the reform of its banking prudential framework until the final adoption of Basel II, thereby implicitly acknowledging the international value of this agreement, they also expressed serious concerns about it, in doing so echoing the criticisms of the then German Chancellor Gerhard Schröder who considered that the agreement would affect the financing and therefore, the competitiveness of German medium-sized enterprises.⁵⁹ For instance, a resolution of the European Parliament emphasized “that the cost impact of [Basel II] on firms of all sizes and from all affected sectors must be properly assessed”⁶⁰ and considered “that the possibility that the new rules will generate procyclical effects has not been completely eliminated.”⁶¹

Even more interestingly, the European Parliament tackled a more structural issue when it expressed some doubt about the democratic character of the international activity of independent regulators. Indeed, in the same resolution, it

“[r]egret[ed] that the Basel Accord and other international agreements laying down a framework for legislation at EU level came into existence without any form of democratic mandate or control by the European Parliament; [and] expresse[d] the view that, in future, questions with such far-reaching political implications should not be determined in advance by expert committees alone.”⁶²

This risk of democratic deficit is all the more clear given that the standard-setting bodies themselves make no secret of their desire to insulate themselves from domestic or regional democratic processes. Responding to the criticisms raised by Gerhard Schröder, Andrew Crockett, the then General Manager of the Bank for International Settlements, the international

⁵⁹ Wood, *supra* note 43, 141.

⁶⁰ EP Resolution of 2 September 2003, OJ 2004 C 76 E/103, § 2.

⁶¹ *Id.*, § 3.

⁶² *Id.*, § 4.

organization hosting the Basel Committee, explicitly stated that “[o]ne of the reasons politicians and governments delegate to speciali[z]ed institutions [...] is to take those technical debates out of the political arena,”⁶³ thereby justifying the international independence of financial regulators as a natural consequence of their domestic independence.

2. Comitology: European Regulators v. European Institutions

Moreover, the growing influence of domestic financial regulators on the European regulatory process through comitology procedures is likely to increase this democratic deficit despite every indication to the contrary.⁶⁴ As part of the Lamfalussy process, the European Commission established several committees of experts comprised of national financial regulators and mirroring the international standard-setting bodies: the Committee of European Securities Regulators (CESR),⁶⁵ the Committee of European Banking Supervisors (CEBS)⁶⁶ and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).⁶⁷ The primary role of these committees is mainly both advising the Commission during the preparation of community legislation and contributing to the development of a common and uniform implementation of this legislation.

While, on paper, these missions suggest that these European Committees have no power to set the European legislation, the practice of comitology has shown their substantial influence in that respect.⁶⁸ Interestingly, in a recent reform of these committees in 2009, the issue of their accountability has been raised. Three European Commission decisions reforming these committees all indicate that “[t]he accountability of the Committee towards the Community Institutions is of high importance and should be of a well

⁶³ ‘B.I.S. Head Hits Back Over Banking Standards’, *Financial Times*, 8 March 2002.

⁶⁴ G. Bertezolo, ‘The European Union Facing the Global Arena: Standard-Setting Bodies and Financial Regulation’, 34 *European Law Review* (2009), 257-280.

⁶⁵ Commission Decision 2001/528 of 6 June 2001, OJ 2001 L 191/45; Commission Decision 2004/7 of 5 November 2003, OJ 2004 L 3/32; Commission Decision 2009/77 of 23 January 2009, OJ 2009 L 25/18.

⁶⁶ Commission Decision 2004/5 of 5 November 2003, OJ 2004 L 3/28; Commission Decision 2009/78 of 23 January 2009, OJ 2009 L 25/23.

⁶⁷ Commission Decision 2004/6 of 5 November 2003, OJ 2004 L 3/30; Commission Decision 2009/79 of 23 January 2009, OJ 2009 L 25/28.

⁶⁸ R. Vabres, *Comitologie et Services Financiers – Réflexions sur les Sources Européennes du Droit Bancaire et Financier* (2009). See also, Y. V. Avgerinos, ‘Essential and Non-Essential Measures: Delegation of Powers in EU Securities Regulation’, 8 *European Law Journal* (2002), 269-289.

established standard while respecting the independence of supervisors.”⁶⁹ However, this amended legal framework has consolidated rather than reappraised their *de facto* control over the European regulatory process with regard to financial law, thereby acquiescing in the loss of power of European institutions to the great benefit of independent regulators.

D. A Proposal: The Establishment of an International Standard-Setting Organization

Thus, the independence of domestic regulators has engendered several risks with regard to the existing standard-setting processes. In our opinion, these flaws, affecting the overall effectiveness of an emerging international financial governance, have insufficiently been taken into account in the latest reforms. Instead of devising a genuine multilateral financial architecture capable of democratically generating in the long run an effective financial regulation, the G20 efforts have mostly been concentrated on the development on new norms for the financial sector. This almost exclusive attention to the substantive aspect of international financial regulation has eclipsed broader institutional issues.

Admittedly, the G20 has entrusted the Financial Stability Board with the mission of monitoring the standard-setting activity and has mandated the Basel Committee, IOSCO and the IAIS (among others) with the task of developing new rules. However, this choice seems more a quick-fix than a sustainable strategy. It will neither preserve state unity on the international stage, nor solve the issues of circumvention of national and regional democratic processes.

In our view, the establishment of an international financial standard-setting organization is one potential way of correcting these flaws. It should be done in respect of two major political constraints: maintaining the domestic independence of regulators and preserving the soft law nature of the standard-setting process. Consequently, this organization would have nothing to do with the setting up of the so-called “World Financial Authority” recommended by John Eatwell and Lance Taylor.⁷⁰ Under their – unrealistic

⁶⁹ Commission Decision 2009/77 (see, *supra* note 65), Preamble, para. 22; Commission Decision 2009/78 (see, *supra* note 66), Preamble, para. 23; Commission Decision 2009/79 (see, *supra* note 67), Preamble, para. 22.

⁷⁰ J. Eatwell & L. Taylor, ‘A World Financial Authority’, in J. Eatwell & L. Taylor (eds), *International Capital Markets: Systems in Transition* (2002), 17, 21. See also, J. Eatwell & L. Taylor, ‘International Capital Markets and the Future of Economic

yet notorious – proposal, this institution would have acted as an international financial regulator and also undertaken the tasks of authorizing and controlling financial institutions, instruments and transactions. Rather, it is possible to suggest the merger of existing standard-setting bodies within a single international organization covering the whole financial sector. Our proposal revolves around four basic principles.

It should be a genuine multilateral organization whose membership would be open to all states rather than restricted to a G20 basis such as the Financial Stability Board or the Basel Committee. More than one hundred states are represented in the IAIS and IOSCO and these institutions have demonstrated that a broad membership does not impose an unbearable burden on the standard-setting process. This multilateral dimension would improve the feeling of “policy ownership”⁷¹ towards financial standards, thereby favoring their implementation in developing countries, and would also ensure a better compatibility with the multilateral framework of the liberalization of trade in financial services conducted under the auspices of the WTO.⁷²

The representation in this organization should be limited to one delegate per state so as to force every member to unify their position on an issue and avoid potential divergences of point of view between different regulators of the same country. Such a measure would also simplify the current representation of the several US financial regulators in the Basel Committee⁷³ and in the IAIS.⁷⁴

Policy: a Proposal for the Creation of a World Financial Authority’, in M. Andenas & Y. Avgerinos (eds), *Financial Markets in Europe. Towards a Single Regulator?* (2003), 263.

⁷¹ Delonis, *supra* note 4, 618.

⁷² This issue is discussed in greater detail in Bismuth, *supra* note 5.

⁷³ Five US institutions are represented in the Basel Committee: the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the OCC, the FDIC and the OTS. See, Basel Committee on Banking Supervision, *History of the Basel Committee and its Membership* (2009) 8, available at <http://www.bis.org/bcbs/history.pdf?noframes=1> (last visited 8 March 2010).

⁷⁴ Given the absence of a federal regulatory framework, regulation of the insurance industry in the US is exercised by fifty state insurance departments and commissioners (For an overview of the American system, see, S. Randall, ‘Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners’, 26 *Florida State University Law Review* (1999), 625-699). The National Association of Insurance Supervisors (NAIC) was established in 1871 in order to coordinate the policies of state insurance regulators. Despite its private status (thereby guarantying its independence *vis-à-vis* the federal government) the NAIC has played on the international stage a similar role to other federal regulators and, in this

The existing consultation procedures would be expanded in order to prevent the risk of regulatory capture such as within the IAIS where the access to the standard-setting procedures is limited to the IAIS members and observers. This would not prevent private actors from influencing the normative activity of the future organization but it would ensure that every interested person or entity has an opportunity to comment upon the proposed new financial standards.

This organization should be established by a treaty so as to prevent the risk of circumvention of domestic or regional democratic processes. Indeed, it would subject the international activities of domestic regulators to the control of their national governments. The mere fact that the organization would be treaty-based does not, of course, ensure that its functioning would be fully democratic. However, this treaty would clarify the legal framework of the standard-setting process and avoid suspicious situations such as the absence of legal personality for the Basel Committee for more than thirty years, the fact that the IOSCO constituent charter is not a public document, and the aforementioned questionable opacity of the IAIS standard-setting activity. This “hard law” institutional framework would not affect the soft law nature of the standard-setting process given that the organization would have only the power to issue recommendations on which domestic regulations should be based. Moreover, it would not affect the independence of regulators under domestic laws.

These are the basic principles that should guide the establishment of an international standard-setting organization for the financial sector. Turbulent and crucial times call for more than quick fixes, hasty remedies and best-endeavor commitments. Courageous measures and a long term strategy are needed and, in our view, the establishment of such an organization is a critical step towards a more democratic, transparent and effective international financial governance.

respect, it ensures the representation of state regulators at the IAIS. However, the representation has been implemented in a strange way given that “the NAIC shall not have a right to vote” but it “may, at any one time, designate up to a maximum of 15 of its members [*state regulators*] who may exercise their rights to vote” (IAIS By-Laws, *supra* note 54, art. 6(4)). It should also be pointed out that, in exchange of these multiple votes, the NAIC shall pay fifteen annual subscription fees. G. Pooley, ‘The IAIS – A Progress Report and Some Thoughts for the Future’, 16 *Journal of Insurance Regulation* (1997) 176.