New Rule-Making Elements for Financial Architecture's Reform

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Financial regulation; Financial services; Internet

Introduction

Since the outbreak of the financial crisis, international financial regulation has been a hotly debated topic. Substantive rules are questioned, supervisory authorities tackled and new architectural rules asked for. Expert reports made available could already fill libraries, and legislators are under considerable pressure to present reform proposals as soon as possible. Therefore, as has never been the case before, a globally-unified approach to market turmoil stretches across the world and time zones.

During recent years, not only new rules but also new regulators have emerged mainly on a "half-governmental level", because established international bodies were not capable of reacting as quickly as necessary and state regulators only have restricted competences in cross-border matters. In the meantime, the manifold activities and actors in the field of international financial regulation make it almost impossible to oversee the large number of (possibly) applicable rules.[1] Nevertheless, the tense network of financial standards was not able to prevent the deep financial crisis and keep it from spreading from the United States to the whole world.

In view of its multiplicity, financial regulation may be defined as supervisory function or authority having a diverse character, not only because of its different financial functions, but also because of differences per country.[2] Financial regulation can be enacted by both government authorities, such as parliaments, executive bodies and public institutions, and self-regulatory agencies; the latter either have a delegated competence to devise regulations or impose such regulations on the members of a specific market-sector in a non-mandatory way.[3]

International financial regulation can be divided into three subsets of rules, namely: (a) systematic or institutional rules, regulating the performance of the financial institutions; (b) rules ensuring institutional safety, systemic stability, and market conduct; and (c) rules pertaining to supervision in the form of self-control, industry supervision or public supervision.[4] The focus of financial regulation lays on crisis prevention and maintenance of financial stability, meaning the safety and soundness of the financial system.[5]

A specific steadily-growing concern in financial-services regulation is consumer protection: the relationship between financial intermediaries and their customers has become an important element of financial regulation.[6] An integrated, but not excessive, regulatory system is not only essential for the functioning of the financial markets; an effective system will also enhance the market players' acceptance of the regulatory interventions.[7]

Many voices now call (again, similarly to 10 years ago in the aftermath of the Asian financial crisis)[8] for a new international financial architecture; experts all over the world try to develop a framework which would be designed to prevent further crises. However, a certain weakness of this approach consists in the fact that financial experts do not necessarily take into account the experiences which have been gained with regulatory structures in other market segments and societal fields.

Subsequently, internet regulation will be looked at as a specific reference model, constituting a comparative example for a development of a sound regulatory framework. Similar to the internet, financial markets have gained a global dimension over the past decades, affecting and involving an increasing number of "participants".

New elements of rule-making processes

Internet regulation encompasses some features which reflect modern developments in regulatory theories. Hereinafter, the notions of spontaneous regulation, multi-stakeholderism and fragmentation trends will be addressed in more detail.

Spontaneous regulation

In the early days of the emergence of cyberspace, internet scholars assigned attributes of independence to this new "province" of the world[9]; it has been argued that the

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[1] See Rolf H. Weber, "Mapping and Structuring International Financial Regulation—A Theoretical Approach" (2009) *European Banking Law Review* 651.

[2] Jan H. Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* (Oxford, 2004), p.908.

[3] For a more detailed discussion see below "Sources of law: making soft law harder."

[4] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 653.

[5] For further details see Rolf H. Weber and Douglas Arner, "Toward a New Design for International Financial Regulation" (2007) 29 *University of Pennsylvania Journal of International Law* 391, 416–17 with further references.

[6] Roy C. Smith and Ingo Walter, *Global Banking* (Oxford, 2003), p.337.

[7] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 654.

[8] See Rolf H. Weber, "Challenges for the New Financial Architecture" (2001) 31 *Hong Kong Law Journal* 241; Mario Giovanoli, "A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting" in Giovanoli (ed.), *International Monetary Law, Issues for the New Millennium* (Oxford: 2000), pp.3 et seq.

[9] See David R. Johnson and David G. Post, "Law and Borders—The Rise of Law in Cyberspace" (1996) 48 *Stanford Law Review* 1367.

participants in cyberspace would create a "net nation" without any regulatory-body policing the internet.[10] The most striking example for this tendency is the manifesto called, "A Declaration of the Independence of Cyberspace", issued by Barlow in February 1996[11]:

> "Governments of the Industrial World, you weary giants of flesh and steel, I come from Cyberspace, the new home of Mind. On behalf of the future, I ask you of the past to leave us alone. You are not welcome among us. You have no sovereignty where we gather. ...
>
> I declare the global space we are building to be naturally independent of the tyrannies you seek to impose on us. You have no moral right to rule us nor do you possess any methods of enforcement we have true reason to fear."

In the meantime the euphoric approach of independence has almost completely vanished. Nevertheless, it can still be said that (indeed) the internet developed beyond a regulatory legal framework and was mainly based on self-regulation by its users since the assumption prevailed that the internet would not be governed by laws in the legal sense, but rather by "codes" defining the relevant parameters resulting from technical protocols, standards and procedures.[12]

Quite obviously, the establishment of an adequate legal framework for the internet requires consideration of the available regulatory models.[13] In theory, the possibility of no regulation at all is an approach which can be taken into account; however, in practice this approach does not seem to be a viable solution. Even promoters of an unregulated internet environment, such as Barlow,[14] assume that at least a social-contract regime must exist. The model of a "social contract" (mainly according to Rousseau)[15] encompasses all individuals of a society voluntarily unifying in order to originate new forces.[16] With the establishment of civil society, each individual is protected by the whole of the community, receiving the same rights and obligations that enable equal opportunities of development for everyone, in particular, with respect to ensuring individual freedoms—which secure the self-determination of all individuals.[17]

In the real world, the (legislative) choice can principally be made between traditional national regulation (having a limited scope of application within nation states' boundaries), international agreements (often being difficult to successfully conclude), and self-regulation.[18] The latter scheme[19] has indeed played an important role in the online world. However, instead of an established form of self-regulation, the virtual world is rather designed by "spontaneous" regulation, encompassing regulatory autonomy and independence from any structured regime of rule making.[20]

Generally speaking, spontaneous self-regulation is justified if it is more efficient than state law and if compliance with rules of the community is less likely than compliance with self-regulation. Seen from a broader perspective, self-regulation is "law" which is responsive to changes in the "environment" and which develops and establishes rules, quite often derived from industry or business standards and shaped by occurring events, independent of the principle of territoriality.[21] Milhaupt and Pistor describe this development as a, "rolling relationship between law and markets".[22]

Since provisions of a self-regulating nature are not enforceable through public action, such rules do not have the legal quality of law.[23] However, self-regulation can result in moral pressure and be understood as a social-control model. Such a system of control may consist of rules of normatively appropriate human behaviour, similar to the notion of the mentioned "social contract".[24]

During the last few years, legal doctrine has developed the notion of "soft law" for commitments in international relations expressing more than just policy statements but less than law in its strict sense, and also possessing a certain proximity to law and a certain legal relevance.[25] Therefore, it can be said that soft law is a social notion close to law and that it usually covers certain forms of expected and acceptable codes of conduct.[26] Furthermore, the role of soft law for the development of good faith and

[10] See Nicholas Negroponte, *Being Digital* (London: 1996), p.237.
[11] Available at *http://www.eff.org/pub/Publication/John_Perry_Barlow/barlow0296.declaration* [Accessed July 27, 2010].
[12] Rolf H. Weber, *Regulatory Models for the Online World* (Zurich: 2002), pp.25 et seq. and pp.89 et seq.; Andrew D. Murray, *The Regulation of Cyberspace, Control in the Online Environment* (New York: 2008), pp.74 et seq.; for the importance of codes for Internet regulation see Lawrence Lessig, *Code and Other Laws of Cyberspace* (New York: 1999) and Lawrence Lessig, *Code Version 2.0* (New York: 2006).
[13] See Rolf H. Weber, *Shaping Internet Governance: Regulatory Challenges* (Zurich: 2009), pp.11 et seq.
[14] Barlow, available at *http://www.eff.org/pub/Publication/John_Perry_Barlow/barlow0296.declaration* [Accessed July 27, 2010].
[15] Jean Jacques Rousseau, *Livre I* (Paris: 1754/62), Ch.VI.
[16] See Weber, *Shaping Internet Governance*, 2009, pp.73 et seq.
[17] See Weber, *Shaping Internet Governance*, 2009, p.88.
[18] For further details see Weber, *Shaping Internet Governance*, 2009, pp.11 et seq.
[19] For a more detailed discussion see below "Sources of law: making soft law harder."
[20] See Johnson and Post, "Law and Borders" (1996) 48 *Stanford Law Review* 1367, 1370 et seq.
[21] See Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 657; for a sociological analysis see Anthony Giddens, *The Consequences of Modernity* (Stanford: 1990), pp.63 et seq.; see also Damian Tambini, Danilo Leonardi and Chris Marsden, *Codifying Cyberspace* (New York: 2008), pp.1 et seq.
[22] Curtis J. Milhaupt and Katharina Pistor, *Law and Capitalism* (Chicago/London: 2008), p.6.
[23] See below "Sources of law: making soft law harder."
[24] Weber, *Shaping Internet Governance*, 2009, pp.20, 73 et seq.; for self-regulation of market institutions see also Cally Jordan and Pamela Hughes, "Which Way for Market Institutions: the Fundamental Question of Self-Regulation" (2007) 4 *Berkeley Business Law Journal* 229.
[25] The term "soft law" was introduced by René Jean Dupuy, "Declaratory Law and Programmatory Law: From Revolutionary Custom to 'Soft Law'" in Akkerman, Krieken and Pannenborg (eds), *Declaration on Principles* (Leyden: 1977), pp.247 et seq.
[26] Weber, *Regulatory Models for the Online World*, 2002, pp.82–83.

customary rules as well as the need to establish rules to govern international relations should not be underestimated; moreover, soft law may contribute essentially with respect to the interpretation of international law.[27] Nevertheless, certain weaknesses of self-regulatory mechanisms cannot be overlooked. These mainly concern the processes of implementation of "private norms" as well as the procedural aspects for their enforcement (for example lack of direct sanctions).[28]

Nevertheless, the experiences in the internet context show that soft law can indeed function as a regulatory scheme; the best example is probably the domain-name allocation process. Even if it is justified to question the legitimacy and the democratic fundament of the Internet Corporation for Assigned Names and Numbers (ICANN), it should not be overlooked that the whole technical system has been implemented and is running without major (legal) frictions.[29]

Multi-stakeholderism

The discussions related to the establishment of an adequate regulatory framework for the internet are more and more crystallised in the appreciation that shared power amongst (all) social participants of the online world would seem to be unavoidable, i.e. multi-stakeholderism would have to become the underlying concept for the development of the internet regulatory environment.[30] The term multi-stakeholderism stems from the discussions held in the context of the Working Group on Internet Governance (WGIG) tackling regulatory problems of the internet between the first and the second Summit on the Information Society (Geneva 2003, Tunis 2005).[31] Subsequently, the inclusion of all interested participants in the online world has become a main feature of the Internet Governance Forum's processes and deliberations.[32]

Legal scholars increasingly express the opinion that a fitting of the regulatory framework needs to consider the principles of the subject it addresses and hence pay special attention to the technological environment of the internet.[33] The bottom-up approach in self-regulation also calls for the inclusion of all interested groups of the online world; diversity and pluralism should be considered as common objectives.[34] Nevertheless, architectural principles must be implemented which take due account of a minimum of predictability required for an adequate legal framework in order to establish reliable relations between natural or legal persons.[35]

As mentioned, the internet was implemented mainly by the private sector which mostly followed a bottom-up approach in self-regulation, taking special account of the technical issues raised by this new network system. Since civil society is concerned by the establishment of communication channels, in practice every individual is potentially a "netizen". Therefore, participation in decision-making processes needs to encompass every member of civil society. In order to reflect this appreciation, Lessig has introduced the notion of the "commons" ("*Allmende*" in the sense of the old German farmers' system) allowing the inclusion of the whole of civil society in the societal processes.[36] Consequently, the inclusion of civil society calls for a bottom-up process, facilitating the enlargement of the foundation for active participation of concerned persons; even if some actors are independently organised, common strategies and goals can be developed and net networks created.[37]

Interactions between science or politics and collective responses from citizens lead to transgovernmental networks which, however, may cause a disaggregation of states in favour of the established networks, i.e. a "disaggregated sovereignty"; in such a context, actual co-operation and solution achievement could be improved, but concerns about legitimacy remain.[38] The respective networks having their own powers, incentives, motivations, abilities, etc. would, thereby, need to take due account of already existing international organisations, corporations, non-governmental organisations, and other actors in the transnational society.[39]

The specialised field of internet regulation requires a high level of competence and expertise. Joint involvement of all stakeholders having the necessary know-how is desirable. Including all stakeholders concerned with the internet in one way or the other generally ensures a form of representation at the international level. This is an important aspect in view of the legitimacy of the regulatory framework; the stakeholders, enhancing communication, co-ordination and co-operation in a kind of forum, frame a central governance point for internet issues, allowing for participation and dialogue.[40]

The envisaged realisation of the concept "multi-stakeholder in governance", perceived as the new way forward in favour of the inclusion of the whole of society, goes beyond the scope of traditional governance theories, which generally pursued an approach strictly distinguishing the state (public law) from society (civil

[27] Weber, *Shaping Internet Governance*, 2009, pp.20–21.
[28] Weber, *Shaping Internet Governance*, 2009, pp.21–22.
[29] For the discussions on the role and legitimacy of ICANN see Weber, *Shaping Internet Governance*, 2009, pp.60 et seq. with further references.
[30] See Weber, *Shaping Internet Governance*, 2009, pp.88 et seq.
[31] *Report of the Working Group on Internet Governance*, para.10, available at *http://www.wgig.org/docs/WGIGREPORT.pdf* [Accessed July 27, 2010].
[32] See Rolf H. Weber and Thomas Schneider, *Internet Governance and Switzerland's Particular Role in its Processes* (Zurich: 2010), pp.17 and 29 et seq.
[33] See Jeremy Malcolm, *Multi-Stakeholder Governance and the Internet Governance Forum* (Perth: 2008).
[34] See Slavka Antonova, *Powerscape of Internet Governance* (Saarbrücken: 2008).
[35] Weber, *Shaping Internet Governance*, 2009, pp.89 et seq.
[36] Lawrence Lessig, *The Future of Ideas* (New York: 2001), pp.19 et seq.
[37] Weber, *Shaping Internet Governance*, 2009, p.77.
[38] See Myriam Senn, "Decentralisation of Economic Law—An Oxymoron?" (2005) *Journal of Corporate Law Studies* 427, 442 et seq.
[39] Otherwise, the risk of fragmentation becomes critical (see below "Fragmentation").
[40] See Weber, *Shaping Internet Governance*, 2009, pp.148 et seq. with further references.

law). Such a development challenges the traditional international legal and political understanding of legitimacy and makes it necessary to tackle the general question of who could be a legitimate stakeholder and which aspects are to be encompassed by such concept of "transnationalism".[41]

Fragmentation

The implementation of the multi-stakeholder principle and the inclusion of all members of civil society in the (autonomous and spontaneous) rule-making process inevitably lead to a certain fragmentation of regulation since societal processes and contradictions are bound to be reflected.[42] Based on a fragmentation of knowledge, power or control,[43] increased specialisation and diversification occur and design multiple variations of regulatory types or regimes of relationships and arrangements.[44] If epistemic communities and networks are involved in the rule-making processes, private actors start to play a role not only as decision-makers, but also as intermediaries and brokers.[45]

Legal doctrine in international law has intensively developed theories about the process of constitution of autonomous regimes, for example:

- Ruggie analysed the functions of the manifold epistemic communities and their role in the rule-making processes, arguing that collective awareness and attention may be mutually beneficial.[46] Epistemic communities are created when no state goes out of its way to construct international collective arrangements.[47] The processes of international regime-formation result from the interactions between science and politics on the one hand and collective response on the other hand.[48] If regulation is left to the "owners of technology", collective values such as public order and morals will be left out of consideration; full disintermediation and private rule-making could Balkanise public discourse and leave civil society without reasonable possibilities to assess the reliability of information processes.[49]
- Koskenniemi highlighted structural conflicts between various regimes and addressed possible approaches for a harmonisation of rule-making processes.[50] In particular, although states may be prepared to participate in hybrid forms of regimes (possibly through delegated experts or by exercising their influence otherwise), they are often also inclined to transpose transnational rules into their legal framework.
- Raustiala assesses the viability of transgovernmental networks and evaluates their relationship to liberal internationalism.[51] Thereby, the conclusion is drawn that "informal" information exchanges, not controlled by the decision-making authorities of the concerned states, may cause a co-operation which leads to a disaggregation of states in favour of the established networks, i.e. to the mentioned "disaggregated sovereignty"[52]; by having such a kind of actual co-operation, the realisation of an acceptable legal framework could be facilitated.[53]
- Slaughter developed principles for government networks, being set out as relatively loose, co-operative arrangements across borders between and among like agencies that seek to respond to global issues[54] and managing to close gaps through co-ordination, thereby creating a new sort of power, authority and legitimacy.[55] Slaughter advocates the establishment of such government networks since they permit the realisation of co-ordination on a global level and create a new authority responsible and accountable for the development of rules.[56]

[41] See Weber, *Shaping Internet Governance*, 2009, p.268; for the "webs" of regulation see also Murray, *The Regulation of Cyberspace*, 2008, pp.22 et seq.
[42] Martti Koskenniemi, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law* (report of the Study Group of the International Law Commission, United Nations, A-CN.4/L.682, April 13, 2006), pp.11–12.
[43] Senn, "Decentralisation of Economic Law" (2005) *Journal of Corporate Law Studies* 427, 444 et seq.
[44] Koskenniemi, *Fragmentation of International Law*, 2006, pp.30–34.
[45] See Peter N. Grabosky, "Using Non-Governmental Resources to Foster Regulatory Compliance" (1995) 8 *Governance: An International Journal of Policy and Administration* 545.
[46] John Gerard Ruggie, "International Responses to Technology: Concepts and Trends" (1975) 29 *International Organization* 557, 562.
[47] Ruggie, "International Responses to Technology: Concepts and Trends" (1975) 29 *International Organization* 557, 570.
[48] Ruggie, "International Responses to Technology: Concepts and Trends" (1975) 29 *International Organization* 557, 559 et seq.
[49] Weber, *Shaping Internet Governance*, 2009, pp.99.
[50] Koskenniemi, *Fragmentation of International Law*, 2006, pp.65–67 and 99–101.
[51] Kal Raustiala, "The Architecture of International Co-operation: Transgovernmental Networks and the Future of International Law" (2002) 43 *Virginia Journal of International Law* 1, 17 et seq.
[52] Raustiala, "The Architecture of International Co-operation" (2002) 43 *Virginia Journal of International Law* 1, 10; see also above II.2.
[53] Raustiala, "The Architecture of International Co-operation" (2002) 43 *Virginia Journal of International Law* 1, 23–24, 55–56; see also Weber, *Shaping Internet Governance*, 2009, pp.94–95.
[54] Anne-Marie Slaughter, *A New World Order* (Princeton/Oxford: 2004), p.14.
[55] See also Weber, *Shaping Internet Governance*, 2009, p.95.
[56] Slaughter, *A New World Order*, 2004, pp.12–13 and 262–63; see also Anne-Marie Slaughter and David Zaring, "Networking Goes International, An Update" (2006) 2 *Annual Review of Law and Social Sciences* 215.

The regulation of the online world clearly shows that fragmentation can create the risk of incompatible or conflicting rules and standards; therefore, the unification aspect must become an appropriate response[57] and the diversification of global legal activities through rapid expansion of cross-border rules needs to take into account the requirement of the implementation of harmonised minimum standards, i.e. legal predictability requires increased attention to "equalise" the inherent risks of fragmentation.[58]

Nevertheless, certain mechanisms can work as a means of overcoming fragmentation:

- Transparency and accountability need to be further developed. Transparency is a recognised, significant principle for regulatory systems; its importance stems from its relevance in the achievement of other necessary tenets of regulation, such as providing sufficient information to enable informed decisions.[59] Further aspects are accessibility, clarity, logic and rationality, truthfulness and accuracy, as well as openness; since a transparent methodology for rule-making processes based on revisable procedures reduces mistrust and can have a legitimising effect, transparency and accountability should be persistent objectives of any governance mechanism.[60]
- Another important aspect concerns conflicts of laws. Contradictory or intersecting objectives of rules and mandates of international financial institutions may cause regulatory redundancies or loopholes, thus weakening the markets (and in particular financial markets) as a whole. For these cases, special conflict rules are necessary in order to determine which regulation or institution takes priority over the other rules or institutions.

Lessons from new rule-making processes for financial regulation

Based on the described findings related to the new elements of rule-making processes, lessons can be drawn in respect of the key elements of financial regulation, namely the actors, the sources of law, the regulatory targets, and the areas of regulation, constituting the four pillars of an adequate legal framework.[61]

Actors: widening the scope of participants

Tendency to polycentric regulation

In all regulatory segments, the institutional actors play a key role in the rule-making processes. As North points out, institutions structure incentives in human exchange whether political, social or economic.[62] Furthermore, institutional change shapes the way societies evolve through time; hence, it is important to understand historical change. Actors also institute processes by producing and disseminating rules that determine the behavioural patterns of the "participants".[63]

In the context of financial regulation, Black refers to the term of polycentric regulations occurring in multiple sites, shaped by practical issues and events.[64] Comparatively speaking, polycentric regulations realising a federalism approach[65] comply with the multi-stakeholder approach[66] since the information exchanges and the decision-making processes are moved to the most concerned "participants" of a specific market segment or regulatory regime.

From an institutional point of view, the actors such as organisations and institutions adopting regulatory rules are quite numerous in the financial markets. The main drivers are the international financial institutions, incorporating a considerable amount of regulatory authority and powers. Even if, over the years, several important institutions and organisations have expanded their activities to new levels, the described multi-stakeholder approach invites the adoption of a more co-operative attitude towards the inclusion of non-governmental organisations and interest groups in the rule-making process.

While it is clear that the multiplicity of regulatory actors bears the substantial risk of incoherent rule-making in the field of financial regulation,[67] such an approach would not necessarily entail an additional fragmentation of regulatory powers. To the contrary, the aim, amongst others, of a more balanced allocation of powers could be achieved by mandating the regulatory actors to co-operate and consult with the various stakeholders. In doing so, it should be taken into account that private actors do not only encompass financial intermediaries and their associations, but also investors, consumers, and the "traditional" industry being dependent on the proper functioning of the financial markets.

This risk of not sufficiently taking into account the polycentric approach of including all concerned stakeholders is enforced by the fact that some regulatory institutions and organisations have expanded their

[57] See Saskia Sassen, *Territory, Authority, Rights. From Medieval to Global Assemblages* (Princeton: 2006), pp.378 et seq.
[58] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 658–59.
[59] Weber, *Shaping Internet Governance*, 2009, p.98.
[60] Weber, *Shaping Internet Governance*, 2009, p.99.
[61] See Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 671 et seq.
[62] See Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: 1991), p.3.
[63] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 682.
[64] See Julia Black, "Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes" (2008) 2 *Regulation & Governance* 139.
[65] Weber and Schneider, *Internet Governance and Switzerland's Particular Role in its Processes*, 2010, pp.60 et seq.
[66] See above "Multi-stakeholderism".
[67] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 682.

activities far beyond their original mandates. In particular the mandates of the Bretton Woods institutions, such as the International Monetary Fund and the World Bank Group, do not reflect the actual scope of operation of these regulatory bodies anymore.[68] Moreover, the extension of the activities of these organisations limits the "playing field" for other stakeholders to eventually be in an at least equal position to contribute to the development of the financial markets and the implementation of a reasonable and fair regulatory framework.

Furthermore, from a geographical point of view, it can also not be overlooked that the Bretton Woods institutions coincide with the historical main actors at the end of the Second World War, namely the United States and its European allies. Simultaneously, Asian countries are substantially underrepresented[69]; not surprisingly, the Asian stakeholders are therefore in the process of establishing their own "Asian Monetary Fund".[70] The need to come to a more equalised representation of countries is also reflected in the fact that the G7/G8 are loosing "moral" competences in favour of the G20 having driven the process of the *Financial Summits* in November 2008,[71] April 2009,[72], September 2009,[73] June 2010 and trying to establish an adequate regulatory framework for the financial markets.[74]

Possible implementations

The implementation of a multi-stakeholder approach makes it desirable to better include the voices of all participants of financial markets in the future. The realisation of this goal would necessitate certain reforms at the institutional level, including the expansion of membership and the enhancement of status of those countries that are currently underrepresented in the regulatory processes. A step in the right direction has been made by the Forth Amendment to the IMF Articles of Agreement, which finally, after a first proposal had been submitted in 1997, came into effect in August 2009. The Amendment provides for a special one-time allocation of special drawing rights (SDR), enabling all members of the IMF to participate in the SDR system on a more equitable basis.[75]

In addition, the re-establishment of the Financial Stability Board (FSB, previously the Financial Stability Forum) by the G20 in April 2009, being the most appropriate body that can be entrusted with further functions and competences, is another step into the right direction. The FSB is a suitable body to install a more diversified and pluralistic system.[76] The FSB could thus take a leading part in the translation of a multi-stakeholder approach into the international financial regulatory agenda.

Sources of law: making soft law harder

Standardisation as soft law

Self-regulation appears to be a vital source in the field of financial regulation, at least in an international context. It generally pursues the regulatory objective of standardisation. Private stakeholders, not being directly accountable to the general public, increasingly introduce industry standards[77] designed to be observed by the relevant market participants.[78] Standards often relate to the usual behaviour of the "reasonable man", understood as an expression of common sense.[79]

The ongoing transformation implies that the evolution of self-regulatory regimes must be given due consideration.[80] A high degree of "organisation" of the market participants facilitates the implementation of international standards,[81] which is the case in the financial markets. Since standards efficiently remove market-access barriers, they are open to harmonisation procedures; with the increasing globalisation of markets, standards can ensure that important financial services meet globally-recognised levels of performance and safety.[82] Standards as such do not have a status as actual legal source as they are often non-binding.[83] Yet most standards qualify as soft law, lacking a legitimate authority of adoption and enforcement but nevertheless providing a

[68] See Weber and Arner, "Toward a New Design for International Financial Regulation" (2007) 29 *University of Pennsylvania Journal of International Law* 391, 393 et seq.
[69] See Edwin M. Truman, "Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform" in Truman (ed.), *Reforming the IMF for the 21st Century* (Washington: 2006), pp.201 et seq.
[70] *Joint Media Statement of the 12th ASEAN Plus Three Finance Ministers' Meeting*, Bali, Indonesia, May 3, 2009, available at *http://www.aseansec.org/22536.htm* [Accessed July 27, 2010].
[71] G20 Declaration, *Summit on Financial Markets and the World Economy*, Washington DC, November 15, 2008, available at *http://www.g20.org/Documents/g20_summit_declaration.pdf* [Accessed July 27, 2010].
[72] G20, *The Global Plan for Recovery and Reform*, London, United Kingdom, April 2, 2009, available at *http://www.londonsummit.gov.uk/resources/en/PDF/final-communique* [Accessed July 27, 2010].
[73] G20, *Leaders' Statement: The Pittsburgh Summit*, Pittsburgh, PA, September 24–25, 2009, available at *http://www.pittsburghsummit.gov/mediacenter/129639.htm* [Accessed July 27, 2010].
[74] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 684–85.
[75] International Monetary Fund, *Special Drawing Rights (SDRs)—Factsheet*, October 31, 2009, available at *http://www.imf.org/external/np/exr/facts/pdf/sdr.pdf* [Accessed July 27, 2010], p.2.
[76] See, e.g. Douglas W. Arner and Michael W. Taylor, *The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?*, AIIFL Working Paper No.6 (June 1, 2009).
[77] The standard setting can be understood as a form of spontaneous regulation; see above "Spontaneous regulation".
[78] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 660.
[79] Alan D. Miller, *The "Reasonable Man" and Other Legal Standards*, California Institute of Technology, Social Science Working Paper no.1277 (September 2007).
[80] See Sassen, *Territory, Authority, Rights*, 2006, pp.378 et seq.; Anthony Giddens, *The Constitution of Society, Outline of the Theory of Structuration* (Cambridge: 1984), pp.228 et seq.
[81] For a discussion of the benefits of self-regulation see Weber, *Shaping Internet Governance*, 2009, p.21.
[82] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 683.
[83] Weber, *Shaping Internet Governance*, 2009, p.20.

concrete benchmark for the behaviour of market participants.[84] However, past experience in the financial markets has shown that the implementation of autonomous regulation and non-state standards can lead to a gradual process of institutionalisation[85]; even if established by epistemic communities and decentralised networks, soft law is suitable to be of public benefit.[86]

Formalisation of soft law

Representatives of states and international organisations increasingly recognise that soft law released by private stakeholders is usually modern and dynamic and allows the implementation of adequate decision-making structures.[87] Consequently, Koskenniemi points out that neither regimes nor states have a fixed nature or self-evident objectives; therefore, the task for international lawyers would not be to learn new managerial vocabularies but the user language of international law to articulate the politics of critical universalism.[88]

Legal doctrine has established several concepts helping to put more emphasis on the legal quality of soft law:

- Hart has described the process of formalisation and institutionalisation or codification of general standards as secondary norms; civil-society actors can monitor the rules of formalisation by applying different instruments depending on their grade of specification.[89] Consequently, various forms of private and hybrid regulatory regimes emerge which, however, need to be included in a general framework that allows compliance with the relevant objectives such as homogeneity and coherence.[90]
- Linked to the increasing influence of civil society (concept of governmentality), Foucault calls for an "art of government" in order to mirror the epistemic networks and autonomous regulation against the public interest.[91]
- Teubner expresses the idea that the unity of regulatory regimes is significant for the perception of phenomena at the supra-, infra-, and trans-state levels, forecasting a new evolutionally stage in which law will become a system for the co-ordination of action within and between semi-autonomous societal subsystems.[92]

All described approaches of legal theory seem to have an inherent link to customary law. In a traditional definition, customary law applies if a uniform, consistent, and general practice is given and if a sense of legal obligation, as opposed to motives of courtesy, fairness, or morality, exists within the group of the concerned persons.[93] Legitimacy can insofar be derived from the fact that fragmentation is overcome since (almost) hard law, accepted by many stakeholders, has become applicable.[94]

Possible implementations

The expanded inclusion of all stakeholders in the financial markets is not only politically reaffirmed in international discussions, but is also a part of the Declaration of the Summit on Financial Markets and the World Economy of the G20 states of November 15, 2008, which refers to the enhanced co-operation between the stakeholders in order to restore global growth and achieve the needed reforms in the world financial systems.[95] Furthermore, the promotion of existing policy networks responsible for setting international regulatory-standards has been at the core of most (national) reports containing recommendations for a redesigning of the international financial architecture.[96] A particularly relevant and valuable function can be fulfilled in this regard by the Financial Stability Board having gained importance in the preparation of the foundations of new regulatory mechanisms.[97]

If based on co-operation and supported by broad consensus, a soft-law regime may, at least in part, be a substitute for a hard-law regime with explicit enforcement powers.[98] A balanced and diversified regulatory process, pursuing the multi-stakeholder approach, can put participants under "moral" and political pressure to support and obey soft law due to its enhanced legitimacy.[99] The experiences in the international financial markets have demonstrated—similar to the internet context—that soft law is suitable to function as a regulatory scheme. In sum, recent developments veer towards a more comprehensive and stringent framework and thus a somewhat "harder" legal approach.

[84] See above "Multi–stakeholderism".
[85] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 660–61.
[86] See also Tommaso Padoa-Schioppa, *Regulatory Finance: Balancing Freedom and Risk* (Oxford: 2004), pp.41–42.
[87] See also above "Multi–stakeholderism".
[88] Martti Koskenniemi, "The Fate of Public International Law: Between Techniques and Politics" (2007) 70 *The Modern Law Review* 1.
[89] Harald L.A. Hart, *The Concept of Law*, 2nd edn (Oxford: 1997), pp.79–81.
[90] See also Paul Schiff Berman, "The Globalization of Jurisdiction" (2002) 151 *University of Pennsylvania Law Review* 329, 366 et seq.
[91] Michel Foucault, *Naissance de la biopolitique, Cours au Collège de France 1978/79* (Gallimard/Seuil, 2004).
[92] Gunther Teubner, *Recht als autopoietisches System* (Frankfurt: 1989), pp.81 et seq. and 118 et seq.
[93] See Weber, *Shaping Internet Governance*, 2009, p.14.
[94] See above "Fragmentation".
[95] See G20 Declaration of the Summit on Financial Markets and the World Economy, 2008.
[96] See, for example, Financial Services Authority, *The Turner Review, A Regulatory Response to the Global Banking Crisis* (March 2009); European Commission, *Report of the High-Level Group on Financial Supervision with the EU* (February 2009).
[97] See above "Actors: widening the scope of participants".
[98] See Arner and Taylor, *The Global Financial Crisis and the Financial Stability Board*, 2009, p.3.
[99] See also Weber, *Shaping Internet Governance*, 2009, pp.100–01.

Regulatory targets: achieving a comprehensive mapping structure

Ongoing market integration

In financial markets—even more than in other legal fields—laws and regulations have to be able to flexibly adapt and respond to market change in order to mitigate uncertainty and restore market equilibrium.[100] Given the increasing integration of financial markets, international financial regulation is confronted with the difficult task of overcoming differences within the organisation of national legal systems and various regulatory frameworks[101] while upholding flexibility and effectiveness. By pursuing various regulatory targets, namely standardisation, harmonisation, reciprocity, mutual recognition, and co-ordination, regulators have sought to achieve this goal.

Nevertheless, it should not be overlooked that different, not coherently-implemented regulatory targets can lead to fragmentation[102] or, even worse, to chaotic arrangements. Already 14 years ago, Harvard Law School scholar Roe noted in looking at the financial system:

> "[W]hat survives depends not just on efficiency but on the initial, often accidental conditions (chaos theory), on the history of the problems that had to be solved in the past but that may be irrelevant today (path dependence), and on evolutionary accidents."[103]

In the field of financial regulation having the objective of encompassing global business activities, such fragmentation is not desirable. Consequently, initiatives need to be implemented which help overcome an inadequate fragmentation in the world of global business.

Standardisation and harmonisation

As already outlined, standardisation is the most common target in international financial regulation. Standards are often a first step to co-ordinate the transactional activities and can also establish a basis for future harmonisation. Standardisation takes up the idea of the customary rules of international law.[104] Even if implemented in a non-binding, mostly recommendatory way, standards may have a considerable influence on the behaviour of market participants as they provide a benchmark for proper business conduct.[105] The signalling effect of standards should not be underestimated; the mere announcement of the adoption of certain standards implies a more proactive stance towards the particular regulatory area and can already trigger behavioural change by the signal's recipient.[106] In a nutshell, standardisation plays a central role as regards every source of law, be it soft or hard.

Yet, in recent years, the principle of harmonisation has gained importance. On the one hand, this fact can be explained with the increasing relevance of the International Monetary Fund, trying to implement a harmonising approach in various areas of financial regulation. On the other hand, the target of harmonisation is promoted by growing integration processes all over the world and the acknowledgement of the concerned stakeholders that a certain degree of coherence is inevitable in order to allow the smooth execution of international transactions.[107] Harmonisation should not be qualified as contrast to standardisation but rather as a further step in the direction of legal convergence. However, from a multi-stakeholder perspective, the regulatory unification that necessarily accompanies the harmonisation process and consolidates the existing regulatory frameworks may be critical. In practice, the drafting of harmonised rules is mostly geared to the regulation and regulatory practices of dominant stakeholders, whereas less powerful groups, such as developing countries, have to stand aside.[108]

Reciprocity, mutual recognition and co-ordination

Contrary to standardisation and harmonisation, the principles of reciprocity and of mutual recognition do not have a major importance in the field of financial regulation.[109] More astonishing is the fact that co-operation—in the sense of a regulatory target—has also not yet found a substantial role to play in financial regulation.[110] Until the outbreak of the current financial crisis, the co-ordination approach has often been pursued rather spontaneously, based on the circumstances of the individual case. However, permanent and institutionalised co-ordination is a prerequisite for transparent, sound, and properly supervised financial markets. The political tenor thus goes toward the strengthening of institutional co-operation, especially between the FSB, the IMF and the World Bank, and the establishment of new multilateral institutional structures such as the FSB as well as the so-called supervisory colleges.[111]

In sum, the co-ordination approach seems to have gained in importance as a result of the financial turmoil that has hit global financial markets with unprecedented intensity and complexity during the past months.

[100] Milhaupt and Pistor, *Law and Capitalism*, 2008, pp.5 and 27–28.
[101] Milhaupt and Pistor, *Law and Capitalism*, 2008, pp.28 et seq.
[102] See above "Fragmentation".
[103] Mark Roe, "Chaos and Evolution in Law and Economics" (1996) 109 *Harvard Law Review* 641.
[104] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 658 and 683; see also above II.2 and III.2.
[105] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 661.
[106] Milhaupt and Pistor, *Law and Capitalism*, 2008, pp.34–35.
[107] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 658–59 and 683–84.
[108] See Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 659.
[109] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 662–63 and 684.
[110] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 684.
[111] See, e.g. United Nations General Assembly, *Outcome of the Conference on the World Financial and Economic Crisis and its Impact on Development* (July, 13 2009).

Compared to other regulatory targets, especially standardisation and harmonisation, co-ordination has the advantage that it is non-exclusive. It rather naturally fosters dialogue and collaboration among various stakeholders, thereby adopting the multi-stakeholder approach, yet without necessarily initiating a regulatory race to the bottom.

Areas of regulation: structuring the relevant issues

Problems of matrix implementation

The dynamic relationship between law and markets is governing the question of which areas are covered by financial regulation. The identification of the actors and the rights that find protection in the regulatory systems necessarily involves a balancing of conflicting interests.[112] Over the past decades, the variety of issues being encompassed by financial regulation has consistently increased. In addition, regulatory frameworks often contain rules with implications in several areas; hence, the regulators do not stick to a specific, single area, but cover several issues in the adopted rules.[113] This way of processing, however, bears the risk of overlapping regulations and of causing interferences, for example between transparency/accountability, prudential regulation, surveillance and market integrity.

The lessons which can be drawn from the new theoretical regulatory approaches for the areas of regulation seem, unfortunately, not to be highly relevant for the redesign of the international financial architecture. Except as far as transparency and accountability is concerned, the areas of regulation are (not very surprisingly) very much driven by the concerned market segment and do not allow to draw too much on a comparative analysis.

Transparency and prudential regulation

As already mentioned in the context of internet regulation,[114] transparency and accountability are regulatory areas which have attracted the regulators' attention to a great extent. These two topics are fundamental both as a feature of the regulatory system and an aim of regulation. By abolishing information asymmetries, transparency and accountability enable the market participants to judge and compare financial services, thereby also becoming an instrument of consumer protection.[115] Disclosure rules and information audits are crucial factors for the functioning of financial markets. Clear, comprehensive, and effective accounting standards can additionally provide for an early warning regarding financial turmoil.[116] By promoting transparency, financial regulation also helps to ensure that the financial sector takes full responsibility for its own decisions and actions in order to reduce moral hazard.[117]

By establishing appropriate requirements for financial intermediaries, prudential regulation aims at implementing safety and soundness related to the financial system as a whole. The term "prudential regulation" is very broad and is not always employed consistent.[118] A reasonable distinction can be drawn between preventive and protective regulation: whereas preventive regulation is concerned with controlling the risks taken by financial intermediaries, thereby reducing the probability of failures of market participants to an acceptable level, protective regulation refers to measures which provide support to financial intermediaries once a crisis threatens, such as deposit insurance systems and the lender-of-last-resort function.[119]

Generally, the objective of prudential regulation is to be seen in the intention to prevent the development of systemic risks in order to maintain the stability of the financial sector.[120] Thereby, prudential regulation helps to promote public confidence, an obviously vital pre-condition for the smooth operation of financial intermediaries.[121] By ensuring that market players operate in a sound and prudent manner and that they hold enough capital and liquidity in order to meet the various challenges of their respective businesses, prudential regulation complements effective management and market discipline.[122] International efforts ensuring adequate prudential regulation have led to the formulation of various minimum standards and best practices, namely those adopted by the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

Surveillance and market integrity

Another important issue in financial regulation is surveillance, constituting both an enforcement technique and an objective for financial stability. Surveillance is only efficient if the supervisors, not necessarily being identical with the regulators, are at least as equally well-informed as the market participants.[123] In the financial

[112] See Milhaupt and Pistor, *Law and Capitalism*, 2008, pp.5, 32.
[113] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 684.
[114] See above "Fragmentation".
[115] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 665.
[116] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 665.
[117] See Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 666 with further references.
[118] Lazaros Panourgias, *Banking Regulation and World Trade Law—GATS and EU and "Prudential" Institution Building* (Oxford: 2006), pp.11 et seq.
[119] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 669; Guido Ferrarini, "Introduction" in Ferrarini (ed.), *Prudential Regulation of Banks and Securities Firms. European and International Aspects* (London/The Hague/Boston: 1995), pp.3–4.
[120] See Rolf H. Weber, "Financial Stability—Structural Framework and Development Issues" (2008) *International and Comparative Law Journal* 1.
[121] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 669.
[122] Douglas Arner, *Financial Stability, Economic Growth and the Role of Law* (Cambridge, 2007), p.196.
[123] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 669–70.

markets, the IMF plays a leading part in the surveillance regime, but this issue is also a fundamental aspect of the WTO's duties and responsibilities being realised through the trade-policy review mechanism.[124]

The integrity of the financial markets, embracing fairness, efficiency and transparency, is a basic premise for their functioning. If there is a risk of them being somehow manipulated or exploited for criminal purposes, investors and consumers are deterred from participating in a financial market since public confidence in the financial system will be impaired by the abuse of entrusted power for private gain[125] and destroy public awareness of the benefits and risks of financial markets.[126] Financial intermediaries, becoming increasingly active in cross-border businesses, also are affected by practical costs and problems of corruption; therefore, combating corruption and upholding market integrity is an important aspect of financial regulation.

With the improved position which the Financial Stability Board has gained since its renaming at the occasion of the Second World Summit of early April 2009 in London, efforts should be taken to give the FSB a stronger co-ordinating role in the implementation of the manifold rules. The FSB could become the most suitable actor for the co-ordination of the rule-making processes in the financial markets.[127]

Conclusions

As the above considerations have shown, many developments in the financial markets have paralleled those in the internet markets. Examples include the rapid progress of technology, the substantial influence of self-regulatory mechanisms, and the frequent lack of adequate responses by state regulators.

However, the differences between the two regulatory fields are similarly numerous. Systemic risks mainly play a role in financial markets, at least as far as the substantive rules are concerned. In the internet market, "only" the technological functionality is systemic. In addition, the risk of contagion is much higher in the financial sector than in the internet markets. Furthermore, the financial business is to a great extent based on confidence and trust among all involved parties, and since confidence is of a fragile nature, financial intermediaries are particularly vulnerable to instability.

Despite these differences, certain experiences made in internet regulation can serve as a basis for future improvement of financial regulation. Over the past few decades, financial markets have undergone a process of integration and globalisation that has extended the circle of their "participants" to an extent comparable with the scope of the internet. While it soon became generally accepted that the development of internet regulation should be based upon the objectives of diversity and pluralism, involving all social participants in the online world, the scope of participants in the financial regulatory process is (still) rather limited. The adoption of a multi-stakeholder approach—similar to the one having been taken in internet regulation—would help overcome the imbalances by implying a more co-operative attitude towards the inclusion of additional stakeholders in the rule-making process.

As the implementation of the multi-stakeholder approach may create the risk of incompatible or conflicting rules, means to overcome regulatory and institutional fragmentation have to be further developed. These may include the strengthening of the principles of transparency and accountability and the implementation of conflict rules. In the financial markets' context, it is particularly important to achieve a comprehensive regulatory mapping structure, especially by enhancing the co-ordination among the international financial institutions, and an efficient pattern of regulatory areas in order to provide for a flexible regulatory framework able to adapt to the rapidly evolving financial markets.

Since the outbreak of the current financial crisis, the need for certain reforms at the institutional level, aimed at better considering the voices of all the participants in financial markets, has become even more apparent. The recent adoption of the Fourth Amendment to the IMF Articles of Agreement (finally) provides for a more equitable allocation of powers among the members of the IMF. At the core of the development towards a more pluralistic and diversified financial regulatory framework is the FSB, having been entrusted with further functions and a broader membership by the G20 in April 2009. The FSB seems to be a suitable actor to incorporate the multi-shareholder approach into the financial regulatory agenda, simultaneously alleviating fragmentation by co-ordinating its efforts with other international financial institutions and stakeholders and by promoting transparency.

[124] Weber, "Mapping and Structuring International Financial Regulation" (2009) *European Banking Law Review* 651, 670.
[125] See UK Financial Services and Markets Act 2000 s.2(2)a; Arner, *Financial Stability, Economic Growth and the Role of Law*, 2007, pp.181–82.
[126] See UK Financial Services and Markets Act 2000 s.2(2)b.
[127] See Arner and Taylor, *The Global Financial Crisis and the Financial Stability Board*, 2009, pp.11–12.