Harmonising International Capital Adequacy Standards For Securities Firms:

Explaining the Contours of Authority in the EU and IOSCO Negotiations

Richard William Kurz

Thesis submitted for the Ph.D. degree in International Relations
London School of Economics and Political Science
University of London
September 12, 2003

Abstract

This thesis investigates the sources, structure, and exercise of authority and influence in international policy-formation. It does this by examining two contemporaneous negotiations to harmonise securities firm capital adequacy standards, the European Union's successful adoption of regional standards and the International Organization of Securities Commission's failed effort to adopt international standards.

The thesis examines the accuracy of state and non-state centric hypotheses in explaining the outcomes of the negotiations. It also proposes a synthetic analysis of empirical findings, which identifies and assesses interactions between observations drawn from state and non-state centric approaches, to develop new perspectives on authority and influence in policy formation.

The thesis argues that international policy-making authority ultimately resided with state actors and institutions. Policy-making was informed by the interaction of state and non-state preferences. Rarely, however, were non-state preferences translated, unaltered, into policy. The case studies demonstrated that international policy-making authority and influence extended beyond state actors, but that states retained their autonomy and sovereignty in policy formation.[1]

This thesis finds that non-state-centric approaches are analytically superior to state-centric perspectives. But synthetic analysis of state and non-state centric empirical observations goes even further, to develop distinctive conclusions that cannot be derived by relying solely on discrete analytical perspectives. This is because it examines the process of policy-formation and the dynamic interaction of state and non-state observations. These conclusions encourage multi-variable, process-focused analysis.

The empirical analysis also qualifies the arguments of certain non-state centric perspectives. First, theorists' conflation of authority and influence detracts from a nuanced assessment of influences on policy formation. Second, the analytical complexity of multiple-variable perspectives is justified by their superior analytical insights. Third,

[1] This argument applies only to the US and EU member-states.

theorists' argument that globalisation has transformed state authority is shown to be overdrawn. Fourth, predictions of international regulatory convergence also appear strained. Finally, the utility of EU integration perspectives in non-EU analyses is demonstrated.

Table of Contents

Table of Contents (continued)

Glossary of Terms

"1992" and "1992 Initiative"	See: "Single Market"
AFBD	Association of Futures Brokers and Dealers (UK). See SRO.
AIBD	Association of International Bond Dealers. Renamed International Securities Market Association. The only international self-regulatory organisation in the UK. Recognised under the FSA as an SRO with responsibility for regulation and supervision of the international and Euro bond markets.
AICPA	American Institute of Certified Public Accountants
Arbeitsgemeinschaft der Deutschen Wertpapierbörsen	The Federation of German Stock Exchanges
BAFT	Bankers Association for Foreign Trade (US banking trade organisation)
The "Bank"	The Bank of England, England's central bank.
Basle Capital Accord (also "Capital Accord")	The Basle Capital Accord of July 1988, sets down the agreement among the G-10 central banks to apply common minimum capital standards to their commercial banking industries, to be achieved by end-year 1992.
Basle Committee	The Basle Committee on Banking Supervision, a committee of banking supervisory authorities, established by the central bank Governors of the G-10 countries.
Bearer security	A "bearer" security is not specifically registered as to ownership to an individual or institution. Rather, it is registered to the holder or bearer of the security. The owner of the security is literally the entity bearing the security. As a consequence, the security can be held confidentially and traded without disclosure of the seller or purchaser. This practice was prohibited in the US as bearer ownership makes it very difficult to track ownership for tax purposes.
BIS	Bank for International Settlements (BIS - Basel, Switzerland). The principal international organisation for central bank cooperation and consultation. The BIS was established in 1930 to deal with reparation payments imposed on Germany by the Treaty of Versailles. The bank acted principally as a trustee for Dawes and Young Plan Loans. As reparations declined, BIS activities focused entirely on cooperation among central banks and, increasingly, other agencies in pursuit of international monetary and financial stability.

Glossary of Terms (continued)

"*Bunds*"	German government bonds
CAD	Capital Adequacy Directive
CBOE	Chicago Board Options Exchange
CBOT	Chicago Board of Trade
CBV	*Conseil des Bourses de Valeurs*. The French Stock Exchange Council. Primarily a private sector legislative and judicial stock exchange authority.
CEA	Commodities Exchange Act, the legislation governing the CFTC.
CFTC	Commodity Futures Trading Commission (US)
"The City"	The "City" refers to the financial district in London where the majority of financial services firms and regulators are traditionally housed.
COB	*Commission des Opérations de Bourse*, French domestic securities regulator.
Commercial paper (CP) Euro-commercial paper (ECP)	Short-term, unsecured promissory notes issued in domestic and international markets including Euromarkets. Maturities typically range from 1 day to nine months.
COREPER	Committee of Permanent Representatives, a Committee of senior EC member-state official representatives based in Brussels. COREPER is the forum where the majority of drafting and negotiating over directives took place prior to ministerial meetings. Its presence ensures member-states maintain control over Council working processes.
Credit risk	The likelihood that an institution will default on a credit (borrowed money) obligation. See market risk.
Derivatives	The term encompasses a wide variety of, frequently complex, financial instruments developed with the use of futures, options, indices and conventional securities, often designed to hedge related asset or liability positions or to take advantage of arbitrage opportunities between or within discrete markets.
Derivatives Policy Group ("DPG")	Forum comprised of representatives from six largest US derivatives dealers. Activities are coordinated, not supervised, by SEC and CFTC.
DG XV	The EC's Directorate General for Financial Services and Company Law. The EC administrative agency responsible for, *inter alia*, developing financial services regulation.

Glossary of Terms (continued)

Disintermediation	The replacement of bank borrowing by securities issuance in capital raising
DJIA	Dow Jones Industrial Average. A widely followed index for US equities
DM	*Deutsche Mark*
DTB	*Deutsche Termin Börse*
DTI	Department of State for Trade and Industry, (UK Government)
EBRD	European Bank for Reconstruction and Development
EC	European Community, the predecessor to the European Union ("EU").
ECB	European Central Bank
ECOFIN	European Council of Economic and Finance Ministers
ECSC	European Coal and Steel Community
ECU	European Currency Unit
EMI	European Monetary Institute, predecessor organisation to the ECB
EMS	European Monetary System
EMU	European Monetary Union
ERM	Exchange Rate Mechanism
Euromarket	The largely unregulated, off-shore debt and equity primary and secondary markets, centred in London and, in the late 1980s and early 1990s denominated principally in US dollars. Also, Eurobond, EuroYen, etc.
European Commission	Administrative arm of EC/EU bureaucracy.
Exchange rate swap	An agreement between borrowers to exchange (or "swap") the currency of their repayment obligations. Also "currency swap.
FASB	Financial Accounting Standards Board, the US SRO responsible for setting US domestic accounting rules and regulations. See IASC.
The "Fed"	The US central bank, the Federal Reserve.

Glossary of Terms (continued)

FIMBRO	Financial Intermediaries, Managers and Brokers Regulatory Organisation, responsible for retail investment management (UK). See SRO.
Foreign exchange risk	The risk to which an institution is exposed by virtue of carrying obligations in multiple currencies whose value, relative to other currencies, is subject to fluctuation. See market risk.
FRBNY	The Federal Reserve Bank of New York. See "Fed."
FRCD	Floating rate certificate of deposit.
FRN	Floating rate note.
FSA 1986	Financial Services Act of 1986 (UK)
FSVC	Financial Services Volunteer Corps (US)
GAAP	GAAP is an acronym for Generally Accepted Accounting Principles, the standard for financial accounting practice in the United States. The Financial Accounting Standards Board ("FASB"), the industry standard-setting body, determines GAAP.
GAO	General Accounting Office (US). The official US federal research and auditing body.
"Germany"	After WW II, Germany was divided into western (*Bundesrepublik Deutschland* - BRD) and eastern (*Deutsche Democratische Republik* - DDR) states. After reunification in 1989, the successor state was called the BRD. For simplicity, I have referred throughout to "Germany." Where the context applies to pre-unification Germany, the reference is to West Germany.
"Gilts" or "Gilt-edged market"	UK domestic government bond market
GNMA	Government National Mortgage Association
"Grandfathering"	The practice of excluding institutions from certain, typically new, regulations, if those institutions meet certain criteria, usually that they began operations in the affected jurisdiction before the regulations were adopted.
IASC	The International Accounting Standards Committee is the international accounting industry body responsible for establishing internationally recognised and accepted accounting and auditing standards. See FASB.
IATA	International Air Transport Association

Glossary of Terms (continued)

IIF	Institute of International Finance. A private, regulatory research and lobbying organisation comprised of international financial institutions.
IMRO	Investment Management Regulatory Organisation, responsible for institutional fund management. (UK) See SRO.
Interest rate swap	An agreement between obligors to exchange (or "swap") interest rate payment obligations.
IPMA	International Primary Markets Association, founded in 1984, as a trade association comprised of senior members of the international financial community involved in the underwriting and distribution of both debt and equity issues in the Euromarkets. Its limited membership was comprised of the leading international banks and securities firms located in London.
IOSCO	International Organization of Securities Commissions
IPE	International Political Economy. Generally considered a sub-discipline of IR although this is contested.
IR	International Relations.
ISD	Investment Services Directive
ISMA	International Securities Markets Association. Global SRO. Has the status of a Designated Investment Exchange in the UK. See AIBD.
ISRO	International Securities Regulatory Organisation (UK)
ISRR	International Securities Regulation Report
Junk Bonds	Junk bonds technically referred to as "high-yield" bonds, carry ratings (issued by independent rating agencies such as Moody's or Standard & Poor's) that are below investment grade, that is, below BBB- and Baa3. By virtue of their lower ratings and higher implied repayment and default risks, these securities carry higher, compensatory, rates of interest.
LAUTRO	Life Assurance and Unit Trust Regulatory Organisation, responsible for retail life assurance and regulated investment schemes. (UK) See SRO.
Leverage	The ratio of capital (shareholder's funds and additional paid in capital) to liabilities, a common measure of risk for financial institutions.

Glossary of Terms (continued)

Liffe	London International Financial Futures and Options Exchange
Liquidity risk	The risk that a firm will not be able to unwind or hedge a position.
LSE	London Stock Exchange
Market risk	The variability of portfolio values due to changes in market prices of portfolio components. May include changes in interest rates, credit values, economic conditions, political concerns, foreign exchange or related market factors. See liquidity risk, credit risk, foreign exchange risk, settlement risk.
MATIF	*Marché à Terme Internationale de France*
Medium-Term Notes ("MTNs")	Unsecured debt obligations with maturities ranging from 9 months to 30 years. Typically issued in small, discrete tranches in US and international markets.
MJDS	Multijurisidctional disclosure system. Agreement between the US and Canada to recognise each other's domestic securities registration requirements.
Moral hazard	The risk that government insurance of bank deposits or other activity will provoke risky lending or similar behaviours.
MOF	Ministry of Finance (Japan).
MOU	Memorandum of Understanding
NASD	National Association of Securities Dealers (US). A U.S. SRO dedicated to trading and broking issues.
NASDAQ	National Association of Securities Dealers Automated Quotation system. The main domestic OTC market.
Program trading	Generally describes debt or equity trading initiated by a computer program, as opposed to the judgment of an individual. Program trading is typically predicated on certain trading actions, the purchase or sale of securities, being triggered by a market achieving pre-defined thresholds. Once a threshold was achieved – for example, once a market index or security price had declined sufficiently – the program would trigger the sale of designated securities. The action was automatic. Because many firms employed program trading strategies (which themselves were relatively well known) as a hedging mechanism they were frequently blamed for creating a "herd mentality" among traders, stimulating large sell-offs in securities

Glossary of Terms (continued)

OECD	Organization for Economic Cooperation and Development
OTC	Over-the-counter. Typically refers to an unregulated market.
PSA	Public Securities Association. US SRO concerned exclusively with bond trading.
Qualified Institutional Investor ("QIB")	The definition of a "qualified institutional investor"(or buyer) is complex but, in essence, it represented an institutional investor managing in excess of $100 million. Estimates of the size this universe of investors represented varied from 800 to over 3,000 investors.
"Quote-driven" markets	Quote-driven markets are characterised by trade pricing being determined without reference to the magnitude of a trade. (See "trade-driven" markets.)
(SEC) "Registration"	Registration of securities with the SEC refers to a procedure whereby an entity wanting to issue securities in the US "public" or registered market, completes the preparation of a Registration Statement and Prospectus containing information regarding the issuer as well as the securities being issued. The documents are submitted to the SEC, which reviews them for completeness and conformity with disclosure requirements stipulated by SEC regulations. If the material meets the appropriate SEC standard, the documents are accepted and the issuer may proceed with the issuance of securities. Meeting the SEC mandated disclosure standard has been an insurmountable obstacle for many non-US based issuers of securities.
"Repo"	Repurchase (or "repo") agreements are agreements entered into by financial institutions to repurchase securities that have been sold, typically to other financial institutions. Repo agreements are widely used for balance sheet management and borrowing. If a firm wishes to decrease the percentage of securities on its balance sheet it can enter into repo agreements and "sell" its securities (with a parallel agreement to buy them back) and invest the proceeds in low risk investments, such as government securities. If a firm wishes to raise money, it can lend (sell) securities and take cash in return, in effect borrowing as it intends to purchase the securities back. The risk associated with this practice is that the value of securities sold changes before the agreement is completed, requiring the lending firm locate additional funds to buy back its securities.

Glossary of Terms (continued)

Rights Offering	An offering of securities ("rights"), typically made to existing securities holders, granting the ability to purchase additional securities (occasionally the right may itself be a share in the company) issued by the company. Rights are generally priced preferentially to existing market share prices, but may incorporate limits on the ability of an investor to exercise their purchase right
"S&L"	Savings and Loan. Also called a "thrift" institution (US). Devoted primarily to mortgage lending.
SBD	Second Banking Coordination Directive (EC)
SBF	*La Société des Bourses Françaises*. The French Stock Brokers Association. An SRO whose membership includes all securities brokers in France.
SEA	Single European Act (see Appendix A.)
SEAQ and SEAQ-I	Stock Exchange Automated Quotations system. SEAQ-International ("SEAQ-I") is the London Stock Exchange's electronic price quotation system for non-UK equities and forms the basis for the London market in international securities. It is based on the National Association of Securities Dealers Automatic Quotation system ("NASDAQ") used in US OTC markets.
SEC	Securities and Exchange Commission (US) Established in 1933.
Securities firm	Financial institutions whose principal activities Are underwriting and trading of securities. Typical securities firm activities also include corporate finance (advice on balance sheet management and corporate strategy) as well as investment advice.
Settlement risk	The risk of settlement default due to operational causes.
SFA	Securities and Futures Authority (UK). Established in 1991 by the merger of the AFBD and TSA (see "SRO")
SIA	Securities Industry Association. The senior US lobbyist/SRO for investment banking and brokerage issues.

Glossary of Terms (continued)

SIB	Securities and Investments Board (UK). Established in 1988 with the implementation of the FSA 1986. Responsible for the regulation and supervision of UK securities markets. Not a government bureaucracy, but a private limited company. However, reports to Treasury Secretary.
SIM	*Società de Intermediazione Mobiliare* Specialised entities eligible to underwrite and trade securities domestically in Italy.
"Single Market"	The goal established through the SEA and the Cockfield Report to harmonise regulatory standards in the EU in selected areas by the end of 1992. Also "1992 initiative."
SRO	Self Regulatory Organisation. UK SROs included a) the Association of Futures Brokers and Dealers ("AFBD") responsible for futures and options contracts, b) The Securities Association ("TSA") responsible for securities dealing and corporate finance, c) the Investment Management Regulatory Organisation ("IMRO") responsible for institutional fund management, d) the Financial Intermediaries, Managers and Brokers Regulatory Organisation ("FIMBRO") responsible for retail investment management, and e) the Life Assurance and Unit Trust Regulatory Organisation ("LAUTRO") responsible for retail life assurance and regulated investment schemes. Other countries have SROs as well
SWIFT	Society for Worldwide Interbank Financial Telecommunications. A commercial organisation set up to facilitate interbank funds transfers and related communication.
Thrift	A savings & loan institution. (US) See S&L.
	US SROs included the NASD, the PSA and the SIA.
"Trade-driven" markets	Trade-driven markets are characterised by trade pricing being determined with prior knowledge of the magnitude of a trade. (See "quote-driven" markets.)
TSA	The Securities Association, UK SRO responsible For securities dealing and corporate finance.
UNCTAD	United Nations Conference on Trade and Development

Glossary of Terms (continued)

Universal banking	Refers generally to a financial institution's authorisation to participate in both traditional bank "credit" or lending activity as well as in securities "underwriting" and trading.
US	United States of America
UK	United Kingdom of Great Britain and Northern Ireland

Chapter 1

Introduction

International finance operates at the intersection of politics and economics, which makes it a particularly rich subject for scholarly inquiry. Governments depend on financial markets to raise capital and to exercise monetary and fiscal policy. Individuals and corporations also rely on financial markets for investment and capital raising. Capital markets, and the financial organisations that operate in them, are highly differentiated; they can be public or private and can function domestically and globally. Financial markets and institutions work under diverse economic and political structures and are subject to distinct national and supranational regulatory regimes. These characteristics make international finance both important and arcane – a potentially volatile and stimulating regulatory combination.

Two features of financial markets and institutions make their operations particularly significant. First, the majority of markets and institutions are private, yet they often provide public goods. Second, private financial institutions typically mediate capital access, yet many of the most important users of capital markets are sovereign or supranational entities.[1] As a consequence, the efficient, fair and prudent operation of financial services institutions and markets is important to supranational actors, to states, to regulators, and to private actors. These characteristics make the regulation of financial institutions an issue of critical concern.

Two aspects of recent capital market evolution have complicated the development of harmonised international regulatory standards. First, capital markets have developed from national into regional and even global institutions. Financial firms, following market evolution, have also become global actors, often with attenuated national affiliations. Second, product and technological innovation in financial services

[1] There are, of course, exceptions. Some governments and large multinational corporations access capital markets directly, rather than through intermediaries.

has accelerated. This has made market institutions and actors constantly changing regulatory targets, able to rapidly adjust their organisational structure and product offerings to accommodate market opportunities or regulatory constraints.[2] Finally, despite the prediction by state/market theorists[3] that globalisation would encourage market and regulatory convergence, distinct national markets and regulatory regimes persist.[4] Technical and operational developments have increased the ability of private firms to arbitrage their operations and capital-raising activities between markets and regulatory regimes. But, at the same time, market growth has increased the demand from private and, particularly, from public sector actors for harmonised rules to manage and monitor multinational markets and institutions. These developments describe a dynamic market environment that operates across borders and that is highly differentiated. It also describes an environment with many conflicting sources of regulatory authority and influence.

Empirical Focus

The primary research objective of this study is to determine how authority was structured and how it was exercised in two case studies of contemporaneous international capital adequacy harmonisation efforts in the securities industry. The case studies are used to assess the structure and avenues for expression of authority and influence in international policy formation.[5]

In the early and mid-1980s, inconclusive discussions between national regulators over bank capitalisation were formalised in talks between representatives of the Bank of England and the US Federal Reserve. These discussions ultimately led to the development of the Basle Capital Accord ("Basle Accord" or "Capital Accord")[6] under the auspices of the Bank for International Settlements ("BIS")[7] and its affiliated

[2] See Chapter 2 for an extended discussion.
[3] See description of state/market theoretical approaches in Chapter 3.
[4] Paul Hirst and Grahame Thompson, *Globalization in Question: The International Economy and the Possibilities of Governance* (Cambridge: Polity Press, 1996).
[5] "Securities firm," "investment firm," and "investment bank" are used interchangeably in this study. All refer to the same type of commercial entity – one whose principal business is underwriting, distributing and trading securities. See Chapter 2 for a discussion of the operational and regulatory implications of the differences between commercial banks and securities firms. See Glossary for additional definitions.
[6] Addressing capital adequacy for "credit institutions."
[7] See Glossary.

institution, the Basle Committee on Banking Supervision ("Basle Committee").[8] The success of these discussions, combined with the increasing prominence of securities issuance in financing and investment,[9] stimulated wider discussions among national and supranational regulators aimed at creating analogous harmonised capital standards for securities firms. These later discussions took place in two forums: in the European Economic Community ("EU"),[10] as part of its 1992 Single Market program,[11] and in the International Organization of Securities Commissions ("IOSCO"). Shadowing both the EU and IOSCO discussions were the Basle Committee's deliberations on the appropriate capital treatment of bank equity portfolios. These latter discussions influenced both the substance and the outcome of the EU and IOSCO negotiations.

The EU negotiations resulted in the adoption of the Capital Adequacy Directive ("CAD") and the Investment Services Directive ("ISD") in early 1993. These directives were intended to harmonise, *inter alia*, capital adequacy standards for investment firms operating in the EU. Concurrently, IOSCO's members laboured to develop an international capital adequacy standard for investment firms. However, IOSCO's negotiations failed to produce an internationally acceptable standard, and they collapsed in 1993. Consequently, this analysis also addresses the question of why the EU negotiations succeeded and the IOSCO negotiations failed.

Theoretical Objectives

The theoretical objective of this study is to assess empirical observations against hypotheses that define state and non-state centric arguments on the location of authority in international decision-making.[12] The thesis examines a central argument of non-state centric theories,[13] that policy-making authority has migrated away from the state, and it

[8] Bank for International Settlements. See Glossary.
[9] Referred to generally as disintermediation. See Glossary.
[10] Throughout this thesis, for convenience, reference is made to the European Union ("EU"). The EU was, of course, preceded by the European Economic Community ("EEC" or "EC"). The EU came into existence in 1993.
[11] Discussed in chapter 4.
[12] Theoretical perspectives range from state-centred to non-state centred. This same range also describes a progression from analyses focused on a limited number of variables to analyses considering multiple variables and levels of analysis.
[13] This refers to state/market and EU integration theories. See chapter 3 and, *inter alia*, Susan Strange, *States and Markets*, second edition. (London: Pinter Publishers, 1988)., Gary Marks, Liesbet Hooghe, and Kermit Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance," *Journal of Common Market Studies* 34, no. 3 (1996).

asks what is the best way to understand the exercise of authority and the resulting patterns of securities market governance across levels of analysis and a range of actors.[14] This study also develops a "synthetic" analysis of empirical data that combines observations derived from state and non-state centric perspectives in order to develop new insights into international policy formation. This analysis reveals where individual theoretical perspectives succeed or fail in explaining international policy-making. Finally, the thesis examines such issues as the complexity of non-state centric analytical perspectives, whether EU integration perspectives are *sui generis*, whether globalisation has encouraged regulatory convergence, and the state/market argument that globalisation has "transformed" the state.

There is an important qualification to these objectives. This thesis examines specific negotiations that were conducted over a short time period, which limits assessment of the migration of authority *over time*. As a consequence, this thesis considers whether, *within the examined environment and timeframe*, states or other actors and institutions had influence over international regulatory policy development. Additionally, by limiting the definition of authority to formal state authority, the thesis clarifies the multiple sources of influence in international policy formation.

Arguments

This thesis argues that international policy is formed by the interaction of state and non-state preferences. It concludes that, for the case studies, state preferences predominated in policy formation, but that non-state preferences influenced the formation of state preferences. These arguments are based on three observations. First, state economic and political structures were central to negotiations over the structure of international policy. In particular, fundamental state preferences acted as thresholds for determining the acceptability of international policy harmonisation alternatives. These preferences were influenced by non-state preferences, but they were dominated by powerful state concerns associated with the preservation of public goods and historic state policies. Second, state actors and institutions were responsible for assessing policy preferences and for acting on their assessment. They preserved state autonomy. Third, few instances are observed of non-state preferences being translated into policy, either

[14] "Governance," "authority," and "influence" are examined in chapter 3.

unaltered or in contravention of state preferences. As a consequence, it is inaccurate to say that authority has migrated away from states. Rather, policy in the case studies was formed by states, influenced by both state and non-state preferences.

The argument that authority has migrated away from the state is overdrawn. However, if we only look at the state and do not examine closely the sources and patterns of non-state influence, we will be equally inaccurate, because these sources of influence helped determine state preferences. Each analytical perspective provides useful diagnostic insights. But these insights are limited; each perspective privileges certain explanatory variables and makes distinctive predictions regarding the outcome of negotiations. Consequently, this thesis argues that only a comprehensive, synthetic analysis will capture the interrelationships of state and non-state preferences in policy formation.

In order to assess sources of authority and influence, this thesis first examines how these terms are defined. The conventional definition of authority is the right to perform some action, including the right to make laws and other rulings.[15] However, authority also implies that actors' actions and preferences carry legitimacy and utility. As a consequence, authority may be formal or informal, public or private; it may appear as the ability to set agendas and fix rules, or the ability to shape actions other than by brute force. This description of authority, similar to that utilised by Weber, Susan Strange and Gramscian scholars,[16] conflates authority with influence and power.[17] This thesis considers whether this conflation clouds our understanding of how authority and influence operate.

Can authority and influence be constructively distinguished? States develop and enforce rules and regulations, exercising their formal authority. States may also "rubber-stamp" the regulatory preferences of influential non-state actors or institutions whose

---

[15] See generally: David Miller, "Authority," in *The Blackwell Encyclopaedia of Political Thought*, ed. David Miller, et. al., (Oxford: Blackwell, 1991) and Chapter 3.

[16] Dr. A.R. Walter suggested this point. On Gramsci see: Randall D. Germain and Michael Kenny, "Engaging Gramsci: International Theory and the New Gramscians," *Review of International Studies* 24, no. 1 (1998). and Craig N. Murphy, "Understanding IR: Understanding Gramsci," *Review of International Studies* 24, no. 3 (1998).

[17] Strange's definition of structural power (defined as the power to decide how things are done – to shape frameworks) is, of course, broader, encompassing brute force or forced compliance. This is contrasted with her definition of relational power (defined as the power of A to get B to do something it would not otherwise do). Both definitions focus on power rather than authority or influence.

recommendations carry utility and legitimacy.[18] Identifying and assessing sources of authority and influence is important in clarifying the location(s) and character of policy-making authority.[19] It is ironic that non-state centric analytical perspectives should conflate authority and influence, since they encourage examination of a wider range of variables than do state-centric approaches. This thesis argues that analysis could be improved by disaggregating authority and influence in policy formation.

The thesis also argues that formal authority is one form of influence among many in policy formation. The conflation of authority with influence obscures other forms of influence, including other forms of authority. Private actors demonstrated influence in the EU case study and helped shape state policy decisions, even though they did not have formal authority and could not unilaterally "adopt" capital adequacy rules. Their influence stemmed principally from their context-based expertise and access to formal authority. Conversely, IOSCO, which represented putative formal authority by virtue of its designated international role, demonstrated very little authority (or influence) because it lacked credibility. These examples indicate that conflating authority with influence raises the risk of misinterpreting the precise "contours of authority."[20]

This study takes the view that non-state centric perspectives develop a more accurate and realistic understanding of policy-making than do narrower state-centric perspectives. Because non-state centric perspectives assess the interaction of a range of variables, they encourage a wider conversation between observations from a range of analytic perspectives, which this thesis considers to be the foundation of synthetic analysis. Synthetic analysis compares and contrasts the observations of non-state centric and state-centric perspectives. This is designed to reveal dynamic relationships between observations. It seeks to identify limitations in theoretical approaches and to develop observations not revealed by individual perspectives alone. Even broad non-state centric perspectives have their limitations. State/market perspectives are limited by their focus on power and the relations of states and markets. EU integration approaches are limited by their even tighter focus on specific variables: policy networks, institutional structures, and MLG. Synthetic analysis studies ways in which the observations derived from

[18] Such as private commercial actors or institutions not formally recognised by the state.
[19] See Chapter 3 for an extended discussion.
[20] This term is used by A. Claire Cutler, Virginia Haufler, and Tony Porter, eds., *Private Authority and International Affairs, SUNY Series in Global Politics* (Albany: State University of New York Press, 1999).

analytically different perspectives interact with and modify each other and, in doing so, affect our interpretation of individual perspectives and of how authority is exercised in policy formation.

Synthetic analysis can reveal the relative significance of analytical variables in identifying how and why policy-making succeeded or failed. A synthetic analysis neither presupposes that one approach is superior, nor assumes that levels of analysis are exclusive.[21] Rather, it identifies more precisely principal and secondary causative factors in analysis across theoretical perspectives. This constitutes an argument against parsimonious analyses that attempt to demonstrate precise connections within an artificially constrained variable universe.[22]

This thesis argues that the complexity of non-state centric and synthetic analyses is justified because they identify the limitations of narrower analyses and the interconnections between levels of analysis, and because they develop new insights into international authority and policy formation.

A synthetic analytical approach builds on theoretical paradigms developed by John Odell,[23] Susan Strange and EU integration scholars,[24] addressing the interaction of domestic and international variables.[25] The hypotheses are derived from research by Marks, Hooge and Blank that examines state and non-state centric analyses.[26] This thesis joins scholarly efforts to identify linkages between analytical perspectives and thereby to expand the universe of authoritative actors assessed. This approach seeks to understand how actors and institutions, public and private, operating domestically and internationally, interact, change and influence international policy-formation.[27] Synthetic

[21] Simon Hix, "The Study of the European Community: The Challenge to Comparative Politics," *West European Politics* 17, no. 1 (1994).
[22] A. Hurrell and A. Menon, "Politics Like Any Other? Comparative Politics, International Relations and the Study of the EU," *West European Politics* 19, no. 2 (1996).
[23] See: John S. Odell, *Negotiating the World Economy* (Ithaca: Cornell University Press, 2000).
[24] Both neo-functionalist and intergovernmentalist scholars.
[25] See Chapter 3 for a detailed exploration.
[26] Marks, Hooghe, and Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance,"
[27] Peter B. Evans, "Building an Integrative Approach to International and Domestic Politics," in *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, ed. Peter B. Evans, Harold K. Jacobson, and Robert D. Putnam (Berkeley: University of California Press, 1993). H. Kassim and A. Menon, eds., *The European Community and National Industrial Policy* (London: Routledge, 1996).

analysis also seeks to generate conclusions that are greater than the sum of observations generated by narrower analyses. This objective is assessed in the final chapter.

The Case Studies

The EU case study negotiations began in 1988 with the circulation of the first draft of an Investment Services Directive,[28] establishing a "single passport" for investment firms to operate anywhere in the EU. Discussions quickly expanded to encompass a proposed Capital Adequacy Directive,[29] which addressed securities firms' capitalisation. The scope and language of the directives were finally agreed upon late in 1992 and ratified by the European Parliament in 1993. The negotiations took place against a complex backdrop of extensive regulatory and institutional change in domestic markets and financial services institutions, assertiveness of expert private actors and institutions, and a well-defined, time-specific regional Single Market objective. These factors were intensified by market and institutional competition and by the resilience of deeply embedded national economic institutions and regulatory practices. An empirical objective of this thesis is to determine the influence of each factor in the final form of the CAD and ISD.

Based on observations developed from different theoretical perspectives, this study concludes that the CAD and ISD were shaped by several factors. Major influences included the resilience of national political, economic and social structures, the preferences of private and supranational actors, and the commitment of the EU member-states to 1992 Single Market objectives. The assessment of observations from different perspectives reveals a complex picture of policy-formation and influence. Member-states rejected policies requiring substantial alteration of national institutions. Private actors worked directly with the EU Commission and the member-states to encourage the development of policy proposals encompassing member-states' structural preferences and private actors' "Euromarket" regulatory preferences. As a consequence, EU policy-making reflected a combination of distinctive inputs. Each was legitimate and credible by virtue of its basis in market knowledge, its institutional source, or its structural

[28] Investment Services Directive, 93/22/EEU, "Council Directive of 10 May 1993 on investment services in the securities field". O.J. N*. L141, 11.06.93, pp. 27-46.
[29] Capital Adequacy Directive, 93/6/EEU, "Council Directive of 15 March 1993, "on the capital adequacy of investment firms and credit institutions", O.J.N*. L141, 11.06.93, pp. 1-26.

context. As a result, each had influence and shaped the directives. However, state preferences were predominant in EU policy-formation.

IOSCO's negotiations also began in 1988 with the creation of an internal working party to investigate the harmonisation of national capital standards for securities firms. Discussions took place concurrently with those of the EU. As a result, the state preferences expressed in EU regional debates were reflected in IOSCO. However, IOSCO's discussions also incorporated the preferences of the world's oldest and largest national securities regulator, the United State's Securities and Exchange Commission ("US's SEC"). After five years of debate, IOSCO's membership failed to agree on a capital standard and abandoned harmonisation discussions in 1993.

This study finds that IOSCO's discussions failed for three reasons. First, for domestic political and institutional reasons, the SEC would not accommodate changes to its domestic capital adequacy standards. IOSCO's weak governance combined with the attractiveness of US markets and the SEC's intransigence enabled the SEC to impede progress in IOSCO. The SEC's stance was reinforced by an aggressive program of exporting US regulatory norms and by an unusually passive domestic private sector. Second, IOSCO was institutionally incapable of orchestrating a compromise that would accommodate SEC and EU member-states' regulatory preferences. Third, recognising the SEC's inflexibility, the Basle Committee's support for their regulatory preferences, and IOSCO's lack of authority, IOSCO's EU members effectively withdrew from IOSCO's discussions. Their decision was bolstered by their commitment to establish a regional capital standard. This thesis argues that non-state actors and institutions were only indirectly influential in IOSCO's deliberation and that state authority predominated.

Analytical Approach

This analysis returns us to the core question of the thesis. Why were the EU negotiations successful while IOSCO's were not? And if multiple factors were prominent in the outcome of negotiations, what is an appropriate way to examine and characterise international policy-making?

The more state-centric approaches suggest distinct investigative avenues focusing on state, institutional, and/or domestic variables. Non-state centric perspectives emphasise the balancing of state/market authority and multi-level variable analysis. This study argues instead that state and non-state centric observations examined through synthetic analysis yield not simply more complete empirical evidence but more accurate and realistic assessments of policy-formation. This is not merely a matter of achieving greater empirical inclusiveness. Altering analytical focus from a "level of analysis" or a constrained variable perspective to an interactive, topical and process-oriented focus reveals international policy-making and authority as dynamic *and* multi-level. Policy formation involves public and private actors and institutions, each with influence, interacting across levels of governance. A synthetic analysis combines observations derived from individual perspectives to generate new insights and more accurate understandings of policy formation processes.

Theoretical Perspectives

This study utilises traditional, positivist theoretical approaches,[30] together with perspectives developed by EU integration and state/market scholars, to build contrasting hypotheses. Non-state centric perspectives assume that international policy-making and authority are complex and influenced by multiple variables. They examine a range of domestic and international variables to develop a comprehensive understanding of policy formation and authority. One conclusion of this study is that this approach is analytically superior to state-centric approaches.

Traditional international political economy ("IPE") and international relations ("IR")[31] perspectives utilised predominantly state-centric analytical paradigms, originally designed as stand-alone diagnostic templates.[32] State-centric perspectives vary

[30] "Positivist" refers to analytical or theoretical perspectives that adopt a limited or constrained variable analytical approach, typically state-centred, often based in micro-economics (also "rational choice"), for the examination of international phenomena. These perspectives include structural (realist and institutionalist), domestic and bargaining approaches. Variables include power, institutions, domestic preferences, institutions and ideas, and "statesmen."

[31] Some scholars consider IPE to be a subset of IR, while other scholars consider it to be distinct from IR. This is, of course, a heavily contested topic.

[32] Research frequently adopted structural/international ("outside-in"), domestic ("inside-out"), or bargaining ("statesman") analytical perspectives. "Outside-in" and "Inside-out" are descriptive terms developed by B.J. Cohen. See: Benjamin J. Cohen, "Phoenix Risen; the Resurrection of Global Finance,"

significantly, ranging from unitary state approaches to intergovernmentalist explorations of domestic variables and their influence on interstate negotiations. Scholars "competed" to refine these perspectives, demonstrating the unique advantages of each in explaining international policy formation.[33] This competition defines an intellectual journey, which, more recently, has encouraged re-examination of the benefits of synthesising observations from multiple analytical perspectives.

The state-centred analytical perspectives that dominated research in the 1980s and 1990s[34] have expanded further to incorporate new perspectives, many of them based in sociology and psychology. Scholars have developed analytical perspectives focusing on process analysis and multi-level actor and institutional interaction to explain transnational policy-formation. Theoretical perspectives developed by Putnam,[35] Moravcsik,[36] Milner,[37] and Odell,[38] together with closely related state/market and EU integration perspectives,[39] are examples of efforts to expand on narrower analytical approaches.[40]

World Politics 48, January (1996). Each perspective, many of which have been extensively sub-divided, is briefly described in Chapter 3.

[33] Peter J. Katzenstein, Robert O. Keohane, and Stephen D. Krasner, "International Organization and the Study of World Politics," *International Organization* 52, no. 4 (1998).

[34] Particularly in the US.

[35] Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization* 42, no. Summer (1988). See also: Peter B Evans, Harold K. Jacobson, and Robert D. Putnam, eds., *Double-Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: University of California Press, 1993).

[36] Andrew Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining," in *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, ed. Peter B. Evans, Harold K. Jacobson, and Robert D. Putnam (Berkeley, Ca.: University of California Press, 1993).

[37] Helen V. Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations* (Princeton: Princeton University Press, 1997).

[38] Odell, *Negotiating the World Economy*.

[39] Moravcsik is often considered an EU intergovernmentalist scholar – see Chapter 3 and Appendix A.

[40] These approaches enlarge the universe of actors and institutions by adopting non-state centric perspectives, by assessing policy development processes and by examining the roles of economic structures and institutional histories. In 1992, Helen Milner alluded to gaps in the research literature when she noted two weaknesses of structural perspectives. She argued that systemic assumptions of anarchy were ambiguous and relativistic. Anarchy was being used to "explain" empirical inconsistencies that could only be clarified by examining domestic politics. By 1998, combinations of theoretical concepts taken from comparative politics, domestic regulation, and systemic analysis had advanced considerably. "Being able to systematically explore domestic politics and its effects on international relations holds out the promise of more cumulative research. Understanding how preferences are aggregated to arrive at 'national interest' and how different political and economic institutions yield different outcomes are important steps." (See: Helen Milner, "Rationalizing Politics: The Emerging Synthesis of International, American, and Comparative Politics," *International Organization* 52, no. 4 (1998)). Odell and Kapstein advanced this observation by linking domestic and international evidence in empirical analyses and building an understanding of international policy-formation by utilising bounded rationality with inductive and deductive examination See generally: John S. Odell, *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change* (Princeton: Princeton University Press, 1982)., Odell, *Negotiating the World Economy.*, Ethan B. Kapstein, *Governing the Global Economy: International Finance and the State*

State/market and EU integration perspectives explore specific variables, potential linkages between analytical variables, and levels of analysis in policy development. State/market literatures assume that policy-making authority lies along a continuum between states and markets and is the product of the interaction of those variables. EU integration builds on domestic perspectives, combining multi-level analysis with inquiry into the sources of domestic preferences in policy-formation. These perspectives acknowledge that the location of authority varies, that it is influenced by economic and political institutions and by the influence and authority of actors involved in policy formation. These perspectives generally assume the interpenetration of the domestic and international and the potential authority and intersubjectivity of actors and institutions, private and public, in policy formation.

Synthetic Analysis

Determinative variables examined by state-centric perspectives are frequently monocausal, and empirical observations derived from these approaches are typically assessed without reference to observations generated from different perspectives. However, this latter observation is also true of non-state centric approaches, which, despite their multi-variable focus, still emphasise certain variables over others. As a result, these approaches often afford a weak approximation of reality. This encourages the comparison of observations from different perspectives and their combined evaluation. A synthetic analysis captures this logic by facilitating a conversation between the observations of non-state centric and state centric analyses. A synthetic approach potentially modifies conclusions by highlighting contrasts between analytical observations and suggesting alternative interpretations of phenomena.

For example, from a (narrow) state-centric perspective, the successful development of the CAD and ISD was a function of EU member-states' commitment to achieving Single Market objectives (and establishing an international regulatory precedent) during a period of declining US and Japanese influence. Conversely, IOSCO's failure was a function of members' inability to resolve conflicting regulatory

---

(Cambridge: Harvard University Press, 1994)., and, generally, Helen Milner, "International Theories of Cooperation among Nations: Strengths and Weaknesses," *World Politics* 44, no. 3 (1992).

objectives. This was exacerbated by IOSCO's institutional weakness and the SEC's efforts to impose its regulatory preferences internationally.

These observations are accurate but incomplete. They do not provide an assessment of the relative significance of a range of empirical observations developed using other analytical perspectives. In the EU case, a focus on state power ignores the role of the EU's (particularly the Commission's) objectives, of influential private actors, of political elites, and of national regulatory histories and economic structures, each of which made important contributions to the shape of the directives. Authority resided predominantly with states, but influence was exercised by a range of actors and institutions. Similarly in the IOSCO case, a focus on state power ignores the significant role of IOSCO's governance structure, the domestic roots of member-state disagreements, the minor contribution of private actors, and the complex pressures shaping the SEC's preferences and international authority. Through a synthetic assessment of both state and non-state centric observations, conclusions regarding the structure and exercise of authority and influence can be made.

Contribution

Empirically, the case studies identify important influences on international policy-making not developed in earlier studies.[41] For the EU CAD/ISD case these include the role of the Basle Accord and of IOSCO in stimulating the EU's regulatory precedential ambitions and the proactive involvement of private actors, principally US and UK investment banks and industry SROs, in influencing the EU Commission and member-states' policy decisions. The influential roles of specific French and British private actors and institutions are also identified. The critical relevance of member-state

---

[41] For the IOSCO case see: Geoffrey R.D. Underhill, "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy," *Review of International Studies* 21 (1995)., for EU see: Philip Brown, "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives," in *The New World Order in International Finance*, ed. Geoffrey R.D. Underhill (London: Macmillan Press, 1997)., Benn Steil, *Competition, Integration and Regulation in EC Capital Markets* (London: Royal Institute of International Affairs, 1993)., William D. Coleman and Geoffrey R.D. Underhill, "Globalization, Regionalism and the Regulation of Securities Markets," in *Regionalism & Global Economic Integration: Europe, Asia and the Americas*, ed. William D. Coleman and Geoffrey R.D. Underhill (London: Routledge, 1998). See generally Jonathan Story and Ingo Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems* (Cambridge, MA: The MIT Press, 1997).

domestic structural variables, which is developed in the "new institutionalist" literature,[42] has not been examined previously in the specific context of the CAD/ISD discussions.

The IOSCO case has been less thoroughly researched than the CAD/ISD, and this thesis develops a deeper empirical perspective. This perspective includes the role of US regulatory, economic and market histories in shaping the SEC's and Richard Breeden's regulatory preferences and Breeden's definition of IOSCO's appropriate international regulatory role. These factors also influenced the development of the SEC's international regulatory harmonisation objectives, which evolved from multilateral harmonisation to the bilateral promotion of US regulatory norms. The interaction of the EU and Basle Committee deliberations with IOSCO's is also developed. These examinations and these findings have not been extensively developed elsewhere. They add to recent research on the role of individuals and bounded rationality in decision-making, a relatively undeveloped area in international negotiations.[43] Additionally, the confusingly small role of US private actors in the IOSCO negotiations – particularly in comparison with private actors' role in the EU deliberations – is identified and explained.

Theoretically and methodologically this study joins research that assesses international policy-formation through examination of relationships between private and public actors and institutions, across sub-national, national and supranational levels of authority. EU integration and state/market approaches have promoted the value of multiple variable analyses of international policy-making.[44] The empirical findings of this thesis add to the theoretical arguments and conclusions of these scholars in three important respects. First, they confirm the value of process-focused, multi-variable, analyses to an accurate understanding of how policy-formation develops from the interaction of preferences. Second, however, this thesis observes that policy-making authority, while influenced by private and public institutions, was still predominantly shaped by state preferences. Finally, the value of a synthetic analysis is confirmed by its identification of the interactions and limitations of narrower approaches.

---

[42] See Chapter 3 and, *inter alia*, J.R. Hollingsworth and R. Boyer, eds., *Contemporary Capitalism: The Embeddedness of Institutions* (Cambridge: Cambridge University Press, 1997). And, Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*.
[43] See: Odell, *Negotiating the World Economy*. and John S. Odell, "Bounded Rationality and the World Political Economy: The Nature of Decision Making," in *Governing the World's Money*, ed. David M. Andrews, C. Randall Henning, and Louis W. Pauly (Ithaca: Cornell University Press, 2002).
[44] See, in particular, literature cited in Chapter 3.

There are four reasons why these cases, and the theoretical questions examined, are important in IPE. First, understanding international policy-formation is central to both IR and IPE and forms the focus for much of the academic literature. Second, this study assesses the utility of core analytical perspectives by synthetically examining events in international financial services regulation and international finance.[45] Third, as noted, international finance operates at the intersection of politics and economics. The effective operation of domestic monetary and fiscal policy, and of domestic and international regulatory regimes, is increasingly subject to the concurrence of private actors and markets. Consequently, the interaction of markets and states is a critical concern to IR scholars. Finally, the internationalisation of financial markets has brought together previously isolated national policies, institutions and regulations, giving rise to the negotiations and analysis that are the focal point of this research. The interaction of national policies, shaped by domestic and international institutions, interests and ideas, has been a core concern of IPE for many years.[46]

This study addresses four gaps in the IPE literature addressing financial services and analytical perspectives. First, the scholarly literature frequently addresses issues related to commercial banking, but it rarely addresses topics that arise in securities or investment banking. This is a glaring omission, considering the prominent role of securities in capital raising and the internationalisation of capital markets.[47] Exceptions

---

[45]These areas have recently received considerable analytic scrutiny. See, for example: Cerny, "Globalization and the Changing Logic of Collective Action," Eric Helleiner, *States and the Re-emergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, New York: Cornell University Press, 1994)., Michael Moran, *The Politics of the Financial Services Revolution: The USA, UK and Japan* (1990)., Louis W. Pauly, *Who Elected the Bankers?*, *Cornell Studies in Political Economy* (Ithaca: Cornell University Press, 1997)., and Geoffrey R.D. Underhill, "Private Markets and Public Responsibility in a Global System: Conflict and Cooperation in Transnational Banking and Securities Regulation," in *The New World Order in International Finance*, ed. G.R.D. Underhill (London: MacMillan Press Ltd., 1997).
For an overview of recent IR/IPE related analytical work in international financial services see: Peter Dombrowski, "Haute Finance and High Theory: Recent Scholarship on Global Financial Relations," *Mershon International Studies Review* 42, May (1998)..

[46] Robert O. Keohane and Joseph S. Nye, Jr., eds., *Transnational Relations and World Politics* (Cambridge: Harvard University Press, 1970).

[47] This omission is being redressed. See: Kapstein, *Governing the Global Economy: International Finance and the State*, Tony Porter, *States, Markets and Regimes in Global Finance* (London: The Macmillan Press, 1993), Andrew C. Sobel, *Domestic Choices, International Markets: Dismantling National Barriers and Liberalizing Securities Markets* (Ann Arbor: University of Michigan Press, 1994), Glenn Tobin, "Global Money Rules: The Political Economy of International Regulatory Cooperation" (Harvard University, 1991), G.R.D. Underhill, "States, Markets and Governance. Private Interests, the Public Good, and the Democratic Process," (Amsterdam: Vossiuspers Universiteit van Amsterdam, 2001)., Miroslava Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics* (Aldershot:

exist, but few studies focus exclusively on securities regulatory development. Second, the preponderance of financial services and regulatory research addresses state or domestic variables. With notable exceptions (Filipovic,[48] Haufler,[49] Porter, Sinclair[50] and Underhill), supranational and private actors are rarely included in analysis. Additionally, these scholars infrequently assess private or supranational actors in conjunction with hypotheses drawn from EU integration or state/market theories – or synthetically.[51] Third, research into international regulatory organisations, particularly the Basle Committee and IOSCO, has been limited. Basle Committee research focuses primarily on the creation of the Basle Accord.[52] Combined Basle Committee and IOSCO research has focused on regime formation[53] and the difficulty of democratically developing international rules with insulated policy communities.[54] Few studies assess EU, IOSCO and Basle interaction.[55] Finally, this study provides new empirical detail concerning the specific roles of private actors, domestic economic and political structure and multilateral governance mechanisms, facilitating a synthetic assessment of policy-making authority.

Ashgate Publishing Limited, 1997)., and Underhill, "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy".

[48] Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics.*

[49] Virginia Haufler, "Crossing the Boundary between Public and Private: International Regimes and Non-State Actors," in *Regime Theory and International Relations*, ed. Volker Rittberger (Oxford: Clarendon Press, 1995).

[50] Timothy J. Sinclair, "Between State and Market: Hegemony and Institutions of Collective Action under Conditions of International Capital Mobility," *Policy Sciences* 27, no. 4 (1994).

[51] Notable exceptions are Porter, Coleman and Underhill, cited previously.

[52] Predominantly attributing the Accord's development to domestic variables. Kapstein, *Governing the Global Economy: International Finance and the State* and Thomas Oatley and Robert Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord," *International Organization* 52, no. 1 (1998).

[53] Porter, *States, Markets and Regimes in Global Finance.*, Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics.* and Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations.*

[54] Underhill, "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy,"
Nancy Worth, "Harmonizing Capital Adequacy Rules for International Banks and Securities Firms," *North Carolina Journal of International Law and Commercial Regulation* 18, no. 1 (Fall 1992).

[55] See studies by Brown, "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives,", Richard Dale and Simon Wolfe, "Capital Standards," in *The European Equity Markets: The State of the Union and an Agenda for the Millennium*, ed. Benn Steil (London: Royal Institute of International Affairs, 1996)., and Steil, *International Securities Market Regulation*, in Benn Steil, ed., *International Financial Market Regulation* (Chichester: John Wiley & Sons Ltd., 1994).

Implications

This study has several research implications. First, analyses based on restrictive assumptions or narrow analytical perspectives may be incomplete or may encourage misleading conclusions. When observations from narrow and broad perspectives are synthesised, factors affecting policy-formation are more accurately revealed and evaluated. Additionally, empirical findings from and across different levels of analysis should be examined interactively rather than hierarchically and as a process executed over time. These conclusions do not invalidate observations of individual perspectives, whether narrow or broad. They suggest that, in the case studies, individual observations, when analysed synthetically, produce more revealing explanations of authority in policy-formation.

Second, the cases indicate that international policy-formation is a function of multiple variables. It is, therefore, a complex process. Policy-making does not succeed or fail absolutely. It is more likely to reflect a negotiation with gains, losses, and compromises. Similarly, the location and composition of authority is the function of a range of variables.[56] To ensure accurate research, consideration of multiple variables and actors is appropriate. Research should also assume that the location and composition of authority will vary from case to case.

Third, narrowly focused research may under-appreciate this complexity, a complaint of state/market and EU integration scholars. However, non-state centric approaches may overstress the role of non-state or market factors in policy-formation, undervaluing the persistent and predominant role of state-centred preferences. This observation encourages synthetic analysis to identify and overcome the limitations of individual perspectives.

Fourth, the cases indicate that EU integration perspectives can be utilised in non-EU contexts. The EU is, of course, *sui generis*. However, the analytical approaches

[56] Assuming IOSCO's negotiations failed and the EU's succeeded is incomplete. The absence of shared understandings on IOSCO's objectives doomed its discussions to failure. In contrast, EU negotiators agreed on objectives and through difficult negotiations established a capital regime. However, the price of cooperation was ineffectual harmonisation.

spawned by the EU can be usefully exploited to identify the roots of international policy formation outside an EU context.

Fifth, state/market analysts' conflation of authority and influence benefits from disaggregation. A broad definition of authority inhibits the identification of specific state and non-state sources of influence, of which formal authority is one. In order to encourage a deeper examination of influences over policy formation, authority is defined more narrowly as formal state authority and as one source of influence among many.

Sixth, the cases indicate that the transformation of state authority and the convergence of regulatory norms, both projected consequences of globalisation, were limited. International policy-making authority has broadened but is dominated by states and state preferences. International regulatory convergence is limited.

Finally, international policy-formation is a dynamic *process*, involving public and private actors who operate across levels of authority. It is not a static or singular event. Negotiators change, national and international preferences evolve, markets adjust, and as a result, available information, national and international commitments, preferences, and institutions all change. This means that authority can be exercised at any stage in a negotiation. In the case studies, multivariable, multilevel analyses, focused around broad questions, produced more accurate and defendable policy-formation research.[57]

Caveats

Complex explanations are not *a priori* superior to monocausal ones. This is an empirical claim that must be proven. Analytical complexity raises concerns about pinpointing causation. Non-state centric research addresses these concerns through a focus on policy-formation processes and specific topics. These simple observations

[57] For example, the combination of IOSCO's policy formation failure and the EU's ineffectual directives encouraged closer cooperation between the Basle Committee, IOSCO, EU and private sector agents in forming regulation after 1993. This observation encourages research recognition of the value of assessing the interaction of observations from different perspectives, across levels of authority. The creation of the "private" Derivatives Policy Group ("DPG") by the FRBNY is a specific example. See Chapter 12, Appendices and Glossary for definitions and further explication.

encourage more extensive dynamic comparative research in policy-making – over time – than is typical in US IR/IPE literature.[58]

Analytical complexity is justified if research subsequently indicates the limitations of narrow perspectives or if it produces new interpretations not available without a complex analysis. This thesis joins recent studies utilising process perspectives[59] and EU integration/state/market studies.

Research design

This thesis uses case studies for analysis and employs systematic, focused comparison to develop clear causal pathways.[60] The thesis examines two cases addressing related topics with different outcomes. Case selection was based on several criteria: both cases focus on financial services and on securities and capital adequacy.[61] The Basle Accord negotiations (which addressed commercial bank capitalisation) and a range of analogous regulatory harmonisation negotiations were excluded because their

---

[58] Excepting, of course, research conducted by US EU integration scholars. State/market literature is associated predominantly with Canadian and British scholars.

[59] Christer Jonsson, *Superpower: Comparing American and Soviet Foreign Policy* (London: Frances Pinter, 1984)., Jeffrey W. Knopf, *Domestic Society and International Co-Operation: The Impact of Protest on US Arms Control Policy*, ed. Smith. Steve, *Cambridge Studies in International Relations* (Cambridge: Cambridge University Press, 1998)., and Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining."

[60] Alexander L. George, "Case Studies and Theory Development: The Method of Structured, Focused Comparison," in *Diplomacy: New Approaches in History, Theory, and Policy*, ed. Paul Gordon Lauren (New York: The Free Press, 1979).

[61] The EU case highlights the influence of state economic structures and of multilateral and private interests. Private actors and associations consistently lobbied and educated the EU and its member-states. However, the CAD and ISD were predominantly negotiated by states and by EU representatives. Negotiations were characterised by compromise and by the preservation of state autonomy. State and multilateral actors made independent decisions, sometimes different from the advice of private actors. In the IOSCO case, private authority was rarely present for two reasons: the SEC used its authority (domestic and international) to impede alteration of capitalisation rules and IOSCO was an unattractive lobbying target, especially in comparison with the EU and its member-states. But SEC preferences, although powerful influences, did not sway other international regulators, and the negotiations collapsed.
Both cases addressed the same objective in the same time frame, and with substantially the same actors.
Similarities: 1) Same states with the exception of US, 2) general regulatory harmonisation objectives and time frame, 3) economic and market sources of harmonisation objectives, 4) similar market dimensions between US and EU, 5) same private actors involved, particularly the most active, US and UK investment banks, 6) state and private actor preferences did not vary significantly – except for the US and, somewhat, France, and 7) Basle Committee deliberations impacted both sets of negotiations.
Differences: 1) Multilateral actors involved (EU and IOSCO), 2) institutional structure and decision-making capacities of EU and IOSCO (EU – supranational, IOSCO – intergovernmental), 3) state actors involved – IOSCO included the US/SEC, 4) state institutional structure, 5) character of state motivation/commitment to harmonisation, and 6) ability of private actors to lobby state and multilateral actors involved in policy formation.

focus did not correlate with the EU and IOSCO discussions.[62] The cases selected differ in the specific explanatory variables identified.[63] However, variation in the dependent variable (authority) was not artificially correlated with explanatory variable values. The theories used to examine the cases are both falsifiable and capable of generating multiple observable implications. The approach is not parsimonious. This thesis assumes that the world is complex.[64]

Organisation of study

To provide context, Chapter 2 briefly examines capital market and institutional globalisation as well as regulatory harmonisation. Chapter 3 reviews theoretical perspectives on international policy-formation and develops hypotheses for the case studies. It also discusses synthetic analysis and criticisms of complex, multivariable analytical approaches. Chapters 4 through 11 present empirical research findings. The final chapter summarises and compares the empirical findings and the accuracy of the hypotheses. It then considers the implications of the study's findings for theory and research.

---

[62] Including IATA discussions on airlines, UNCTAD negotiations on ocean shipping and GATT and WTO discussions on financial services.
[63] For the EU: the roles of national institutions, negotiations embedded in wider regional processes, and private actors. For IOSCO: dominant domestic preferences.
[64] Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton: Princeton University Press, 1994).

Chapter 2

Securities Firms, Banks, Market Globalisation and Regulation

Introduction

This chapter positions the case studies in the evolution of international securities markets, firms and regulation. It has several objectives: first, to establish the context for the questions addressed by this study; second, to examine securities market globalisation and factors affecting regulatory harmonisation; and, finally to consider why regulatory harmonisation became an objective for IOSCO, the EU and the Basle Committee.

The chapter highlights rationales and incentives for international regulatory harmonisation and variables that define differences between national regulatory systems. These variables include the history, structure, and commercial objectives of the financial services industry and its relationship with domestic supervisors and regulation. These variables are focal points for the EU integration and state/market theoretical literatures described in Chapter 3 and shape empirical research for the case studies.

Securities market globalisation

During the 1970s and 1980s, economic and technical advancements spurred the globalisation of securities markets[1] and the growth and increased interdependence of capital markets.[2] These trends were stimulated by market deregulation, the oil crisis of the early 1970's and the elimination of exchange controls in many industrialised

---

[1] "Globalisation" is a highly contested term and topic, referring generally to the international dispersion of economic, political, social and technological developments and norms – and their effect on state sovereignty and authority. See, *inter alia*, Paul Hirst and Grahame Thompson, *Globalization in Question: The International Economy and the Possibilities of Governance* (Cambridge: Polity Press, 1996).

[2] Franklin R. Edwards and Frederic S. Mishkin, "The Decline of Traditional Banking: Implications for Financial Stability and Regulatory Policy," *Economic Policy Review*, (July 1995).

countries. These developments encouraged growth in international trade and in cross-border capital flows and spurred the growth of securities markets. Also encouraging these phenomena were the increasing size and influence of institutional investors and concomitant growth in competition and product innovation among financial services providers.[3] These changes enabled investors and borrowers to access capital more cheaply through a broader array of products offered through national and international markets.

Deregulation and market expansion

Growth in international securities transactions can be traced to specific national deregulatory decisions that commenced in the mid-1970s.[4]

In the US, disintermediation of bank lending was initially encouraged by the deregulation of brokerage commission rates in 1975.[5] In 1982, the SEC adopted Rule 415, which simplified public registration requirements for securities and streamlined foreign disclosure and reporting requirements. These steps encouraged foreign borrowers to enter US securities markets. The SEC's initiatives were designed to enhance the competitiveness of domestic markets and discourage the migration of capital markets activity to the growing Euromarkets.

In Europe and Japan domestic market deregulation started in the early 1980s coincident with a dramatic increase in Euromarket securities underwriting. Differences in the timing of national deregulation were indicative of variations between countries in political, economic and commercial factors affecting market operations. They were largely a function of the extensiveness of public share ownership (broad in the US, limited in Europe and Japan), the ratio of equity and debt in corporate capitalisation (balanced in the US, higher debt usage in Europe and Japan) and the nature of relationships between financial services institutions and other corporate and state interests (arms-length in the US, much closer in Europe and Japan). These factors

---

[3] Terry M. Chuppe, Hugh R. Haworth, and Marvin G Watkins, "The Securities Markets in the 1980s: A Global Perspective," (Washington, D.C.: U.S. Securities and Exchange Commission, 1989), from which this historical description is adapted.
[4] For a detailed discussion see: Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996).
[5] SEC, "Fifth Report to Congress on the Effect of the Absence of Fixed Rates of Commissions," (Washington, D.C.: US Securities and Exchange Commission, 1977).

encouraged the greater use and the faster growth of securities markets in the US than in Europe or Japan.

Exchange controls in France, the UK and, partially, in Italy were removed during the 1980s. The Japanese MoF permitted the issuance of Yen-denominated Eurobonds. Deutschemark, Sterling and other currencies were used for the first time to denominate bonds issued in Swiss capital markets. Following the 1986 deregulation of British securities markets, France, Canada and Spain opened their domestic markets to greater competition.

Increased growth of cross-border securities markets was also encouraged by economic and commercial developments that restricted the ability of bank credit markets to meet investor demands for flexible and liquid investment vehicles.

International securities markets expansion was preceded by increases in Euromarket bank lending in the 1970s. Primarily petrodollar recycling stimulated this expansion. The economic recovery of the mid-1980s increased corporate and government capital demands. However, persistent government budget deficits limited bank credit and encouraged borrowers to access international securities markets, which represented a relatively under-exploited supply of capital.[6]

Also during the 1980s, investors also began to acknowledge that internationally diversified portfolios were less risky than portfolios concentrated in domestic assets. The development of new financial techniques, including interest rate and currency swaps and, later, derivatives, further encouraged the growth of international markets.[7] Moreover, the characteristics of securities made them increasingly attractive to borrowers and underwriters.[8]

---

[6] Toyoo Gyohten, "Global Financial Markets: The Past, the Future, and Public Policy Questions," in *Regulating International Financial Markets: Issues and Policies*, ed. Franklin R. Edwards and Hugh T. Patrick (Boston: Wolters Kluwer, 1992).

[7] Joseph A Grundfest, "Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences," *Journal of Financial Services Research* 4 (1990). and David E. Van Zandt, "The Regulatory and Institutional Conditions for an International Securities Market," *Virginia Journal of International Law* 32 (1991).

[8] Securities are typically freely marketable and have market-determined prices.

These factors prompted dramatic growth in cross-border transactions and portfolio investment, in the percentage of foreign assets held by financial institutions, and in foreign equity listings. Foreign offices of major securities firms also expanded. The internationalisation and growing interdependence of capital markets were further demonstrated by narrowing interest and exchange rate differentials between national markets. As securities issuance increased, commercial bank lending decreased.

Financial institutions' response

International banks' responses to market globalisation varied significantly. Large British clearing banks[9] reacted by rapidly expanding into investment and asset management. This dramatically increased sectoral competition, particularly for US investment and commercial banks that had already established pre-eminent international positions in securities underwriting, syndicated lending and mergers and acquisitions advisory work. UK and US institutions also aggressively exploited advances in technology; increasing their capital investments in trading, settlement, and information assessment in order to reduce their personnel and retail expenses.

Large German banks[10] expanded very cautiously into international investment banking. Deutsche Bank moved its small investment banking operation from Frankfurt to London in 1984 but only solidified its commitment to securities-related businesses with the 1989 acquisition of Kleinwort Benson, a UK accepting-house.[11] Six years later, Dresdner Bank acquired another old-line London securities firm, Morgan Grenfell. But neither Commerzbank nor WestDeutsche Landesbank made a UK bank acquisition. As a result, German banks have consistently lagged behind their US and UK counterparts in securities underwriting and investment banking services. German banks also failed to rationalise their vast domestic retail operations or adopt information technology improvements.

---

[9] The major British "clearing banks" were Barclays, National Westminster, Midland and Lloyds. 'Clearing bank' refers generally to a financial institution that directly clears cheques or other payment instruments with other institutions. Some direct clearers, for a fee, also clear payments on behalf of other banks and non-bank financial institutions.

[10] Deutsche, Dresdner, Commerz and WestDeutsche Landesbank were the largest German banks at the time.

[11] "Accepting house" is an archaic term for a British investment (or "merchant") bank. Traditionally they represented a select group of UK banks whose main function was 'accepting' bills of exchange, thereby facilitating the lending of money.

During the 1980s, French banks expanded rapidly into neighbouring retail markets and grew their London-based syndicated lending operations. However, their expansion into securities businesses was, as with German banks, slow. This was, in part because the French *Tresor* decided French banks should become more like German universal banks. But, more generally, French banks' sluggish entry into securities-related businesses was caused by the *Tresor's* frequent "interference" with French banks' business plans and by the nationalisation of the banking sector in 1982.[12] Crédit Lyonnais, the most aggressive French bank, did acquire a small London merchant bank in 1986,[13] but generally, the big French banks moved cautiously into international securities activities in the 1980s and early 1990s, encouraged by their government to focus on developing domestic capital markets in tandem with government-initiated domestic regulatory reforms.

The aggressive penetration of US and UK banks into higher margin investment and securities businesses was reflected in their higher returns on equity, particularly in comparison with German and French financial institutions. Story and Walter attribute these disparities in large part to different corporate governance systems.[14] US and UK institutions are predominantly shareholder-managed. Conceptually, this means that institutional and managerial viability is closely tied to market-determined share price performance.[15] French and German banks are stakeholder-driven institutions. This means they are subject to the persistent influence of corporate or state owners and influential employee board representatives. It also means that they traditionally focused strategically on commercial lending. As a result, both the US and UK have long-standing, powerful and influential securities markets, firms, and related infrastructures, which do not exist in Germany or France.

---

[12] Referred to generically as *dirigisme*. See: Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*.

[13] Alexander Laing & Cruickshank. Société Générale acquired Hambros Bank in the 1990s. Crédit Lyonnais, of course, had to be rescued by the French government in the mid-1990s after a series of disastrous international lending initiatives.

[14] Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*. p. 354ff.

[15] The equity performance of technology companies in the 1990s brings this hypothesis into question. More specifically, governance systems are only one of several significant influences on business strategy and commercial performance. Other important factors include government regulation, competition, economic structure and management skill.

Regulatory harmonisation

Securities market globalisation was uneven. Deregulation in one market could encourage the migration of new issue activity or trading in order to take advantage of lower borrowing costs or more favourable regulatory standards. The potential for regulatory arbitrage and market contagion acted as incentives for international regulatory harmonisation. In addition, deregulatory trends were accompanied by an upsurge in scandals associated with financial institutions.[16] Globalisation meant that national regulatory regimes could be compromised by activities in other jurisdictions.

The principal economic justification for regulatory harmonisation was the avoidance of market failure, which could arise from the activities of firms, markets or powerful individuals.[17] The political rationale was that it would create a "level playing field" and discourage a regulatory "race to the bottom" as jurisdictions were deterred from regulatory competition or "competition in laxity."[18] These analyses encouraged national regulators to develop cooperative regulatory strategies.

As domestic regulators became more aware of international market developments, their institutional focus expanded to encompass the potential problems caused by differing national regulatory standards. These and other factors stimulated discussions between national regulators, which encouraged the development of the Basle Capital Accord ("Basle Accord") in 1988.[19] These concerns also encouraged regulators

---

[16] Charles Goodhart et al., *Financial Regulation: Why, How and Where Now?* (London: Routledge, 1998).

[17] Principally contagion. See: Lawrence J. White, "International Regulation of Securities Markets: Competition or Harmonization," in *The Industrial Organization and Regulation of the Securities Industry*, ed. Andrew W. Lo (Chicago: The University of Chicago Press, 1996). See also: Uri Geiger, "The Case for the Harmonization of Securities Disclosure Rules in the Global Market," *Columbia Business Law Review* 1997, no. 2&3 (1997).

[18] See: Joseph A. Grundfest, "Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences," *Journal of Financial Services Research* December, no. 4 (1990).
Paul Guy, "Regulatory Harmonisation to Achieve Effective International Competition," in *Regulating International Financial Markets: Issues and Policies*, ed. Franklin R. Edwards and Hugh T. Patrick (Norwell, Massachusetts: Kluwer Academic Publishers, 1992), Roberta S. Karmel, "National Treatment, Harmonization, and Mutual Recognition: The Search for Principles for the Regulation of Global Equity Markets" (paper presented at the Capital Market Forum, London, 1993), Steil, *Competition, Integration and Regulation in EC Capital Markets*.

[19] Sources of the Accord included, particularly American, concerns over IMF quota increases and low international bank capital levels. These concerns were reflected in the US' International Lending Supervision Act of 1983. The Basle Committee's initially tepid response to US calls for more congruent international capital standards; coupled with the collapse/rescue of US bank Continental Illinois prompted the US Federal Reserve to release supplementary capital guidelines in 1986. Fed Chairman Volker suggested a joint capital agreement with the Bank of England, which was announced in 1987. The Accord

to focus more generally on the control and supervision of global markets and financial institutions. If, as regulators suspected, financial institutions were able to avoid regulatory oversight and thereby spark negative systemic "events," then new, internationally coordinated, regulatory responses were needed to address these "market inefficiencies."[20]

However, in the mid-1980s, regulatory harmonisation prospects were complicated by the wide diversity of national securities regulatory regimes, supervisory entities, and financial services institutional configurations. The US regime dated from the 1930s, the UK and France had only formalised their regimes in the mid-1980s, and Germany had no securities regulatory regime. Differences in regulation and capital treatment arose from different market histories, financial services institutional structures and regulatory objectives. As bank and securities firm activities expanded internationally and pressures to harmonise national regulatory regimes increased, differences between banking and securities businesses, as well as differing domestic market and institutional structures, were highlighted.

The Relationship of Risk and Regulation

Traditional banking involves taking deposits and extending credit with the expectation of repayment. This relationship places a high value on evaluating a borrower's ability to repay. In contrast, securities firms act as financial intermediaries; they underwrite and trade securities, but rarely hold them to maturity like loans. For this reason, secondary market pricing and liquidity are more important than ability to repay. As a result, from a risk management perspective, securities firms typically focus on

---

followed in 1988. See: Kapstein, *Governing the Global Economy: International Finance and the State.* and Tobin, "Global Money Rules: The Political Economy of International Regulatory Cooperation".

[20] Worth, "Harmonizing Capital Adequacy Rules for International Banks and Securities Firms," A counter argument notes that domestic regulation may create market failure by inhibiting the efficient allocation of financial resources by capital markets. As a consequence, regulatory harmonisation may perpetuate inefficiencies. This perspective argues that a superior harmonisation approach encourages regulatory regimes to compete, which will enhance the overall efficiency of international capital markets See: George J. Benston, "Competition Versus Competitive Equality in International Financial Markets," in *Regulating International Financial Markets: Issues and Policies*, ed. Franklin R. Edwards and Hugh T. Patrick (Boston: Kluwer, 1992).
Edward J. Kane, "Tension between Competition and Coordination in International Financial Regulation," in *Governing Banking's Future: Markets vs. Regulation*, ed. Catherine England (Boston: Kluwer, 1991).
Benn Steil, "Regulatory Foundations for Global Capital Markets," in *Finance and the International Economy*, ed. Robert O'Brien (Oxford: Oxford University Press, 1992).

liquidity and market risk while banks focus on credit and repayment risk.[21] This distinction has powerful implications for the structure of capital regulations designed to mitigate institutional risk.

An additional risk for banks is that a mismatch between funding and lending will prevent them from repaying depositors, provoking a funding or cash crisis and a potential "run" on the bank.[22] Because the provision of bank services, principally deposit-taking, is considered a public good, regulators have determined that the prevention of catastrophic deposit loss, through regulation and government insurance, is appropriate.[23] However, to avoid "moral hazard"[24] regulators (particularly in the US) have historically constrained the scope of banks' business activities to enhance institutional safety and soundness.

The relationship of regulation and risk is less clear with securities firms. Their principal risks are portfolio liquidity and counterparty default.[25] These risks arise from core securities businesses: underwriting, brokerage, and trading. Because a regulator has several securities "businesses" on which to base regulation, national regulators' business orientations differ and affect the type of regulation it develops.

This distinction is evident when the securities regulations of the UK, US, France and Germany are compared. In the UK, where individual share ownership was historically limited, securities regulation was traditionally designed to encourage competitive underwriting and trading institutions, not the protection of investors.[26] In the US, share ownership has historically been broader, and securities regulation, developed following the 1929 market crash, has focused on investor protection rather than institutional competitiveness. In Germany and France, limited securities market development meant that regulation emphasised different principles, principally support for government mandated economic policies. Because securities firms typically do not

[21] See Glossary.
[22] Securities firms do not accept deposits.
[23] Deposit-taking is a public good because banks provide a "safe haven" for depositors' funds.
[24] See Glossary.
[25] "Counterparty default" is the failure or inability of a party with whom an institution or financial actor has entered into a financial transaction, to settle or complete that transaction.
[26] The UK's regulatory orientation shifted to a greater emphasis on investor protection in the late 1990s.

have access to public safety nets,[27] regulators, particularly in the US, have also emphasised the promotion of fair and transparent markets. These distinctions were critical in the negotiations studied in this thesis.

Institutional Structure and Regulation

Organisational distinctions between banks and securities firms may also differ between countries. In Germany, Austria and Switzerland, financial institutions perform banking and securities functions through universal banks. In other European countries, the historic distinction between banking and securities businesses has evolved toward universal banking as well, but sectoral distinctions remain. In some countries, financial conglomerates control both types of firms.[28] Until 1998, the US kept banking and securities activities institutionally separate under the provisions of the Glass-Steagall Act of 1933. However, over the preceding decade the Act had been weakened through the decisions of courts[29] and by commercial banks' offshore investment banking activities conducted under Federal Reserve Regulation K.

Four approaches to securities supervision, based on the institutional structure of domestic financial services, are developed by Worth.[30] First, central banks or finance ministries generally regulate universal banks. This is the case in Germany and Switzerland. Second, mixed financial services systems may have bank supervisors regulate bank credit and securities activities while separate securities regulators monitor brokers and conventional securities firms. France follows this model. Third, as in the UK, several national regulators might work together to supervise the same institution. A final approach, exemplified by the US, institutionally segregates regulatory oversight,

[27] In the US, the Securities Investor Protection Corporation ("SIPC") provides limited investor insurance against broker bankruptcies. However, SIPC is not a government agency or regulatory authority. It is a non-profit, membership corporation, funded by its member securities broker-dealers. It was created by an Act of the US Congress in 1970. See: http://216.181.142.217/sipc/.

[28] These countries include: Belgium, Canada, Finland, France, Greece, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. See: Worth, "Harmonizing Capital Adequacy Rules for International Banks and Securities Firms."

[29] In 1988, commercial banks were permitted to operate "Section 20" subsidiaries with limited underwriting powers.

[30] Worth, "Harmonizing Capital Adequacy Rules for International Banks and Securities Firms."

assigning securities regulation exclusively to the SEC, and bank supervision to the Federal Reserve and other government agencies.[31]

Differing national structures for the provision of financial services are reflective of differing perspectives on business and the role of regulation. In universal banking countries, financial services regulation traditionally concentrated on credit services, high capital levels and overall institutional security. Securities markets were often underdeveloped and securities regulation and regulatory institutions rudimentary. In mixed countries, securities regulation ranged from the sophisticated, competitive regime established by the UK[32] to less sophisticated systems focusing primarily on equity market management and modest investor protection, as in France. At an extreme, the US regulatory model encompassed an independent regulator, a conservative approach to capitalisation, and a large, sophisticated securities market.

The extensiveness and location of securities regulatory authority also helps distinguish regulatory systems. France, Japan, the UK and the US, countries with powerful securities regulators, located authority primarily at the national level. Canada, Australia and Germany, countries with less powerful regulators, until recently located authority at a provincial or state level.[33]

These historic structural arrangements are deeply embedded in individual countries' economic, political and commercial histories. As a result they have a profound impact on national regulatory norms. It should not be surprising, therefore, that regulatory harmonisation debates frequently revolved around possible amendments to these norms.

The Scope for Harmonisation

In 1990, IOSCO released a report on the scope for international harmonisation of domestic capital adequacy standards for securities firms that confirmed the diversity of

[31] This model is not completely accurate as the Fed, through its supervision of commercial banks' securities activities, does impinge on the SEC's functional regulatory responsibilities. As a result, the US is probably closer to Worth's "mixed" model than it is a distinct model.
[32] Under the Financial Services Act of 1986.
[33] Germany now has a national securities regulator, the *Bundesaufsichtsamt für Wertpapier*. Australia and Canada operate hybrid systems.

national approaches to securities regulation.[34] The US had developed a conservative, comparatively inflexible, approach to capitalisation. Securities firms could choose between a basic capital adequacy model (aggregate indebtedness could not exceed 15 times capital) and a model requiring a minimum capital cushion representing at least 2 percent of customer and customer-related receivables. Japan and the UK permitted greater flexibility. The UK allowed firms to minimise capital requirements by employing hedging and portfolio diversification.

British and Japanese capitalisation provisions both incorporated graduated securities classifications based on the liquidity of securities held in investment firms' portfolios. In contrast, the US simply defined securities as either "readily marketable" or "not readily marketable" and imposed a unilateral 15 percent charge against all equity securities. US regulation did not include portfolio diversification in determining required capital.

Another factor differentiating national regulatory regimes was portfolio valuation methodology. In the US and UK, securities firms were required to value asset portfolios at current, rather than historic, market prices.[35] Other countries (e.g., Germany and Japan) valued assets at original, historic cost. This latter practice camouflaged the current value of a firm's securities inventory. US securities laws were promulgated in 1933, and significantly updated in 1975 and 1991; British rules were promulgated in 1986, French and Japanese in 1989.[36]

Early Harmonisation Efforts

In addressing the consequences of globalisation, regulators' principal objectives were the maintenance of regulatory authority over multinational institutions and the prevention of systemic problems. When the EU and IOSCO began their regulatory

[34] Technical Committee IOSCO, "Capital Requirements for Multinational Securities Firms," (Montreal: International Organization of Securities Commissions, 1990).
[35] This is referred to as "marking to market."
[36] In general, irrespective of national rules, large international securities firms maintained capital levels in excess of minimum requirements. This accommodated unexpected capital demands and acted as a marketing tool.

harmonisation discussions in 1987/88, regulators had limited experience in crafting multilateral responses to globalisation.[37]

Euromarket growth spurred the G-10 central bank governors to create the Euro-currency Standing Committee[38] in 1962. The 1974 Herstatt bank crisis led the G-10 governors and the BIS to form the Basle Committee on Banking Supervision in order to ensure adequate supervisory oversight of banks' domestic and international activities.[39] These committees were established to ensure that regulatory responsibilities were clear in a financial crisis. In 1975, the Basle Committee released the Basle Concordat, establishing the principle that home country regulators were responsible for supervision of their domestic banks' international activities.[40]

Financial crises have often prompted the development of international regulatory standards and supervisory forums. Harmonised capital adequacy standards are an example. In 1982, the Mexican debt crisis and the collapse of Banco Ambrosiano encouraged the examination of bank capital adequacy. This exercise culminated in the adoption of the Basle Capital Accord in 1988 and the subsequent international discussions on capital adequacy for securities firms.

Four roughly contemporaneous developments encouraged securities regulators to initiate discussions on the harmonisation of capital adequacy regulation. These included: market globalisation and securitisation; the October 1987 stock market crash, which graphically demonstrated the interconnectedness of domestic capital markets; the successful conclusion of Basle Capital Accord in 1988, which established a precedent for international capital harmonisation; and finally, the 1985 development of the EU's 1992 Single Market program, which established specific regional regulatory harmonisation objectives.[41]

---

[37] For a detailed discussion see William R. White, "International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues," (Basle: Bank for International Settlements, 1996).
[38] To monitor Euromarket developments. It was created under the auspices of the BIS.
[39] See: http://www.bis.org/bcbs/aboutbcbs.htm.
[40] This understanding was modified in 1981; home country supervision would be managed on a consolidated basis. See: Andrew Walter, *World Power and World Money*, Revised ed. (Hemel Hempstead: Harvester Wheatsheaf, 1993). p. 227.
[41] The 1987 stock market crash and the EU's 1992 Single Market objectives are described in the case studies. The Basle Capital Accord is examined in Appendices B and C.

Following promulgation of the Basle Capital Accord, the Basle Committee and EU both considered expanding it to accommodate additional risks, including market risks associated with equity positions held by commercial banks. Separately, as part of the EU's Single Market program, the EU Financial Services Commission drafted the ISD in 1988, providing a "single passport" for securities firms and mirroring provisions available to banks in the SBD.[42] The CAD was drafted shortly afterward to address harmonisation of securities firms' capital, also mirroring SBD provisions. Multilateral consultation was expanded to incorporate IOSCO because bank and securities firm market risks overlapped. Separately, IOSCO released its 1989 study on the harmonisation capital adequacy standards, which identified a "need for a common conceptual framework."[43] IOSCO's report actually highlighted two needs: addressing gaps in the Capital Accord and developing a common international understanding of capital for securities firms. A 1990 IOSCO report outlined the scope for international regulatory harmonisation.[44] As a consequence of these efforts, three multilateral institutions, the EU, IOSCO, and the Basle Committee, each addressed itself to the development of harmonised capital adequacy standards for securities firms and securities portfolios. But by 1993, only the EU had ratified a capitalisation standard. IOSCO abandoned its efforts in that year. Also in 1993, the Basle Committee, focused more on developing regulatory standards for banks than securities firms, released a limited bank equity capitalisation proposal. The Committee's standards immediately superseded the standards just adopted by the EU a few months earlier.

Market globalisation, financial crises, and conflicting regulatory precedents created incentives for international harmonisation of securities capitalisation standards. However, distinctions in the structure and historic role of national securities markets, and in approaches to securities regulation, ensured that international harmonisation would generate conflicts.

The next chapter examines theoretical bases and develops hypotheses for analysing the EU and IOSCO negotiations.

[42] See Glossary.
[43] Technical Committee, IOSCO, "Capital Adequacy Standards for Securities Firms," (Montreal: International Organization of Securities Commissions, 1989).
[44] IOSCO, "Capital Requirements for Multinational Securities Firms".

Chapter 3

Perspectives on Authority and Influence

Introduction

This study seeks to assess authority and influence in international policy-making by examining the development of international regulations that address the capital adequacy of securities firms. The central question is whether policy-making authority has migrated away from the state. The thesis investigates this question by assessing arguments addressing the best way to understand both the exercise of authority and the resulting patterns of securities market governance across levels of analysis and a range of actors. If regulatory authority has migrated away from the state, why, how, and to whom? State-centric theoretical approaches emphasise the role of unitary states or state institutions on policy-formation.[1] Non-state centric theoretical perspectives[2] argue that globalisation and related factors have caused authority to migrate away from states to private and supranational actors and institutions and that they have encouraged policy-formation processes to spill across borders. Non-state centric theorists argue further that migration has also contributed to the "transformation" of international authority by diluting state power and by empowering private and supranational actors and institutions. These perspectives also argue that these forces encourage regulatory norms to converge onto a single set of standards. This thesis evaluates these arguments by examining empirical findings from the case studies of EU and IOSCO negotiations.

Empirical evidence is assessed against hypotheses that describe contrasting analytical perspectives. These perspectives range along a continuum defined, *inter alia*, by the degree to which supranational, state and private actors or institutions predominate

[1] These include realist and institutionalist perspectives, as well as perspectives based on analysis of the impact of domestic structures and bargaining on state policy-formation.
[2] "Non-state centric theoretical perspectives" refers primarily to state/market, and EU integration perspectives. The continuum of theoretical perspectives is described in this Chapter 3.

in international policy-making. The extreme limits of this continuum reflect state and non-state authority in policy-formation.[3] Other variables potentially affecting authority include economic, political and regulatory structures and the relationship and participation of policy-communities in policy-making. A secondary objective of this study is to assess the efficacy of state centric and non-state centric analytical perspectives in defining the character of authority in international policy-formation.

The continuum describes intellectual and research progression in IPE from narrow, idealised analyses focused on specific variables (state centric perspectives) to broader, more realistic analyses of a spectrum of potentially interrelated variables (non-state centric perspectives).[4] However, the analytical objective is more than the binary determination of whether state or non-state actors are authoritative or influential in international policy-making. Non-state centric theorists argue that policy-making encompasses state, private and transnational actors and institutions. This implies a diminution in state authority. Their objective is to assess empirical findings derived from multiple levels of analysis in order to understand the developmental process of international policy-making. This thesis' study of this process seeks to identify the relative accuracy of hypotheses highlighting contrasting theoretical perspectives, in order to locate and assess the sources and structure of authority in international policy-making.[5] However, since analytical perspectives are limited by the variables they evaluate, further objectives of this thesis are to expand the range of variables assessed and to compare and contrast observations from differing theoretical perspectives in order to develop new insights.

This thesis examines a spectrum of perspectives on policy formation and develops hypothesised predictions for the case studies. The current chapter explores the

[3] Jayasuriya defines these limits as "corporatist state" (positive coordination) and "competition state" (negative coordination) based on the degree of state control (positive coordination) over policy-formation. See: K. Jayasuriya, "Globalization and the Changing Architecture of the State: The Regulatory State and the Politics of Negative Coordination," *Journal of European Public Policy* 8, no. 1 (2001). Cited in: Daniel Muegge, "The Governance of the European Securities Industry: From the Investment Services Directive to Lamfalussy" (University of Amsterdam, 2002).

[4] As noted earlier in Chapter 1, proponents of non-state centric perspectives argue that this continuum also describes the evolution of international policy-making. They have observed the "transformation" of the state's role in international policy-formation, referring to the evolution of international policy formation into a multi-level process involving supranational, state, domestic and private variables, all with potential influence. It also implies a diminution in state authority.

[5] A "by-product" of dynamic comparative analysis, encompassing distinctive perspectives, is the identification of perspectives that are more accurate than others in explaining policy-formation.

strengths and weaknesses of a range of perspectives, extending from state-centric structural, domestic and bargaining approaches to non-state centric EU integration and state/market approaches. Each is assessed by examining its main arguments.[6] It is, of course, difficult to assign analytical perspectives precisely to state or non-state centric "camps." Few perspectives are exclusively state or non-state centric; virtually all acknowledge, in varying degrees, the influence of non-state actors. State and non-state centric expressions of these perspectives are used to generate contrasting hypotheses. Finally, this chapter examines research methodology and criticisms of complex approaches to analysis.

This thesis also considers whether it is possible to examine observations generated by different theoretical perspectives and to develop new or unique conclusions regarding the sources of regulatory authority. This examination does not simply assess a wider field of observations.[7] Instead, it facilitates a "conversation" between analytical observations developed from different perspectives, state and non-state centric, to determine whether new conclusions can be developed about the policy-formation process. This examination is referred to as a "synthetic" analysis.

IR/IPE studies, especially in the US, have been dominated by state-centric, "rational choice"[8] analytical approaches. These argue that states, whether unitary or disaggregated, represent dominant international decision-making authority. Since the late 1970s,[9] these arguments have been challenged by analytical perspectives that stress the influence of non-state, private, sub-national and supranational actors and institutions. They explicitly acknowledge that authority lies on a continuum. They were particularly encouraged by changes in the legal structure of the EU in the mid-1980s and by earlier research initiated by Susan Strange, Ernst Haas, Robert Keohane and others.[10] These

[6] The theoretical perspectives described do not attempt to encompass the universe of IPE perspectives.
[7] This is, in essence, what a non-state centric analytical approach does.
[8] Also referred to as "positivist."
[9] As discussed in this chapter, "functionalist" research by Ernst Haas, David Mitrany, Karl Polanyi and others predates the late 1970s resurgence in neo-functionalist and state/market research.
[10] These research programs did not insist on the decision-making authority of the state, but observed instead that governance norms could also be shaped and enforced by non-state actors and institutions.

studies brought EU integration research, and IR/IPE with it, through the "dark ages"[11] of state-centred analysis, enhancing analytical substance significantly.

The Contours of Authority

The specific roles of agents and institutions are significant in understanding the formation of governance norms and the structure of authority. Policy-making establishes governance, defined as "the intentional regulation of social relationships and...underlying conflicts by reliable and durable means and institutions, instead of the direct use of power and violence."[12]

Governance in the international sphere operates as a set of rules for the interaction of actors and institutions. But this does not describe how authority and influence operate in forming international rules. Governance is defined by a (typically) non-coercive process of setting up regulatory boundaries within which actors and institutions interact.[13] But governance depends on recognition and enforcement, which in turn depend on legitimate authority and influence. These variables define how policy-making determines governance norms and how governance operates.

This thesis contrasts two definitions of authority. The first defines authority narrowly[14] as the right to perform certain actions, including the right to make laws. This definition links authority with legitimacy and with explicit power.[15]

---

[11] R.O. Keohane and S. Hoffmann, "Institutional Change in Europe in the 1980s," in *The New European Community. Decision-making and Institutional Change*, eds. R.O. Keohane and S. Hoffmann (Boulder: Westview, 1991).

[12] M. Jachtenfuchs, "The Governance Approach to European Integration," *Journal of Common Market Studies* 39, no. 2 (2001). quoting M. Zürn, *Regieren Jenseits des Nationalstaates. Globalisierung und Denationalisierung als Chance* (Frankfurt: Suhrkamp, 1998). Young concurs with Zürn that "...governance involves the establishment and operation of social institutions capable of resolving conflicts, facilitating cooperation, or, more generally, alleviating collective-action problems in a world of independent actors." Young defines 'social institutions' as: "rules of the game that serve to define social practices, assign roles, and guide interactions among the occupants of these roles." (See: Oran Young, *International Governance: Protecting the Environment in a Stateless Society* (Ithaca: Cornell University Press, 1994)., p.15). Keohane and Nye define governance as "the processes and institutions, both formal and informal, that guide and restrain the collective activities of a group." (See: Robert O. Keohane and Joseph S. Nye, Jr., "Introduction," in *Governance in a Globalizing World*, ed. Joseph S. Nye, Jr. and John D. Donahue (Washington, D.C.: Brookings Institution, 2000)).

[13] Governance can operate formally and informally.

[14] Two variants of this definition of authority exist: the first derives from legitimacy and utility and the second, from the unconditional relationship between ruler and ruled. These conceptions hinge on a construction of governance that rests on authority, defined as a social relationship, where "decisions issued by one actor are expected to be obeyed by a second." See: Kim Scheppele and Karol Soltan, "The

A second definition, developed by Susan Strange and preferred by state/market theorists, defines authority broadly, as "structural power." This definition conflates authority with power and influence.[16]

Both conceptions of authority rest on compliance based on legitimacy and utility. More specifically, they depend on "recognition," which derives from context-based expertise and/or power.[17] However, a general definition of authority does not help to differentiate the roles of state and non-state actors in policy-formation. Both state and non-state actors may express legitimacy or utility – and authority. A more precise definition of authority, based on its source, helps differentiate types of authority from other potential sources of influence.[18] Policy is formed by the interaction of formal authority and other sources of influence. Rather than combine variables as Strange does, each variable may be separately identified and examined: formal authority implies the

---

Authority of Alternatives," in *Authority Revisited: Nomos XXIX*, ed. J. Roland Pennock and John W. Chapman (New York: New York University Press, 1987). The second concept hinges on the recognition that, for example, words uttered by a ruler (or other authoritative entity) must be accepted, unconditionally, as authoritative. This description implies that authority lies at the centre of a relationship between ruler, rules, ruled and response. The first definition is defined above. Under this definition authority is elastic, referring to any system of social or political guidance considered legitimate and demonstrating utility by those to whom it applies. This Weberian conception does not focus on specific rules or methodologies, but argues that authority rests on "a particular type of attitude among a people regarding the mode of subordination to which they are subject." (Weber famously defined three types of authority systems: charismatic, traditional, and legal-rational. This study focuses on the last system. See: Miller, "Authority.")

[15] Ibid., and from which this section is adapted.

[16] See also earlier discussion on page 21. Structural power "confers the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises. The relative power of each party in the relationship is more, or less, if one party is also determining the surrounding structure of the relationship." Strange, of course, includes brute force in her definition of structural power, which authority excludes. Strange also posited "Relational Power," a simpler, realist notion of power. See. Strange, *States and Markets*.

[17] This assertion is, however, contested, as it goes to the ability of authority and autonomy to co-exist. This has led to the development of a taxonomy of the constituent parts of authority: first, there must be means to recognise those entitled to positions of authority (who may be formal or informal), and second, authoritative rulings must be grounded in legitimacy, based on expertise or superior knowledge for which intellectual (or experiential) authority is the archetype. This characterisation stresses the importance of recognising that context defines the balance between these concepts and the ability or need to balance authority with independent judgement. Finally, authority is a "human artifice" depending on human recognition.

[18] Weber defined power as "the probability that one actor in a social relationship will....carry out his own will' against the resistance of others." (See: Weber, M, *Economy and Society*, vol. I., ed., G. Roth and C. Wittich, New York, Bedminster, 1968, quoted in Miller, *Political Thought*, p. 400.) This definition implies that one actor compels another's compliance. Influence is defined as the ability "to affect or alter by indirect or intangible means." (See: *Webster's Seventh New Collegiate Dictionary* (Springfield, MA: G.&C. Merriam Co., 1963). This implies an indirect avenue to policy-formation based on persuasion or other means. These definitions associate formal or explicit authority with power, distinguishing it from influence. Power, authority and influence are, of course, closely related. They describe the ability of one actor to get another actor to do something – directly or indirectly – that it might otherwise not do.

right to make rules; influence and power both define additional potential "inputs" into policy-formation, one of which may be informal authority based on utility or legitimacy.[19] This defines authority as one, differentiated, form of influence. Each variable may express inputs with legitimacy and utility and each may operate discretely in policy-formation.[20] Acknowledging this possibility focuses analytical attention on the multiple sources of influence and the process of international policy-making.[21]

An Analytical Taxonomy

Benjamin Cohen distinguishes two broad theoretical perspectives on international policy-making, "outside-in" and "inside-out,"[22] and he uses "level of analysis" to differentiate influences on policy-formation. An outside-in explanation, typically presented as either institutionalist or realist/neo-realist, is based on structural or systemic variables. An inside-out explanation is based on analysis of domestic or societal considerations, particularly how competition between domestic interests and institutions influences interstate cooperation.[23] Each perspective privileges analytical variables and causative agents. However, despite their different analytical focuses, these perspectives have a common view on the primary location of international rule-making authority;

---

[19] "Informal authority" may include contextual or moral components.

[20] This observation is refined in a distinction made by Zürn about state and non-state analytic biases. Traditional state-focused analyses revolve around the power or authority of states or institutions in conflict resolution. Non-state oriented analyses emphasise a greater variety of paths to successful governance, which do not necessarily operate through or incorporate the state or state institutions for validation, credibility or authority. Authority may rest with states or it may rest with non-state actors and institutions. See: M. Zürn, *Regieren Jenseits des Nationalstaates. Globalisierung und Denationalisierung als Chance* (Frankfurt a. M.: Suhrkamp, 1998). Quoted in Jachtenfuchs, "The Governance Approach to European Integration".

[21] Contemporary theories of legitimacy come in three basic forms: those that derive legitimacy from "immanent" or "divine" traditions, those that limit legitimacy to rationally accepted conventions governing citizen/state relations, and, finally, theories insisting that norms and standards are pervasive and conventionalised, implying "discursive consent" to patterns of living or acting. The second option implies explicit consent. The third option, reflected in the work of Habermas, broadens the definition of legitimacy to encompass practices, standards and norms previously considered private or market-derived as increasingly shaped by power and politics. See: J. Habermas, *Legitimation Crisis*, trans. T. McCarthy (Boston: Beacon, 1973). and W.E. Connolly, "Legitimacy," in *Political Thought*, ed. D.W Miller, et al. (Oxford: Blackwell, 1991).

[22] Cohen, "Phoenix Risen; the Resurrection of Global Finance." See also: Sobel, *Domestic Choices, International Markets: Dismantling National Barriers and Liberalizing Securities Markets*. and Kenneth N. Waltz, *Man, the State and War: A Theoretical Analysis* (New York: Columbia University Press, 1959).

[23] Cohen actually prefers a tripartite analytical typology, which he defines by reference to "systemic (or structural)", "domestic (or unit)", and "cognitive" levels of analysis. This approach expands on state-centric perspectives.

states[24] are principal policy-makers and allocate only limited authority to either supranational or sub-national institutions or actors.[25]

Cohen's two-level model serves as a theoretical starting point for describing a taxonomy of analytical perspectives based on their state/non-state causative emphases. Analytical concepts developed by Putnam,[26] Moravcsik,[27] and Milner[28] build a third, "bargaining" analytical perspective, which links structural and domestic perspectives and introduces non-state actors and institutions into analysis. Odell[29] expands this linkage by introducing the variable of time by examining the "process" of policy formation

EU integration and state/market perspectives expand on bargaining perspectives.[30] EU integration encompasses "middle-level" theories emphasising the ability of domestic and supranational actors and institutions to influence policy-formation, independently and across levels of authority.[31] State/market perspectives identify state and market authority components in policy-formation. Both perspectives explore the relocation and re-balancing of authority in reaction to intensifying regionalisation or globalisation. Both research programs continue to expand empirical focus beyond state actors and institutions, identifying additional sources of authority and governance.[32]

---

[24] That is, state actors and institutions.
[25] Marks, Hooghe, and Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance."
[26] Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games."
[27] Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining,".
[28] Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations.*
[29] Odell, *Negotiating the World Economy.*
[30] Non-state perspectives grew, in part, out of David Mitrany's research, which encouraged Ernst Haas to explore non-state oriented approaches to the development of international governance norms. Haas's empirical research focused on multilateral institutions and other supranational actors, especially those that proved difficult to assess adequately using prevailing state-centric paradigms. In particular, the development of powerful EU regional institutions confounded analyses premised on the decision-making authority of states. The mid-1980s enhancement of EU institutional authority through the adoption of the SEA and TPU further encouraged this research program. EU integration research was complemented by research programs of Keohane/Nye and Strange, both prompted by the early consequences of globalisation. Each emphasised the role of non-state institutions and actors. Keohane worked within a substantially positivist framework while Strange, though often referred to as a realist, promoted an analytical platform stressing economic and political structures and processes rather than states or parsimonious research equations.
[31] Marks, Hooghe, and Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance."
[32] The definition of "state" can be confusing. States are not defined as unitary. They are comprised of public actors and institutions, which represent or act through national governmental organs, as well as non-governmental actors and institutions. Where state is used in the text it refers to the first component of a "state."

The juxtaposition of these perspectives along an intellectual continuum prompts the central empirical and theoretical questions of this research; where is policy-making authority located and which perspective best explains international policy formation influence?

Theoretical Perspectives

This section assesses five theoretical perspectives ranging from state-centric to non-state centric. This discussion is divided into sections corresponding to the analytical perspectives assessed: 1) structural (neo-realism and institutionalism), 2) domestic (preference, institutional and ideational), 3) bargaining, 4) EU integration, and 5) state/market perspectives on policy-formation. The degree to which authority and influence in policy-formation rests predominantly with the state distinguishes the three initial approaches from EU integration and state/market theoretical perspectives. The latter two perspectives more explicitly acknowledge the potential for linkage between and across levels of analysis. The movement from state to non-state centric represents a broadening of conceptual and empirical focus, a move from an idealised analytical view to a more complex and realistic one. These five perspectives do not represent "bright-line" theoretical distinctions nor do they represent a smooth, two-dimensional continuum.[33]

State/non-state theoretical distinctions raise an additional question: "Can the roles of supranational or intergovernmental actors, such as IOSCO, the EU or the Basle Committee, be assessed using state-centric perspectives?"[34] This question is relevant because the perspectives do not explicitly assume that intergovernmental actors should be analysed in the same manner as states. Additionally, EU integration perspectives, particularly MLG,[35] treat EU analysis as *sui generis*. This question is answered affirmatively in this thesis. Intergovernmental actors share many characteristics with states, which argues for substantially similar analytical treatment. Supranational actors,

[33] As mentioned, with the exception of neo-realism, these perspectives all, to varying degrees, acknowledge the potential influence of non-state actors and institutions as variables.
[34] See discussion of Hix/Hurrell/Menon debate in footnote 109 on page 72. This question is related to the contention that EU integration perspectives are *sui generis* to the EU, which is addressed separately.
[35] "MLG" or multi-level governance is defined below.

as well as state and private actors, can be understood both as unitary and differentiated. Internal differentiation arises from the contrasting preferences of members and institutions, their review and ratification procedures, their governance mechanisms, their underlying principles and objectives, their distinctive, independent bureaucracies, and their memberships. Like states, intergovernmental actors are influenced by their members, by other supranational actors, and by public and private interest groups. Supranational actors have a "domestic" polity similar to states, comprised of their members.

A significant distinction between states and intergovernmental actors is that intergovernmental actors are typically not subject to election pressures. However, their members generally are and, as a consequence, the pressures and motivations attendant on politicians domestically are reflected in the actions of intergovernmental assemblies. A further significant distinction is that intergovernmental actors make collective decisions and recommendations regarding states. This differentiates state and intergovernmental actor roles but does not necessitate different analytical treatment.

Structural Perspectives

Neo-realism

Neo-realism lies at the extreme state-centric end of the policy-formation spectrum. It argues that unitary states survive in a competitive, anarchic world by amassing power. Power, not legitimacy, gives states the ability[36] to determine international governance standards, should any be established.[37] Order and stability are achieved by balancing the objectives of competitive states.[38] A more refined view argues that states are pre-eminent, unitary, decision-making actors in the international system.[39] Institutions are insignificant. Governance norms can be established hegemonically or

[36] "Ability" does not equate to authority, as legitimacy is not necessarily included.
[37] See, e.g., E.H. Carr, *The Twenty Years Crisis 1919 - 1939, an Introduction to the Study of International Relations*, 2nd ed. (New York: Harper and Row, 1946)., Hans J. Morgenthau, *In Defense of the National Interest* (1951)., Hans J. Morgenthau, *Politics among Nations: The Struggle for Power and Peace, 5th Edition* (1978)., and Reinhold Niebuhr, *The Irony of American History* (1952).
[38] Morgenthau, Politics Among Nations: The Struggle for Power and Peace.
[39] Neo-realism has also been called "structural realism" See Charles Glaser, "Realists as Optimists: Co-operation as Self Help," *International Security* 19 (1994/1995). Other neo-realists include Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987).
K. Waltz, *Theory of International Politics* (Addison-Wesley, 1979). and Joseph M. Grieco, "Anarchy and the Limits of Co-operation: A Realist Critique of the Newest Liberal Institutionalism," *International Organization* 42 (1988).

where agreement is prompted by one state respecting another's right to protect its autonomy.[40] But major obstacles exist: interstate relationships are antagonistic, cooperation is temporary, and states increase their security by maximising their power. Moreover, governance arrangements can limit independence, produce uneven relative gains, or encourage defections and cheating.[41]

The analytical shortcomings of neo-realism stem from its narrow focus on power and its unitary conceptualisation of states. By defining state preferences as the interests of the most powerful actor, this perspective ignores potentially significant distinctions between competing supra and sub-national interests.[42] The significance of non-state actors does not arise solely from their association with states or through power but could arise, for example, through context-based expertise. In developing international standards, non-state actors may even make policies that are not in states' interest.[43] An example is found in bond-rating agencies.[44]

Neo-realism fails to answer obvious questions raised by the different outcomes of the cases. For example, neo-realism explains EU and member-states' support for the CAD and ISD as a function of efforts to improve their international regulatory stature. But it fails to explain how agreement among EU member-states was achieved. This is particularly critical in understanding the structure of authority and influence, because empirical examination reveals that starkly differing regulatory preferences within core EU member-states – Germany, France and Britain – were reconciled. In the other case study, realism explains IOSCO's failure as a consequence of a stalemate between

[40] See, for example: Stephen Krasner, "State Power and the Structure of International Trade," *World Politics* 28, April (1976), David Lake, *Power, Protection and Free Trade* (Ithaca: Cornell University Press, 1988)., and Charles Kindleberger, *The World in Depression: 1929-1939* (Berkeley: University of California Press, 1973).
[41] John Mearsheimer, "The False Promise of International Institutions," *International Security* Winter, no. 19 (1994).
[42] See: John E. Richards, "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets," *International Organization* 53, no. 1 (1999). who cites Baldev Raj Nayar, "Regimes, Power, and International Aviation," *International Organization* 49, no. 1 (1995). Realism also risks misinterpreting circumstances where powerful actors defer to weaker actors or make decisions that are not in their self-interest. Ibid. See also: Stephen Krasner, "Global Communications and National Power: Life on the Pareto Frontier," *World Politics* 43, no. 3 (1991). for a further example of this approach.
[43] A. Claire Cutler, Virginia Haufler, and Tony Porter, eds., *Private Authority and International Affairs*, (Albany: State University of New York Press, 1999).
[44] Sinclair, "Between State and Market: Hegemony and Institutions of Collective Action under Conditions of International Capital Mobility."

balanced, but opposed states, the UK and the US. However, it fails to explain why the UK and the US adopted different regulatory preferences in the first place.[45]

Institutionalism[46]

Institutionalism assumes a larger role for mutual interests and international institutions in mediating interstate relations, but it adopts neo-realist assumptions.[47] Guided by microeconomic theory, institutionalists argue that international actors try to maximise mutual interests through the promotion of international, cooperative institutions and mutually acceptable regime norms.[48]

This optimistic perspective views international society as dynamic rather than static; states trade autonomy and power to approach Pareto optimality.[49] Power and autonomy remain prominent influences, and unitary states remain primary decision-makers. Keohane and other institutionalists expand concepts of authority and actors by placing greater emphasis on legitimate authority, expressed through regimes, rather than brute power.[50] Authority may be concentrated or dispersed but is not based on hegemony or power. Instead, it is represented by institutions and regimes created by states to organise and manage international society. Institutions and regimes promote shared

---

[45] For a less pessimistic view of realism's analytical utility see: Fred Halliday and Justin Rosenberg, "Interview with Ken Waltz," *Review of International Studies* 24, no. 3 (1998)., Jack Donnelly, "Realism: Roots and Renewal," *Review of International Studies* 24, no. 3 (1998)., and Barry Buzan, David Held, and Anthony McGrew, "Realism Vs. Cosmopolitanism: A Debate," *Review of International Studies* 24, no. 3 (1998).

[46] Scholars have used various names to describe this perspective including "liberal institutionalism", "rationalist institutionalism", "neo-liberal institutionalism", and "neo-liberalism". Although some scholars accord unique significance to each characterisation, I have used the term "institutionalism" to describe this approach, which challenges neo-realism from similar premises. See: Robert J. Beck, "Institutionalist Approaches," *International Rules* 3 (1996).
Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton: Princeton University Press, 1984). and Robert O. Keohane, *International Institutions and State Power: Essays in International Relations Theory 3* (1989).

[47] Institutionalism adopted neo-realist assumptions, in part, to emphasise that cooperation can emerge despite neo-realist cynicism.

[48] Institutionalists argue that rational states seek utility maximisation and that power asymmetries do not necessarily discourage cooperation.. Robert Keohane argues that an emphasis on asymmetries is "illogical" when cooperation develops significant mutual gains and states are not threatened by force. See: Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy.*

[49] Governance norms, even restrictive norms, may be acceptable if they lead to other gains.

[50] States develop regimes or institutions to resolve market failure and promote mutual interests. State or non-state actors may in turn, influence market failure and mutual interests. Institutions enforce regime or governance norms by encouraging reciprocal relationships. See: Robert O. Keohane, "International Institutions: Two Approaches," *International Studies Quarterly* 32 (1988).

benefits that move states closer to Pareto frontiers.[51] This is accomplished by encouraging mutually beneficial agreements, transparency and regime compliance.[52]

The decision of states to establish regulatory regimes vests these institutions with authority. Non-compliance attracts penalties and/or market censure. This distinguishes institutionalism from realism, but still locates authority principally with states.[53] However, institutionalism introduces non-state-centric analysis and has encouraged non-state centric enquiry.[54] Keohane/Nye's theory of complex interdependence rejects a restrictive focus on state sovereignty. Their definition of regimes as "sets of governing arrangements… networks of rules, norms and procedures that regularize behaviour and control its effects," implicitly assumes that regimes may be created in response to non-state centric concerns.[55]

Institutionalism's main contributions come from its acknowledgment of influential non-state actors, its non-static perspective and its argument that regimes and institutions help organise international society and promote regulatory convergence.

Research programs led by Strange, Puchala, Hopkins, Young and Keohane/Nye[56] examined regime concepts.[57] Their observations encouraged the development of cross-border and multi-level neo-functionalist organising concepts.

---

[51] Keohane defines regimes as "persistent and connected set(s) of rules (formal and informal) that prescribe behavioural roles, constrain activity, and shape expectation." Keohane, *International Institutions and State Power: Essays in International Relations Theory 3*. Krasner's well-known definition described regimes as "sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations." Stephen D. Krasner, "Structural Causes and Regime Consequences: Regimes as Intervening Variables," *International Organization* 36, no. 2 (1982).

[52] Compliance may be realised through institutional enforcement of regime guidelines or rules or through self-enforcement or self-compliance. See Lisa Martin, "Theories and Empirical Studies of International Institutions," *International Organization* 52, no. 4 (1998).

[53] States remain the major analytical focus; they create regimes, may act contrary to regime rules, and can enter or leave regimes. This focus is consistent despite institutionalism's emphasis on lowering transaction costs and increasing predictability, accomplished through the "conditioning effect" of existing relationships (the "shadow of the future") and the fear of reciprocal regime enforcement. Robert Axelrod and Robert O. Keohane, "Achieving Cooperation under Anarchy," in *Neorealism and Neoliberalism: The Contemporary Debate*, ed. David A. Baldwin (1993).

[54] See generally: Volker Rittberger, ed., *Regime Theory and International Relations* (Oxford: Clarendon Press, 1995).

[55] Robert O. Keohane and Joseph S. Nye, Jr., *Power and Interdependence: World Politics in Transition* (Boston: Little, Brown, 1977). p. 19.

[56] See page 59.

[57] Strange, presaging her state/market perspective, argued that regimes were epiphenomena. She identified underlying economic and political variables, influenced by public and private actors, as changing behaviour and outcomes. (See: Susan Strange, "Cave! Hic Dragones: A Critique of Regime Analysis,"

But institutionalism is limited by its adoption of neo-realist assumptions. Exploration of the potential authority of domestic or supranational variables is ignored or assumed, defined as a source of "residual variance."[58] Like neo-realists, institutionalists assume state preferences are "exogenously given"[59] and do not evolve.[60] By assuming that states create regimes to address market failure, institutionalism ignores potentially significant investigative avenues: "Do regimes address issues other than market failure?" or "Can non-state actors create regimes?" This limits examination of potential relationships between regime development, structure, and distributional consequences and discourages locating authority outside states.[61]

Institutionalism suggests that the EU succeeded in creating the CAD and the ISD because the directives promoted collective benefits. This fails to explain why states confronting similar market failure developed differing policy preferences. Conversely, IOSCO's failure is explained by its inability to create a regime. But the same question raised about the EU's policy formation process applies to IOSCO; why did states facing the same market failure and sharing membership, mutual interests and objectives, fail to agree?

International Organization 36, no. 2 (1982).) Krasner observed that Hopkins, Puchala and Young's regime analyses drew on Grotian traditions of finite state power, stressing interconnected supranational and national "elites," where sovereignty was a "variable" rather than an "assumption." (See: D. Puchala and R.F. Hopkins, "International Regimes: Lessons from Inductive Analysis," in *International Regimes*, ed. Stephen D. Krasner (Ithaca: Cornell University Press, 1983). and Oran Young, "Regime Dynamics: The Rise and Fall of International Regimes," in *International Regimes*, ed. Stephen D. Krasner (Ithaca: Cornell University Press, 1983). See generally: Stephen D. Krasner, ed., *International Regimes* (Ithaca: Cornell University Press, 1983).)

[58] Knopf, *Domestic Society and International Co-Operation: The Impact of Protest on US Arms Control Policy*.
Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining."

[59] Keohane, "International Institutions: Two Approaches," Alexander Wendt, "Collective Identity Formation and the International State," *American Political Science Review* 88, June (1994).

[60] That is, they do not evolve in response to international relationships or to domestic variables. "[Few institutionalists] treat state interests as endogenous to interaction...interests are formed outside the interaction context...systemic interaction does not transform state interests." Ibid.. Game theoretic analyses confirm this problematic conclusion by identifying domestic constraints encountered by states pursuing utility maximising objectives. Duncan Snidal, "The Game Theory of International Politics," in *Cooperation under Anarchy*, ed. Kenneth A. Oye (Princeton: Princeton University Press, 1986).

[61] See: Oatley and Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord,". and Richards, "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets,".

Neo-realist and institutionalist analytical weaknesses do not invalidate their use as "first cuts" in assessing authority.[62] However, limiting analysis to structural variables consigns domestic policy development to a "black-box," where it enters analysis only when systemic assumptions generate empirical results incongruent with initial hypotheses.

Domestic Perspectives

To address structural shortcomings and clarify state decision-making, scholars integrated domestic preference formation with structural perspectives, building on theories of comparative politics[63] and regulation.[64] Unitary state assumptions and structural motivations were abandoned. Milner argued that states were "polyarchic."[65] Moravcsik commented that structural theorists' domestic assumptions were "indeterminate" and incapable of defining fundamental state motivations. He concluded that these could only be understood by examining domestic factors.[66]

Where these scholars disagreed was not over the potential influence of domestic variables but over their ability to influence decision-making without the support of state actors or institutions. Consequently, domestic analytical perspectives adopt both state-centric and non-state centric formulations, although, in empirical research, this distinction is frequently difficult to isolate. States may be the predominant authority in policy formation – or their role may be empty, a formalistic acknowledgement of non-state actor preferences. Because definitive distinctions may be elusive, analytical objectives are more refined; determining degrees and areas of authority, often across levels of analysis. Nevertheless, these perspectives encouraged analytical attention to

[62] Robert O. Keohane, "The World Political Economy and the Crisis of Embedded Liberalism," in *Order and Conflict in Contemporary Capitalism*, ed. John Goldthorpe (Oxford: Clarendon Press, 1984).
[63] For an overview see: Peter A. Hall, "The Role of Interests, Institutions, and Ideas in the Comparative Political Economy of the Industrialized Nations," in *Comparative Politics: Rationality, Culture, and Structure*, ed. Mark Irving Lichbach and Alan S. Zuckerman (Cambridge: Cambridge University Press, 1997).
[64] For overviews see: Christopher Hood, *Explaining Economic Policy Reversals* (Buckingham: Open University Press, 1994). and Thomas Romer and Howard Rosenthal, "Modern Political Economy and the Study of Regulation," in *Public Regulation: New Perspectives on Institutions and Policies*, ed. Elizabeth E. Bailey, *MIT Press on the Regulation of Economic Activity* (Cambridge: MIT Press, 1987).
[65] Neither anarchic nor hierarchic, but comprised of actors sharing decision-making power and varied interests. Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations*.
[66] Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining,".

non-state actor and institutional preferences in policy-making and foreshadowed the development of both EU integration and state/market perspectives.

Relaxing structural assumptions facilitated the development of three domestic analytical perspectives. These assumptions are first, that state preferences are constant over time; second, that states have an unlimited ability to mobilise domestic resources; and third, that states are rational. Relaxing these assumptions generated analytical perspectives on the potential impact of three domestic variables on international policy-formation: domestic actor preferences, domestic institutions for resource mobilisation, and the distribution of information among domestic actors.[67]

Preferences

Preference perspectives argue that states' international policy preferences are linked to variations in domestic interest group pressure.[68] Analysis of the interests of domestic regulators, politicians or business groups affected by international policy development provides insight into factors motivating states and the success or failure of international cooperation. However, while domestic actors may be influential, international policy authority under this perspective remains with states.[69]

Analytical focus is critical in identifying connections between preferences and international negotiating positions. Key analytical steps include the identification of a catalogue of domestic interests, assessing their relationship with potential outcomes, and determining comparative advantage. Preferences are typically deemed to influence upwards, from domestic to state to international levels. However, they can also operate in the opposite direction. This opens two potential analytical pathways: the impact of international developments on domestic preferences and its reverse, the effect of

[67] Adapted from Hall, "The Role of Interests, Institutions, and Ideas in the Comparative Political Economy of the Industrialized Nations. " See also: Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations*. and Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining.".

[68]The theorised relationship between state policies, the development of international governance norms and the domestic preferences of individuals or groups can be traced to research in international and comparative politics. See: Helen Milner, *Resisting Protectionism* (Princeton: Princeton University Press, 1988). and Peter Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Ithaca: Cornell University Press, 1978).

[69] See description of Moravcsik's "nested" intergovernmentalist perspective under EU integration section.

domestic preferences on international policy-formation.[70] This observation encourages an assessment of the interaction of variables identified at different levels of analysis.

A central concern is to determine whose preferences to analyse. Scholars have focused principally on domestic producer groups. In the context of securities capital adequacy negotiations, producer groups include the firms involved in securities businesses,[71] as well as state producers of regulation.[72]

This perspective's tight focus may over simplify policy formation. The potential influence of other domestic or supranational groups is excluded.[73] The possibility that motivations other than economic gain, re-election or job retention might lie behind policy decisions is not taken into account.[74] This perspective may be powerful because of its clarity and falsifiability, but it sacrifices empirical accuracy in order to preserve consistency. Private and public sector preferences may be multi-faceted rather than unitary. In addition, private sector preferences may relate not to individual states, but to policies or proposals with multilateral or industry emphases.

Institutions

Institutionally oriented domestic research was encouraged by studies authored by Katzenstein[75] and earlier by Keohane/Nye.[76] They argued that domestic institutions operate prominently in shaping state politics and policy-making, although

[70] See: Peter Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics," *International Organization* 32, no. 4 (1978).
[71] Including securities firms as well as firms with securities-related business, including, for example, rating agencies and stock exchanges.
[72] A variation focuses on politicians and politically sensitive bureaucrats, including regulators, but may exclude significant social and economic actors. A basic assumption is that politicians' desire to be re-elected influences the structure of domestic preferences and policy objectives. This focuses examination on voting patterns, electoral politics and campaign contributions. Extending this hypothesis to international policy-formation, international cooperation and institution building are encouraged if they enhance politicians' or bureaucrats' domestic political support and re-election prospects. Alternatively, international cooperation may benefit domestic political constituencies through transfers of property rights or wealth. An important difference between this perspective and comparative politics lays in the observation that wealth, property rights or other benefits can be transferred between countries, not just within domestic economies. See: Oatley and Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord,". and Richards, "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets".
[73] Distribution of costs and benefits and the problems associated with collective action and disbursed groups "theoretically" preclude wider analysis. See: Ibid.
[74] Hood, *Explaining Economic Policy Reversals.*
[75] Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States.*
[76] Keohane and Nye, eds., *Transnational Relations and World Politics.*

internationally, states remain predominant policy decision-makers.[77] Domestic institutional research and preference research are tightly linked;[78] institutions shape the processes and biases through which preferences are translated into policy.[79] For this thesis, institutions are comprised principally of national structures, which may be normative, economic, political, market, sociological/cultural or historic. Domestic preferences are influenced by these structures, among other factors. The linkage between preferences and institutions encourages analysis of domestic structures with potential to influence policy formation.[80] Relaxing fixed resource mobilisation assumptions encourages analysis of the allocation and contours of policy-making influence and authority among domestic policy-making institutions. This isolates nationally distinctive responses to common exogenous stimuli by identifying connections between institutional structures, economic organisation, and domestic incentives and constraints on policy-formation.[81] A close relationship exists between "new institutionalism," a variant of EU integration theory discussed in the next section, and institutionalism.

The utility of this theory hinges on the identification and examination of the most influential institution(s). In multi-country analyses, risk lies in selecting too many or too few institutions or selecting only those that fit predicted patterns. Also, assuming that domestic resources are fixed ignores the observation that resources and institutions change. Dynamism is lacking in a fixed institutional model. Assessing change in institutional variables reveals that they influence the development of national regulatory regimes. In turn, national regulatory regimes influence international negotiations.

For this study, domestic regulatory regime selection was based on the prominence of national securities markets. This judgement was based on market size and

[77] As discussed in a structural context, institutions represent groups of socially accepted rules or constraints defining and structuring preferences. Institutions are distinct from organisations; institutions are structures and organisations agents.

[78] The association of domestic preferences and institutions in broader analysis of domestic politics and international policy-formation is frequently found, reflecting the difficulty of isolating distinctive causal pathways. See, in particular, recent studies in international finance by Sobel, *Domestic Choices, International Markets: Dismantling National Barriers and Liberalizing Securities Markets*, Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*. and Reinicke, *Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980 - 1990.*

[79] Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations.*

[80] See "new institutionalism" below.

[81] Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries.*

institutional stature/influence. By these standards, the US and British/Euro[82] markets and regulatory institutions were the most influential in the world. Japan, despite the relative magnitude of its domestic markets,[83] lacked the stature to meaningfully influence regulatory development internationally.[84] However, this thesis expands selection criteria to incorporate additional factors that affect market prominence – size of domestic economy and international standing of national currency[85] – leading to the inclusion of French and German regulatory regimes.

Informational/Ideational perspectives

Domestic perspectives that address the influence of ideas and information resources on policy-formation and the potential for linkage between ideas, preferences and institutions are associated with Peter Haas. Haas's research focuses on the role of epistemic or knowledge communities. This research is closely allied with EU "policy networks" research.

Haas's communities share "causal understandings" and policy recommendations and often assume policy leadership roles.[86] Epistemic communities are broadly envisaged, commensurate with the gregariousness of ideas.[87] Haas identifies three ways that epistemic communities affect policy formation. First, they serve as "focal points" for policy leaders and discussion. Second, they represent context-based knowledge; in policy debates they define and "expertise" constraints and incentives on policy-formation.[88]

[82] The domestic British and supranational Euromarket regulatory regimes are closely linked for several reasons. First, financial institutions operating in the largest sector of the Euromarket, the US dollar sector, operated overwhelmingly from a London base. This meant their institutions were subject to British domestic regulatory standards. Second, standard Euromarket practice has been for contracts to be executed under English law. Third, British regulators, cognisant of the Euromarket's prominence and London operating base, developed the English regulatory regime with a view not solely to domestic Sterling markets, but also to the vastly larger, multi-currency, Euromarket.

[83] Market size is typically measured in US dollar terms. As a result, it is often distorted by exchange rate fluctuations reflecting wider macro and microeconomic variations that have little bearing on the comparative stature, authority or influence of domestic markets.

[84] Additionally, the Japanese securities regulatory regime was based on a US model.

[85] Either as a reserve or borrowing currency.

[86] Peter Haas, "Introduction: Epistemic Communities and International Policy Coordination," *International Organization* 46, no. 1 (1992).

[87] They may be domestic or international, public or private, and appear in various forms: industry associations, advocacy groups, and similar organisations with interests in policy-formation.

[88] The conclusions drawn by Dimson and Marsh in reviewing the relative efficacy of competing capital adequacy formulations represented a belated coda to international debates over capital adequacy harmonisation. Their article highlighted gaps in arguments made in the IOSCO negotiations and suggested other rationales may have encouraged negotiators' opinions. See: E. Dimson and P. Marsh, "City Research Project: The Debate on International Capital Requirements - Evidence on Equity Position Risk for UK Securities Firms, Subject Report VIII," (London: London Business School, 1994).

Finally, ideas may act as causal factors when they tap into underlying "meaning systems."[89] Informational perspectives might suggest that the evolution of domestic securities regulation reflects a coherent national view, which influences national preferences in international policy debates.[90] Consequently, as with domestic institutional arguments, domestic regulatory histories are important in understanding national participation in policy debates.

Idea-based analyses generally assume that epistemic communities influence states. But this assumption is not rigidly held. Epistemic communities may be based in the public or the private sector. This ambivalence acknowledges the mobility and breadth of ideas and their ability to exert influence independent of the state. These communities often serve as conduits for integrating private sector preferences into policy-making processes.

The difficulty with employing idea-based analytical perspectives lies in distinguishing the impact of ideas from the impact of other variables. "Meaning systems" analysis does not provide guidance in understanding how ideas or epistemic communities independently influence policy-formation.[91]

Bargaining Perspectives

The weaknesses ascribed to domestic perspectives do not disqualify them as tools for analysing authority and policy-making. Structural and domestic perspectives restrict research to accommodate underlying assumptions. Structural approaches discount the significance of domestic variables. Domestic perspectives may exhibit selection bias or narrowly define preferences. Nonetheless, particularistic approaches continue to thrive, a testimony to the embeddedness of rational, parsimonious research design.[92]

---

[89] "Meaning systems" are the ideological, psychological or cultural orientations of states and other actors that are often based in economic and historic structures.

[90] Three examples are Germany's preoccupation with risk avoidance and conservative capitalisation based on its 1930s experience with hyperinflation and the importance of banks in economic recovery post-WWII. In France, the belief that the state should lead and control economic development policy – rather than the private sector – motivated the Mitterrand government's approach to international policy-formation. In the US, the traumatic experience of the 1929 crash stimulated the creation of the SEC and the adoption of its central regulatory focus – investor protection.

[91] However, see "new institutionalism" below.

[92] See, in particular, Robert O. Keohane and Helen V. Milner, eds., *Internationalization and Domestic Politics, Cambridge Studies in Comparative Politics* (Cambridge: Cambridge University Press, 1996).

In response to the weaknesses of these approaches, more comprehensive methodologies for analysing authority and cooperation have been developed.[93] These are: 1) perspectives that build comprehensive analyses by sequentially examining the impact of domestic variables on state policy preferences and international policy-formation (a "ground-up" perspective); 2) a cumulative approach that layers domestic and systemic perspectives (an "integrated" perspective); and 3) a "process" perspective that examines negotiation processes, bypassing level-of-analysis distinctions. EU integration and state/market perspectives further expand the conceptual compass of bargaining perspectives.

A "Ground-up" perspective

Helen Milner builds an analytical perspective that combines the three domestic perspectives previously discussed.[94] Her premise is that international decision-making is influenced by the domestic, particularly distributional, consequences of cooperation.[95] Breaking with parsimonious research design, she acknowledges political complexity and makes the case that a range of factors, beyond survival and market failure, determine state decisions. In acknowledging the myriad interrelationships that influence state policy formation, she significantly departs from narrowly focused perspectives.

Milner claims that domestic preference structures, the distribution of information among domestic actors, and the allocation of decision-making authority among domestic institutions, taken together, are critical in forming states' policy positions in international negotiations.[96] Increasing the complexity of domestic decision-making decreases the potential for international cooperation.[97] She acknowledges the potential significance of formal authority and influence, of policy complexity, and the relationship of domestic preferences to state policy formation. However, Milner's approach still discounts the

[93] Referred to herein as "bargaining" perspectives.
[94] Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations.*
[95] Her work has influenced arguments proposed by Richards (See: Richards, "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets.") and Oatley and Nabors. (See: Oatley and Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord.") and others.
[96] Complexity is equated with the "distinctiveness" of policy preferences, the distribution of actor veto power, and the allocation of institutional information and power. These variables are interconnected. As distinctiveness increases, the distribution of information and institutional power becomes more balanced, more actors hold veto power and policy-formation becomes increasingly anarchic, decreasing the potential for agreement. Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations.*
[97] See: *Ibid.*

potential for domestic variables to influence international policy formation other than through states.[98] Her perspective adds complexity but privileges domestic variables and fails to synthesise domestic and structural theories. Her analysis does not provide guidance as to which domestic or structural factors may be analytically significant, nor as to their potentially independent or joint influence on international outcomes.[99]

An "Integrated" perspective

Robert Putnam's "two-level" games perspective recognises the role of domestic variation in forming state interests and international outcomes.[100] He examines a mediating "statesman" role – between domestic and international incentives and constraints – and identifies policy-making as a two-stage, two-way process involving international bargaining and domestic ratification. The international bargaining options of states are constrained by what can be ratified domestically. Variables defining domestic policy options also define win-set boundaries. In Putnam's model, the link between levels of analysis is the chief negotiator or statesman, who represents the state. He is an honest broker who wields decision-making authority and is influenced by personal as well as domestic political and societal considerations.

Andrew Moravcsik expands Putnam's metaphor into formal hypotheses that integrate domestic and structural perspectives. His core assumption is that a policy vacuum is created when international and domestic objectives differ. The statesman's role is to resolve these differences and to assist policy development. The statesman is "Janus-faced," in that he considers both domestic and international constraints and preferences in policy-making.[101] The statesman's personal views enter the policy-making equation through his "acceptability-set," defined as the range of policy outcomes acceptable to him.

---

[98] All decisions may go through the state but this may be true only in a formal sense. If non-state actor preferences are met, we might conclude they influenced or even dominated policy–making. Comment made by Dr. A.R. Walter.

[99] Oatley and Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord,". and Richards, "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets,".

[100] Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games."

[101] He refers to his approach as "intergovernmentalist" or "liberal intergovernmentalist." Moravcsik does not necessarily limit the application of his theoretical arguments to the EU but acknowledges the EU's special characteristics more clearly support his perspective. See: Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining."

Moravcsik argues that juxtaposing domestic win-sets and statesman acceptability-sets illuminates negotiating options and constraints, the statesman's potential role and influence, and the vigour with which he will pursue negotiations. International policy-making analysis is based on Putnam's contention that the degree of win-set overlap, coordinated by statesmen, determines the outcome of international negotiations. But, like Milner and Putnam, Moravcsik assumes that policy-making is largely based on the interaction of states. The potential for non-state actor or institutional preferences to influence international outcomes is included indirectly; they are viewed as potential influences on state domestic policy formation and statesman preferences.

The integrated perspective's strengths are its design of a simple analytical tool and its acknowledgement of a range of potential public and private causal variables. This approach also introduces the idea that understanding policy-making means examining negotiation processes and sources of authority and influence, rather than focusing exclusively on domestic or structural variables. Nevertheless, this approach privileges state decision-making authority and avoids synthesising levels of analysis. Little direction is given to analytically significant variables and, because domestic win-sets define the range of international outcomes, the potential for novel, non-state governance arrangements is minimised.

A "Process" Perspective

John Odell[102] dispenses with level-of-analysis distinctions and encourages examination of the process of negotiation. He argues that negotiating strategies evolve over the course of policy formation, stimulated by state and non-state influences.

Odell contends that policy-making should be considered part of a larger interactive process, in which a range of influences affects the development of negotiated agreements. This approach dispenses with a limited-variable universe and replaces precise variable analysis with process analysis and actor strategy assessment. Negotiating strategies are formed and interact in a context comprised of stimuli, defined as "aspects of the situation that are normally beyond the influence of the...negotiator."[103] Odell is

[102] Odell, *Negotiating the World Economy.*
[103] Ibid.

explicit that authority may arise from non-state sources, including markets, beliefs, domestic politics, cultures, power relationships, and international and domestic institutions. This approach does not assume that actor preferences are fixed or that they are based on utility maximisation. It departs from state-centric structural and domestic assumptions and examines a broad range of explicit, implicit and anecdotal factors in ascertaining outcomes.[104] Odell's approach is closely related to the EU integration and state/market literatures discussed below.

The strength and the weakness of this approach stem from its complexity. A process perspective is neither parsimonious nor idealised – it reflects a messy, shifting reality. Analytically, it assesses a broad range of potential causal variables, providing a superior approximation of reality. However, it may fail to trace outcomes to specific variables, relying instead on a surfeit of empirical evidence to bolster observations and conclusions. It relies on inductive reasoning and multiple case studies to develop hypotheses and inferences. The methodology is justified if the observations it develops are not available from narrower analyses or if they modify the conclusions of narrower analyses.[105] Odell's theoretical work serves as a bridge to EU integration and state/market literatures, as well as to synthetic analysis.

EU Integration and State/Market Perspectives[106]

Scholars' efforts to assess authority and policy-making in the EU stimulated the development of distinctive EU analytical models. The development of these models was prompted by the EU's unique structure and the inability of conventional analytical models to encompass the interaction of the EU's multi-layered political, economic and

[104] Similarly to Milner and Moravcsik, Odell concentrates primarily on domestic factors influencing negotiator preferences. But he does this, not by dismissing structural factors, but by highlighting the weak correlation between security/structural conditions and negotiated outcomes and the difficulty negotiators encounter trying to influence structural variables.

[105] Inductive arguments are "ampliative" (that is, arguments where something beyond initial premises is inferred), however, induction is differentiated from theoretical arguments, which share an ampliative character, "by being confined to inference in which the conclusion involves the same properties or relations as the premises." David Hume challenged this conclusion, arguing that nature is not uniform and that induction therefore was flawed. See: David Hume, *An Enquiry Concerning Human Understanding* (1748). John Stuart Mill proposed five inductive principles to regulate scientific inquiry arguing, *inter alia*, that multiple case studies, linking observed outcomes, helped resolve Hume's concerns. See: John Stuart Mill, *Principles of Political Economy* (1848). See: Simon Blackburn, *Dictionary of Philosophy* (Oxford: Oxford University Press, 1996).

[106] For a longer discussion of the origins of EU integration perspectives see Appendix A.

governance processes. While rooted in domestic and bargaining perspectives, this development expanded the variables and the actor and institutional relationships under consideration. State/market analytical perspectives were stimulated largely by globalisation analyses, but concluded similarly that analytical premises had to be expanded.

Early EU research developed in the 1960s and 1970s and conceptualised regional integration processes as either evolutionary, "self-reinforcing processes," called "neo-functionalist," or as state-centric decision-making procedures, termed "intergovernmentalist."[107] In the early 1980s,[108] debates between these approaches were invigorated by accelerated EU integration. State-centric approaches abandoned unitary state assumptions, opened the "black-box" of domestic variables, and adopted Moravcsik's two-stage decision-making process. Neo-functionalist approaches embraced the influence of supra and sub-national actors and institutions, both private and public, interacting directly, rather than through state governments.[109]

EU integration perspectives on policy formation derive, in part, from Majone's arguments describing the EU as a "regulatory state."[110] Majone helped bridge intergovernmentalist and neo-functionalist approaches by focusing on the

[107] See generally: M.A. Pollack, "International Relations Theory and European Integration," *Journal of Common Market Studies* 39, no. 2 (2001). and P. Taylor, "Intergovernmentalism in the EC in the 70s: Patterns and Perspectives," *International Organization* 36, no. 4 (1982).
P. Taylor, *The Limits of European Integration* (London: Croom Helms, 1983).
[108] Following a fallow period in the late 1970's associated with stagnation in EU governance development and regional integration.
[109] Hix, Hurrell and Menon assessed this analytical evolution in a well-known debate. Hix argued EU politics was not inherently different from politics between states. Consequently, analysis of the EU as an "international organisation," using neo-functionalist and intergovernmentalist perspectives, was appropriate. However, "internal EU politics" was more accurately assessed using conventional comparative (domestic) politics models. Hix, "The Study of the European Community: The Challenge to Comparative Politics." Hix also assumed bright-line distinctions between international and internal EU politics, and, despite shared ontological and methodological assumptions, between international and comparative (domestic) theoretical perspectives. Hurrell/Menon disagreed, arguing EU international and internal politics were essentially indivisible, resting on the centrality of states, the EU's complex nature and power: "Although not easy to operationalise, there is no fundamental contradiction between accepting the centrality of the state in EU policy-making and the need to open up the state and enquire into the domestic processes though which interests and identities are shaped and determined." Hurrell and Menon, "Politics Like Any Other? Comparative Politics, International Relations and the Study of the EU." Hurrell/Menon's argument synthesised international and domestic, state and non-state centric perspectives – and marked a departure from earlier IR perspectives.
[110] Jachtenfuchs, "The Governance Approach to European Integration." It is useful to compare Majone's "regulatory state" with Cerny's "competition state," with which it shares many characteristics. See: Cerny, "Globalization and the Changing Logic of Collective Action."

regulatory/policy consequences of integration and by comparing regulatory systems.[111] He suggested analysing EU regulatory development through time series examination of institutional and economic structures and processes.[112] This perspective transcends nation-state/supranational distinctions by focusing on the development of a new "Euro-polity," distinct from nation-states and international organisations. Majone's analysis encouraged research leading to the network, new institutionalist and multi-level governance perspectives described below. His research also supported state/market arguments that globalisation had transformed the structure of authority, particularly international policy-making authority.

The reinvigoration of EU research in the 1980s was accompanied by simultaneous investigation into the impact of globalisation on the relationship of states and markets, particularly in the context of regulation and international financial services.[113] This prompted the development of state/market analytical perspectives that generally focus on the causes and consequences of variations in the balance of public and private authority. These two literatures, EU integration and state/market research, advanced concepts regarding the influence of non-state actors in the development of international governance norms and proposed alternative analytical constructs for understanding the interaction of actors and institutions.

EU integration perspectives

In the large and diverse literature on EU integration, debate between neo-functionalism and intergovernmentalism has dominated and been well documented.[114] Neo-functionalists describe political and policy change as incremental processes that are

---

[111] He considered the EU ideally suited for the development of Pareto efficient regulation - defined as regulations that require a "high degree of specialized technical knowledge ...and (are) independent of political pressure but not for politically volatile redistributive policies" For discussion see: Jachtenfuchs, "The Governance Approach to European Integration," and G. Majone, "Cross-National Sources of Regulatory Policymaking in Europe and the United States," *Journal of Public Policy* 11, no. 1 (1991). See also: G. Majone, "The European Community between Social Policy and Social Regulation," *Journal of Common Market Studies* 32, no. 2 (1993).

[112] Majone defines institutional (or regulatory) structures in terms of their responsiveness to the operational demands of global markets, and as solutions to problems of credible commitments and democratic legitimacy. Jachtenfuchs, "The Governance Approach to European Integration."

[113] See, particularly, Strange, *States and Markets*.

[114] For intellectual histories and reviews see: J. Caporaso and J. Keeler, "The European Community and Regional Integration Theory" (paper presented at the Third Biennial Conference of the European Community Studies Association, Washington, D.C., 27-29 May 1993), Robert O. Keohane and S. Hoffmann, "Institutional Change in Europe in the 1980s," in *The New European Community*, ed. Robert O. Keohane and S. Hoffmann (Boulder: Westview, 1991).

responsive to external and internal events. Intergovernmentalists, arguing from a modified rational-choice perspective, explain EU integration as a consequence of agreements negotiated between states.[115]

These approaches privilege different actors and describe the processes of decision-making differently. Variations in approach and emphasis complicate clear distinctions. However, to assess the CAD/ISD and IOSCO negotiations and to facilitate focused analysis, these approaches are refined to core questions and concepts.

The central intergovernmentalist argument[116] is that European integration does not challenge the autonomy or authority of member-states.[117] This argument develops from the observation that member-state agreements typically rest on a "lowest common denominator" calculus.[118] Supranational actors support member-states by facilitating agreements and providing information that would not otherwise be readily available. But regional decision-making is driven by member-state preferences and power rather than by supranational actors, whose impact on decision-making is modest.[119]

Intergovernmentalism departs from unitary state assumptions. However, domestic preferences are "nested" within each state and do not interact with corresponding

[115] On rational choice, see: Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy*. p. 13, 70.
[116] Moravcsik re-labelled "intergovernmentalism" as "liberal intergovernmentalism" to distinguish his approach from neo-realist intergovernmentalist analyses with which it is often confused. Liberal intergovernmentalism includes both domestic and state level empirical analyses and departs from the unitary state assumptions of neo-realism. See: A. Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmental Approach," *Journal of Common Market Studies* 33, no. 4 (1993).
[117] EU membership reinforces, and can strengthen, state sovereignty; European integration is motivated by agreements negotiated between member-state governments who maintain control over their degree of integration with the EU. M. Mann, "Nation-States in Europe and Other Continents: Diversifying, Developing, Not Dying," *Daedalus* 13 (1993), Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining," Andrew Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community," *International Organization* 45, no. Winter (1991), W. Streeck and P.C. Schmitter, "Neo-Voluntarism: A New European Social Policy Regime?" in *Governance in the Emerging Euro-Polity*, ed. G. Marks, et al. (London: Sage, 1996).
[118] A "lowest common denominator" calculus contends that most regional decision-making is based on preserving unanimity by permitting states to maintain control over the comprehensiveness of integration and collective decisions. This thesis has been contested. See: A. Heritier, "The Accommodation of Diversity in European Policy-Making and Its Outcomes: Regulatory Policy-Making as a Patchwork," *Journal of European Public Policy* 3, no. 2 (1996). And A. Heritier, C. Knill, and S. Mingers, *Ringing the Changes in Europe. Regulatory Competition and the Transformation of the State. Britain, France, Germany* (Berlin/New York: de Gruyter, 1996).
[119] Marks, Hooghe, and Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance."

interests in other member-states. This assumption preserves the argument that authority rests with state executives and that state executive bargaining is primarily responsible for policy-making. Moravcsik defines European decision-making as "a process that takes place in two successive stages; governments first define a set of interests, then bargain among themselves in an effort to realize those interests."[120] Based on empirical research, intergovernmentalism has evolved but retains its central premise that state preferences and intergovernmental bargaining determine international policy outcomes.[121]

Neo-functionalists argue that states remain important actors in regional governance and policy-making but that political control has shifted to supranational institutions, diluting state sovereignty. Comparative politics and policy analysis specialists agree, arguing that the EU's structure and character breaks down barriers between domestic, comparative and IR analyses.[122] They cite collaboration between domestic and supranational actors and institutions in the development of EU regulation and international and domestic policies. States' control over individual citizens and corporate actors has also shrunk.[123] Their observations encourage scholars to question whether state autonomy is threatened by regional integration.[124] These conclusions arise from assessments of member-state regional decision-making and from the increasing autonomy and influence of EU institutions.[125]

These conclusions are also supported by empirical studies highlighting the influence of informal groups and private associations as well as of supranational institutions. These analyses encouraged the refinement of both intergovernmentalist and

[120] Moravcsik, "Preferences and Power in the European Community: A Liberal Intergovernmental Approach."
[121] See footnotes 139 and 140 in this chapter.
[122] Hurrell and Menon, "Politics Like Any Other? Comparative Politics, International Relations and the Study of the EU."
[123] Moravcsik, following Putnam, argues that he addresses this issue by basing EU integration on national preference formation and interstate bargaining. "Control" refers generally to authority and specifically to the regulation of (and the development of regulations for) business enterprises.
[124] These questions were raised by earlier analyses of the impact of the international system on domestic economic decision-making but had, despite the literature on interdependence and transnational relations, remained analytically marginal until the early 1990s. See: Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics."
Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States.*
[125] The European Commission and Council of Ministers, the European Court of Justice and the European Parliament, particularly after the 1985 SEA.

neo-functionalist perspectives into more precise analytic "frameworks."[126] These frameworks adapted concepts developed in other disciplines, generally defining "middle-level" approaches to integration. They stopped short of developing comprehensive theories addressing broader IR/IPE concerns.[127]

Three interrelated, predominantly neo-functionalist, "focal-points" or frameworks emerged from EU empirical research: the "Europeanization" of politics and policies,[128] the analytical implications of collective regulatory policy-making, and the development of new forms of governance.[129] These literatures address differences in levels of Europeanization, which are apparent in policy sectors and in the EU's ability to resolve problems.[130]

This research stimulated the development of several neo-functionalist approaches, all emphasising the role of non-state actors and institutions: 1) policy networks assessment, 2) "new institutionalist" or economic structure analysis, and 3) "Euro-polity"/multi-level governance ("MLG") perspectives.[131] Similar themes, albeit addressing international relations and globalisation more generally, were echoed in state/market literatures.[132] Both literatures sought to address related questions; for the integration literature: "How have authority, influence, and governance been affected by

---

[126] Writing in 1998, Bulmer defined five separate "frameworks" for analysis of EU governance These are liberal intergovernmentalism, multi-level governance, policy network analysis, the new institutionalism and a "fusion thesis" explanation for integration attributed to Wessels. See: S.J. Bulmer, "New Institutionalism and the Governance of the Single European Market," *Journal of European Public Policy* 5, no. 3 (1998).

[127] The development of EU integration approaches was paralleled by state/market research and by broader rationalist and constructivist debates. For an extended discussion see: Katzenstein, Keohane, and Krasner, "International Organization and the Study of World Politics." This observation also prompts the question whether EU integration perspectives are *sui generis*. See page 81.

[128] Europeanization refers to the extensiveness and source of the EU's influence on member-state policy-formation. It asks which entity, the EU or the member-state, determines regional policy, and why? M. Green Cowles, J. Caporaso, and T. Risse, *Transforming Europe, Europeanization and Domestic Change* (Ithaca: Cornell University Press, 2001).

[129] This analysis is based on Jachtenfuchs, "The Governance Approach to European Integration."

[130] S. Scharpf, "Die Problemlösungsfähigkeit der Mehrebenenpolitik in Europa," in Regieren in Entgrenzen Raumen, PVS Sonderheft 29/1998, ed. B. Kohler-Koch (Opladen: Westdeutscher Verlag, 1998). S. Scharpf, "Introduction: The Problem Solving Capacity of Multi-Level Governance," Journal of European Public Policy 4, no. 4 (1997). In state/market research these questions focused on globalisation consequences: "which entity (or what combination), the state or the market, determined policy and why?"

[131] This list differs slightly from Bulmer's cited above.

[132] See below under "state/market perspectives."

the development of the EU?" and, for state/market literatures: "How has globalisation affected authority, influence, and governance?"[133]

Network perspectives are prominent in EU integration analyses.[134] Networks are informal, non-hierarchical structures, comprised of actors or institutions, which operate across political and economic boundaries and may express authority or influence independent of states. Potential roles include bargaining and collaboration between interest groups, member-states, and EU institutions.[135] Although criticised for "fuzziness,"[136] network analysis opens EU integration studies to comparative research into the influence on policy formation of institutional structures and the lack of dominant central authorities.[137]

The "new institutionalist" approach[138] focuses principally on the power of EU institutions to establish agendas for policy-making and policy-makers[139] This approach

---

[133] The dependent variables are authority, influence and governance rather than integration or globalisation.

[134] Network analysis closely parallels Peter Hass's research. See: Tanja A. Börzel, "What's So Special About Policy Networks? An Exploration of the Concept and Its Usefulness in Studying European Governance," European Integration online Papers (EIoP) 1, no. 16 (1997), B. Kohler-Koch, "European Networks and Ideas: Changing National Policies?," European Integration online Papers (EIoP) 6, no. 6 (2002), Volker Schneider, Godefroy Dang-Nguyen, and Raymund Werle, "Corporate Actor Networks in European Policy-Making: Harmonising Telecommunications Policy," Journal of Common Market Studies 32, no. 4 (December 1994).

[135] These characteristics differentiate networks from intergovernmentalist precepts regarding information and authority transmission and from epistemic or idea communities, which facilitate governance by providing specialised information. See also: Keohane and Hoffmann, "Institutional Change in Europe in the 1980s,", p. 13.

[136] T. Börzel, "Organizing Babylon. On the Different Conceptions of Policy Networks," *Public Administration* 76 (1998).

[137] A variant of network analysis conceptualises networks as a distinctive form of authority lying between anarchy (or markets) and hierarchy, a concept particularly suited to the EU. A. Benz, "Politikverflechtung ohne Politikverflechtungsfallle. Koordination und Structurdynamik in Europaeischen Mehrebenensystem," *Politische Viertlejahrschrift* 39 (1998). cited in Jachtenfuchs, "The Governance Approach to European Integration". It is also useful to note the parallelism between this conception of networks and Milner's conception of state institutional structures lying on a continuum between anarchy and hierarchy.

[138] "New Institutionalist" scholars accept Moravcsik's nested intergovernmentalist structure but reject parsimonious interstate bargaining, arguing EU institutions are as important as states in shaping policy. See: Bulmer, "New Institutionalism and the Governance of the Single European Market," and Colin Crouch and Wolfgang Streeck, eds., *Political Economy of Modern Capitalism: Mapping Diversity and Convergence* (London: Sage Publications Ltd, 1997).
Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001), and Hollingsworth and Boyer, eds., *Contemporary Capitalism: The Embeddedness of Institutions.*

[139] Especially the Commission, Council, Parliament, and QMV. See: D. Puchala, "Institutionalism, Intergovernmentalism and European Integration," *Journal of Common Market Studies* 37, no. 2 (1999). In 1998, Moravcsik added a third layer of analysis to his liberal intergovernmentalist framework, bringing his approach closer to constructivist perspectives. Within a rationalist structure defined by national preferences and intergovernmental bargaining, Moravcsik added a notion of institutional choice. He acknowledged that

defines institutions very broadly, encompassing formal and informal institutions, associations, values, norms and cultural conventions. The mutability of new institutionalism has spawned at least three variants.[140] In each variant emphasis is placed on assessing the influence of domestic (economic) institutional structures on actors' multilateral institutional preferences. State policy preferences are a function of the effect that multilateral decisions have on domestic comparative advantage.[141] Comparative advantage is also based on a state's specific form of capitalism. Analysis of policy-making, therefore, must focus on comparative domestic economic history, structure, coordination, and supervisory processes.[142]

A third perspective adopts Majone's arguments explicitly, calling regional integration a "polity-creating process," where authority and decision-making power are shared and contested across multiple levels of governance.[143] The principal model, "multi-level governance," accepts that state executives and institutions remain the most important variables in assessing integration.[144] However, MLG also examines the larger European polity, arguing that states do not dominate collective decision-making or the

---

institutions might enjoy agenda-setting powers and argued that nation-states might pool their sovereignty – through institutions – in order to increase the "credibility" of their commitments. See: A. Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca: Cornell University Press, 1998).

[140] These include rational choice, historical, and sociological institutionalism.

[141] Theoretical discussion focuses on economic structures. However, structures may include political, commercial or social structures, among others.

[142] Orfeo Fioretos, "Sources of Multilateral Preferences," in *Varieties of Capitalism*, ed. Peter A. Hall and David Soskice (Oxford: Oxford University Press, 2001). and Hall and Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage.*

[143] See generally: G. Marks, "Structural Policy after Maastricht," in *The State of the European Community*, ed. A.W. Cafruny and G Rosenthal (New York: Lynne Rienner, 1993), G. Marks, "Structural Policy and 1992," in *Euro-Politics: Institutions and Policymaking in the 'New' European Community*, ed. A. Sbragia (Washington, D.C.: Brookings Institution, 1992). Also, drawing on the theoretical work of Wendt. See, in particular: A., Wendt, *Social Theory of International Politics* (New York: Cambridge University Press, 1999). and Ruggie John Gerard Ruggie, *Constructing the World Polity: Essays on International Institutionalization* (New York: Routledge, 1998)., scholars (See: T. Risse, "Exploring the Nature of the Beast: International Relations Theory and Comparative Policy Analysis Meet the European Union," *Journal of Common Market Studies* 34, no. 1 (1996), Wayne Sandholtz, "Choosing Union: Monetary Politics and Maastricht," *International Organization* 47, no. 1 (1993), Wayne Sandholtz, "Membership Matters: Limits of the Functional Approach to European Institutions," *Journal of Common Market Studies* 34, no. 3 (1996).) argue EU membership alters the preferences and characteristics of (national) decision-making groups creating a "Euro-polity" with distinctive, non-member-state, biases in governance formation. These scholars accuse Moravcsik of ignoring the endogenous impact of EU membership, a central characteristic of integration.

[144] MLG derives from several sources. See: Marks, "Structural Policy after Maastricht," Marks, "Structural Policy and 1992,".A. Sbragia, "Thinking About the European Future: The Uses of Comparison," in *Europolitics: Institutions and Policymaking in the 'New' European Community*, ed. A. Sbragia (Washington, D.C.: Brookings Institution, 1992)., and P. Schmitter, "The Emerging Europolity and Its Impact Upon National Systems of Production," in *Contemporary Capitalism: The Embeddedness of Institutions*, ed. J.R. Hollingsworth and R. Boyer (Cambridge: Cambridge University Press, 1997).

ability to promote domestic preferences. These abilities are found in actors and institutions at different political levels, most particularly in supranational institutions.[145] Actors at different levels of the European polity may express authority or influence and should be evaluated to assess their potential contribution to policy-formation.

These models imply a diminution in states' authority. This diminution implies that lowest common denominator decision-making is likely to be replaced by zero-sum policy-formation. This would be most probable in lower-level decision-making, including regulatory policy, where regional unanimity is not critical. These perspectives further imply that political preferences are not "nested," but are interconnected. MLG in particular does not believe that domestic preferences are only projected up through states; it argues instead that actors operate across political levels, creating "transnational associations."[146] These approaches eliminate distinctions between domestic and international politics by insisting on consideration of potential interactions between supranational, state and sub-national actors.[147]

EU integration approaches* – sui generis*?

EU scholars frequently argue that EU integration perspectives are *sui generis*, developed to explain the EU's "unique" multi-level structure, and may be difficult to relate to other IR/IPE issues. However, as noted earlier, parallels are evident between IR/IPE concepts and EU integration. The broader applicability of EU scholars' approaches is examined in Chapter 12.

State/market approaches

"State/market perspectives" refers to analyses, principally of the evolving relationship between the state and economic/financial markets. Not surprisingly, this literature has focused attention on the consequences of globalisation for financial market authority. It also assesses a range of global economic and social activities affecting states, markets and related actors and institutions. Because state/market concepts are not

[145] MLG considers authority independent, unconnected with supranational institutions' potential agency with states.
[146] Marks, Hooghe, and Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance."
[147] This approach makes a clear distinction between actors and institutions and avoids assigning characteristics to states that should more appropriately be assigned to specific groups or individuals. This permits a more refined focus on the actions, histories and constitutions of particular actors or institutions within states and further distinguishes this approach from unitary state analyses. See: Ibid.

limited by rational choice assumptions, they encompass a wide spectrum of concepts and actors and maintain flexible boundaries in terms of hypotheses addressed.[148] However, the balancing of state and market authority is central to this literature.

Early state/market concepts are often associated with Susan Strange's research[149] although prior roots have been identified.[150] What distinguishes this early research from contemporaneous "transnational relations" analyses[151] is the inclusion of "social structures and relationships" in state/market studies.[152] These relationships embrace a broad spectrum of domestic and international actors. Early research includes private political and economic actors and structures and closely parallels the developing new institutionalist and MLG literatures. State/market approaches were sharply distinguished from more rigidly structured perspectives operating within rationalist frameworks.[153] Robert Cox characterised Strange's analytical approach by observing that, "...instead of defining the world exclusively in terms of states, she sees power as the basic concern of realism and asks: Where does power lie? With states certainly... but also with markets. With firms, too, and possibly with some other entities."[154] Strange argued: "[S]tate authority has leaked away, upwards, sideways, and downwards. In some matters, it even

[148] For surveys see: Richard Stubbs and Geoffrey R.D. Underhill, eds., *Political Economy and the Changing Global Order* (London: The MacMillan Press Ltd., 1994) and G.R.D. Underhill, "The State-Market Relationship: Prospects for Change in World Order," *International Affairs* 76, no. 4 (2000).

[149] See, *inter alia*, Thomas C. Lawton, James A. Rosenau, and Amy Verdun, eds., *Strange Power: Shaping the Parameters of International Relations and International Political Economy* (Burlington, VT: Aldershot, 2000), Strange, "Cave! Hic Dragones: A Critique of Regime Analysis," Susan Strange, "International Economics and International Politics: A Case of Mutual Neglect," *International Affairs* 46 (1970), Susan Strange, "Rethinking Structural Change in the International Political Economy: States, Firms and Diplomacy," in *Political Economy and the Changing Global Order*, ed. Richard Stubbs and G.R.D. Underhill (London: Macmillan, 1994), Susan Strange, "Wake up, Krasner! The World Has Changed," *Review of International Political Economy* 1, no. 2 (1994)., and Strange's several books listed in the bibliography.

[150] Geoffrey Underhill, "The State-Market Relationship: Prospects for Change in World Order," identifies Richard Cooper's positivist view of international economic interdependence. See: Richard Cooper, *The Economics of Interdependence* (New York: McGraw-Hill, 1968). and James Rosenau's concept of the interrelatedness of domestic and international politics as state/market precedents. James A. Rosenau, ed., *Linkage Politics: Essays on the Convergence of National and International Systems* (New York: Free Press, 1969).

[151] See, for example, Keohane and Nye, eds., *Transnational Relations and World Politics*.

[152] Cooper cited in Underhill, "The State-Market Relationship: Prospects for Change in World Order,".

[153] Robert Gilpin adopted a states vs. markets framework, but was also a realist who emphasised the dominance of states in the international system. See: Gilpin, *The Political Economy of International Relations*.

[154] See: Robert Cox, *Approaches to World Order* (Cambridge: Cambridge University Press, 1996). p. 183. In her later work, Strange focused on the evolution of structural power, arguing analysis began with empirical questions regarding the role of political/economic processes and structures in policy outcomes, assessed through examination of who benefited and who was put at risk by agreements. "Structural power" is a seminal Strange construct combining politics and economics. See footnote 13 and related text

seems to have gone nowhere, just evaporated."[155] Strange's argument that states compete over economic and financial market-shares rather than over territory was later echoed in Philip Cerny's "competition state."[156] Strange and Cerny both attributed these changes primarily to globalisation, particularly to changes in technology and production modalities. These changes affected the international authority and governance capacities of states by expanding the influence and capabilities of both state and non-state actors. It also changed the character of state/firm bargaining. This was revealed principally in market governance, which evidenced a "new medievalism."[157] These arguments further combined comparative and international perspectives by attributing shifts in domestic and international authority to globalisation.

The principal implication of state/market arguments is that understanding the dynamic relationship of authority, influence, and policy-making requires examination of the interaction of a broad range of international processes and variables associated with state and non-state actors and institutions.[158] The assertion of influence and authority by new actors or institutions implies a dramatic realignment in the policy-making ability and power of institutions, actors and states. Underhill argues that market "creation" involves the delegation of wealth formation and "distribution" authority to private individuals. This leads to the conclusion that "political authority is not just vested in the formal institutions of states and... regimes.... It is also present in the agents of the market as part of the state-market condominium."[159] Cerny linked the evolution of market structure and of private authority to changes in international financial governance. He argued that "national varieties of capitalism will be tolerated only so long as they do not undermine profits in international financial markets. If genuinely new forms of transnational regulation are not forthcoming from states acting in concert, then the transnational financial structure is increasingly likely to be run by a *de facto* private

155 Susan Strange, "The Defective State," *Daedalus* 24 (1995).
156 Cerny, "Globalization and the Changing Logic of Collective Action."
157 A term describing the anarchic character of a transformed international system no longer dominated by states. The term is attributed to both Strange and Cerny.
158 See: Cutler, Haufler, and Porter, eds., *Private Authority and International Affairs*. and Sinclair, "Between State and Market: Hegemony and Institutions of Collective Action under Conditions of International Capital Mobility".
159 Underhill, "States, Markets and Governance. Private Interests, the Public Good, and the Democratic Process."

regime centred in the financial markets themselves."[160] Both scholars argue that significant sources of policy-making authority include non-state actors and economic structures. Cerny maintains that markets and market actors have policy-making authority, while for Underhill, market evolution reveals shared governance through the continuous re-balancing of market competition and state regulatory processes.

Shared observations

EU integration and state/market literatures make common observations. First, in varying degrees and configurations, policy-making authority is migrating away from the state – either upwards to supranational actors or downwards to private actors, or in both directions. This development challenges state autonomy. Second, international policy-making analyses focusing tightly on the interaction of unitary states cannot capture the dynamic evolution of regulatory norms. The impact of networks and economic structures must be included. Third, both perspectives share the observation that the interaction and influence of supra and sub-national actors is significant. Finally, globalisation and regional integration are identified as having altered international policy-making, governance, and the capabilities and preferences of states. These observations lead these theorists to argue that unless these consequences are considered, analyses will be incomplete or misleading.

Synthetic Analysis

As described earlier in Chapter 1, a synthetic analysis seeks to develop a conversation between observations and conclusions developed by individual analytical perspectives, including both state and non-state centric observations, in order to develop new insights into international policy formation. This is achieved by juxtaposing observations and comparing and contrasting empirical findings from different theoretical perspectives. A synthetic analysis is neither a simple accumulation of evidence nor an effort to develop a unified theory. It differs from non-state centric approaches by including state-centric observations. It differs from cumulative or sequential analyses by seeking to understand the process of policy formation, not simply specific actor or institutional roles, and by addressing specific questions. Moreover, it views policy

[160] P. Cerny, "International Finance and the Erosion of Capitalist Diversity," in *Political Economy of Modern Capitalism*, ed. C. Crouch and W. Streeck (London: Sage, 1997). attributing Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics.*

formation as a process that changes over time. As a consequence, it argues for examination and assessment of the entirety of a policy formation exercise instead of an examination that seeks a binary explanation of success or failure, or that focuses on a specific variable or variables.

Synthetic analysis acknowledges that each discrete analytical perspective develops its own observations. The impetus behind synthetic analysis is not, however, to develop a unified theory. Instead it is to develop new insights into international policy formation by combining, comparing and contrasting observations from different perspectives.

Debates between theoretical perspectives would seem to encourage the development of a unified, theoretical approach. However, this objective may be flawed.[161] The phenomena examined by competing analytical perspectives are different. Empirical observations and conclusions derived from state/market analysis will likely differ from observations derived from analyses based on no-functionalist EU integration theory. Intergovernmentalist and institutionalist observations will differ yet again. More generally, state and non-state centric analytical perspectives explain how different phenomena affect policy formation.

Because analytical perspectives examine different policy-influencing phenomena, developing a unified or cumulative analytical approach to explain highly differentiated events or observations runs the risk of creating confusion. International policy formation necessitates resolving the interests of highly differentiated constituencies. Analysing the influence of one category of affected constituent risks an incomplete or inaccurate analysis. A unified approach, rather than an approach that compares and synthesises empirical evidence from different perspectives, runs different risks. The first is that of over-simplification and the second is that of over-complication. A theory that unifies differentiated perspectives will need to identify unifying analytical principles. This simplification process creates its own potential for ignoring important phenomena. At the other extreme, a unified theory that encompasses all analytical perspectives would be hopelessly complicated. These problems prompted John Odell to focus on the process of

[161] This analysis is made by Puchala, "Institutionalism, Intergovernmentalism and European Integration".

policy formation. It is also why state/market perspectives are vague in defining which specific variables are important in analysing state/market relationships.

The goal of generating analytical conclusions that are greater than the sum of the empirical evidence will be more readily achieved by comparing and contrasting the observations and conclusions of multiple analytical perspectives rather than by attempting to develop a unified theory. As noted earlier, a more modest synthetic effort to identify the limits of individual analytical approaches by juxtaposing them will facilitate more accurate evaluation of the sources and contours of influence in policy-formation.

Hypotheses

The development of comprehensive EU integration and state/market perspectives in response to state-centric analyses is part of the larger contemporary debate in IR/IPE theory between rationalist and constructivist scholars.[162] This debate contrasts the conscious role of the state in policy-making with the authority and influence of social, political and economic institutions on actors and governance. These perspectives contrast opinions on the evolution of market authority and form the basis for building hypotheses in order to focus empirical research.[163] They also define different views on the use of variables in analysis. Narrower approaches focus analytical attention on the role of the state and state autonomy; non-state centric approaches focus on a wider array of public and private actor and institutional roles. This contrast helps to re-frame the central empirical question of this study: "Is authority migrating away from the state?" to, "How should we understand changing patterns of (securities) market governance across levels of analysis and among a range of actors?"[164] Recasting this question expands the focus of research from sources of authority to the broader identification of sources of influence as

---

[162] Katzenstein, Keohane, and Krasner, "International Organization and the Study of World Politics".

[163] A major distinction between rational choice and constructivist analyses lies in their treatment of institutions. If we consider intergovernmentalism and neo-functionalism as sub-sets of rational choice and constructivist approaches respectively, this distinction also defines how the rival of interest in neo-functionalism opened new research avenues for scholars. While both perspectives agree that institutions matter causally, they differ as to how. Rationalists generally define institutions as "rules of the game," shaping actor strategies in pursuit of exogenously defined preferences. Constructivists define institutions more broadly to include formal and informal rules, understandings and norms. Significantly, institutions are also defined as discrete actors who shape their own preferences. See Pollack, "International Relations Theory and European Integration."

[164] The phrasing of this question was suggested by Prof. G.R.D. Underhill.

well. This prevents research from simply noting the obvious, that authority has migrated, by extending analysis to the identification and examination of the components and contours of international policy-making influence.

This thesis argues that, based on the case studies, state influence and authority remain predominant in international policy-making. This argument rests on three observations: state economic and political structures primarily determined international policy outcomes; lowest common denominator decision-making prevailed; and, finally, state autonomy was preserved. In particular, fundamental state preferences acted as thresholds for determining the acceptability of international policy harmonisation alternatives. These preferences were influenced by non-state preferences, but they were dominated by powerful state concerns associated with the preservation of public goods and historic state policies. The thesis notes that sources of authority and influence have expanded significantly, reflecting increasing market complexity, dispersed context-based expertise, and constrained state regulatory capabilities. These developments have increased states' reliance on non-state expertise and authority, expanding the role of these sources of influence on state policy-making. However, in the case studies, state autonomy was preserved and decision-making was driven primarily by state actors and institutions.

Structural, domestic, and bargaining perspectives generally argue that states are the final arbiters in policy-making, although they may consider private actor or institutional preferences in making decisions. Integration and state/market perspectives argue that understanding the composition of policy-making authority and influence is a function of identifying how (and why and where) the preferences of state and non-state actors and institutions are represented. These latter two perspectives conclude that, at a minimum, policy-making is shared between states and non-state actors and institutions.

Each analytical perspective makes distinct predictions regarding the evolution of governance norms. This thesis argues that employment of narrow perspectives inhibits assessment of the *relative* importance of individual variables and the identification of limitations or inaccuracies in narrower approaches. The evaluation of a spectrum of variables is necessary to determine the contours of influence and the accuracy of contrasting hypotheses. Analysis based on one perspective may or may not provide insight into larger questions of international authority or influence and may be constrained by theoretical limitations. A synthetic approach assesses empirical findings comparatively in order to assemble a more accurate understanding of the sources of authority in policy-formation. It resembles a non-state centric approach but adds consideration of state-centric observations. By juxtaposing theoretically generated hypotheses with empirical observations we can assemble a dynamic and robust understanding of authority and policy-making, assess the ability of each perspective to draw inferences from the evidence, and more accurately track the relationship between stages in governance development (agenda-setting, negotiation, ratification) and explanatory or influential variables.[165]

Hypotheses are drawn to reflect state and non-state centric perspectives. They are derived from intergovernmentalist and neo-functionalist arguments. States are not deemed unitary. Non-state actors are assumed to be potentially authoritative. For clarity, states represent national public authority. Non-state actors represent either international or domestic private authority (whether national, supranational or sub-national). A critical difference between state and non-state centric perspectives lies in a state's ability to manage the mobilisation of non-state preferences, particularly when they differ from its own preferences. When state and non-state preferences overlap, it will be important to assess whether this represents agreement or capture. Similarly, where multilateral actors are influenced by private actors (or vice versa), it is important to identify why. Was it a function of the location of authority or traceable to other factors?

State-centric hypotheses[166]

The central decision-making role of the state in policy-formation serves as the basis for generating testable hypotheses. To demonstrate support for these hypotheses, empirical evidence should indicate a pattern of state executive decision-making dominance and little or no migration or diminution of state executive authority in favour of either sub or supranational actors or institutions.

[165] Andrew Walter, "NGOs, Business , and International Investment: The Multilateral Agreement on Investment, Seattle, and Beyond," *Global Governance*, (January 2001).
[166] State and non-state centric hypotheses are adapted from Marks, Hooghe, and Blank, "European Integration from the 1980s: State-Centric v. Multi-Level Governance."

1. National governments will be able to impose their preferences on international actors or institutions.
2. National governments will ensure their individual sovereignty *vis a vis* other governments and international institutions.
3. National governments should be able to control the mobilisation of sub-national interests.

These hypotheses revolve around the argument that states overwhelmingly dominate the development and structure of international governance norms. State-centric hypotheses predict that the EU's regulatory success and IOSCO's failure were explicitly related to the actions of states, which imposed their preferences on other states and on non-state actors and institutions.

State actions in international policy-making negotiations produce affirmative policy outcomes and are legitimate. Their actions reflect the objective of preserving their individual sovereignty and autonomy, which may be demonstrated through ability to avoid compromises, perseverance in maintaining national negotiating preferences, or through preservation of domestic economic and political institutions or preferences. Finally, to support these hypotheses the empirical evidence will demonstrate that states will act affirmatively to control the independent opinions or coalition formation efforts of sub-national actors and institutions. Authority in the development of international regulatory standards will clearly emanate from national executives or institutions.

Non-state centric hypotheses

Non-state centric approaches, while not formal theories, stress the increasingly predominant role of non-state actors and institutions in international policy-making. State authority is not entirely discounted but is shrinking in favour of the affirmative role of non-state actors and institutions. As noted earlier, arguments made by MLG and related literatures overlap with arguments made by state/market scholars.[167] However, for non-state actors to be deemed influential in policy-formation they must evidence legitimacy, recognition, and utility. The same is true for states. Moreover, to demonstrate that authority is migrating away from states, the cases must indicate not only a clear pattern

[167] They combine the roles of networks, private actors, economic and/or market structures and multi-level governance in regulatory development.

of diminished state autonomy, but also enhanced private or supranational authority and regulatory autonomy. These elements are important in understanding the role of non-state actors and institutions in the development of international governance norms. Authority will appear to be vested independently in these agents – potentially at the expense of state autonomy. Non-state centric perspectives should shed light on how and when and where state and non-state actors matter. These conceptual overlaps permit the development of common testable hypotheses for examining empirical evidence.

1. A pattern of shared decision-making between levels of government will be evident.
2. Individual state executives will be unable to deliver desired policy outcomes through collective state executive decisions.
3. Sub-national interests will mobilise directly in the supranational arena or will use it as a public space to pressure state executives.

Empirical evidence in the case studies should reveal that collective decision-making evidenced the influence of sub and supranational actors, institutions or markets as well as states. Additionally, outcomes will reflect the role of non-state market structures, affecting multilateral preferences and, ultimately, policy-making authority. More critically, the (national) preferences of state executives will be frustrated through collective bargaining processes. This may result either in the acceptance of stalemate or compromise regulatory proposals, reflecting a state-centric lowest common denominator outcome, or in decisions to sacrifice preferences in favour of more significant objectives (a non-state centric zero-sum outcome). Finally, the legitimacy and authority of sub/supra-national interests and/or market structures will be manifest in the outcome of negotiations. Overall, these hypothesised observations will reflect shared authority in the development of governance norms in financial services, between states and non-state actors and institutions, diluting state authority and sovereignty.

Distinguishing these hypotheses are the roles of non-state actors, economic and political structures and the interaction of non-state and state actors across political levels in rule-making and governance. This leads to an empirical focus on the process of rule-making and not simply on ratification.

Objectives

The objective of this thesis is to describe the structure of authority and influence in international policy-making. It is not simply to determine whether authority is migrating away from the state, but also how public and private actors and institutions interact across levels of authority in the policy development process, and to determine when and how they are (or are not) influential. A comprehensive analytical perspective is achieved by utilising integration and state/market approaches, focusing on sources of authority and influence; by focusing empirically on policy-making processes rather than individual variables; and by emphasising the critical role of structure (economic, political, regulatory and historic) in determining national policy preferences.

This thesis also seeks to determine whether conclusions drawn from different analytical perspectives can be juxtaposed to develop new and different observations regarding the structure of authority and influence in policy formation. Synthetic analysis is designed to develop insights that are greater than the accumulation of empirical observations. By comparing and contrasting a broad spectrum of evidence, new understandings, relationships and conclusions may be identified. As a result, a goal of synthetic analysis is the development of observations that transcend narrower perspectives. Such an analysis could be used to assess a wide range of international phenomena and its potential conclusions would not be artificially constrained by its assumptions.

The Negotiations

As a starting premise, the EU negotiations are deemed to be "successful," as they resulted in the adoption of the CAD and ISD. The IOSCO negotiations are deemed to be "unsuccessful," as they produced no regulatory agreement. However, analytical perspectives do not assume success or failure. They predict influences on and location(s) of authority in policy-making. For example, the EU's success may be associated with member-states protecting their sovereign authority – or with state executives being unable to collectively deliver preferred policy outcomes. Similarly for IOSCO, failure may be related to a state successfully imposing its unpopular preferences – or to the failure of negotiating states to share collective decision-making authority. In other words, negotiated outcomes do not bias hypothesised relationships. It may be difficult to distinguish distinct hypothesised outcomes from the empirical evidence. These difficulties are resolvable by refocusing on identifying contours of authority and influence rather than on negotiated outcomes. Conclusions will turn on the balance of state and non-state authority and influence, which is, of course, a matter of degree rather than an objective calculation.

Criticisms of "Complex" Analytical Approaches

Non-state centric, synthetic and sequential analyses are closely related. Non-state centric analyses examine sources of authority and influence across and along levels of analysis. Synthetic analyses juxtapose empirical observations from different analytical perspectives. Sequential analyses build analytical conclusions from distinct levels of analysis. Because the approaches are closely related, criticisms of sequential analyses are relevant to the first two approaches. Sequential analyses have been criticised for three reasons: arbitrariness, incompleteness, and "ad hoc-ism."[168]

These criticisms are based on the observation that sequential analyses are imprecise regarding their analytical "starting points," regarding their definition of causal linkages between levels of analysis, and regarding their development of an overarching theoretical structure. These criticisms are addressed by noting first, that influence and authority can be exercised vertically (in both directions) as well as horizontally. Recognising this possibility encourages analysis from multiple perspectives. Second, causal linkages between levels of analysis may be tied to multiple actors and institutions, both public and private. Positing a statesman linkage between levels of analysis, as Moravcsik does, is arbitrary and ignores other possible links. Finally, non-state centric and synthetic perspectives address concern with ad hoc-ism by examining policy-formation processes and core questions across levels of analysis and actors.[169]

---

[168] See Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining," p. 14, for a discussion.

[169] Moravcsik notes most sequential analyses start with systemic level examinations and subsequently incorporate domestic variables. He considers this arbitrary because it prioritises structural theories and introduces bias into empirical research. He also notes it is possible to start research from a domestic theoretical base and build an understanding of international cooperation.

There is no *prima facie* reason to assume bias in analysing evidence, whether the starting context is systemic, domestic or both. Integration and state/market approaches do not assume an explicit starting context. Rather, they examine processes and authority simultaneously with actors and institutions. Non-

Moravcsik, although emphasising state predominance, specified three levels of analysis and sought a cumulative understanding of cooperation.[170] His perspective relies on empirical research for the generation of inductive hypotheses. This is not significantly different from non-state centric perspectives and synthetic analysis, which embrace a wider universe of causal variables. But by establishing the priority of state preferences, Moravcsik introduced analytical constraints. The other two approaches accept *a priori* that international and domestic environments influence each other. Identification of how domestic interests are translated into international policy outcomes – or vice versa – is joined with identification of why domestic interests are translated into international negotiating strategies – or vice versa.

Finally, the complexity of international policy-formation – and of both non-state centric approaches and synthetic analysis – confounds parsimonious analysis and encourages the inclusion of complex sets of explanatory variables. Complexity, in turn, may inhibit the development of tightly defined causal connections. However, if we build an understanding of policy-formation starting from narrower perspectives, with fewer

---

state centric perspectives are precise and well defined, facilitating the development of testable hypotheses. There is also no *a priori* reason why multiple perspectives cannot be utilised simultaneously in analysis, nor why one should be identified as a "starting point."

Moravcsik also criticises domestic theories of bureaucratic politics and interest group formation as incomplete because they rarely address the impact of domestic politics on international authority. To address this gap he introduces a statesman. This has merit because it approximates reality. Two-level games perspectives reflect the resonance of domestic and international variables.

This is an elegant, though narrow, solution to the level of analysis problem. The utility of bargaining perspectives lies in the "statesman" metaphor. Instead of focusing attention exclusively on structural or domestic factors, the bargaining approach seeks expressly to identify the strategies and preferences which bridge the domestic – international analytical divide and affect international policy-formation. However, this approach is also incomplete. Focus on the statesman necessarily excludes the potential independent authority, influence or interaction of supranational, other national, or sub-national actors or institutions in policy-making (See, for example, Haufler, "Crossing the Boundary between Public and Private: International Regimes and Non-State Actors,". and Cutler, Haufler, and Porter, eds., *Private Authority and International Affairs*.)

Moravcsik's final critique focuses on the failure of sequential analyses to develop an overarching theoretical construct, employing the same assumptions and variables for analysis across perspectives. When this concern is extended to bargaining or intergovernmentalist analyses, Moravcsik argues the problem evaporates as analysis has narrowed its focus and need not be concerned with differing assumptions for different levels of analysis. Despite this analytical sleight of hand, potential problems remain.

As noted earlier, focus on one analytical perspective or level of analysis is restrictive and unrealistic. However, to avoid ad hoc-ism analytical attention is paid to the over-arching questions synthetic perspectives ask: "Where is policy-making authority and how does it operate?" rather than simply, "How has one level of analysis affected another?" This methodology analyses core questions across analytical perspectives and avoids an *ad hoc* focus on one variable or analytical level.

[170] Moravcsik, "Introduction: Integrating International and Domestic Theories of International Bargaining," p. 23.

variables, and advance to more complex explanations, we may be able to better manage complexity and more precisely tie specific variables to specific empirical observations. In this way, initial parsimonious observations may add analytical rigor to subsequent complex observations. The disappearance of analytical connections as explanatory complexity increases may signal a loss of analytical rigor. In this sense, parsimonious approaches may act as a control for complex analyses.[171] More fundamentally, complex perspectives and analyses are justified if they clarify policy-formation processes or identify the limitations of narrower approaches.

Research Methodology

Research was conducted using primary and secondary source materials. Primary resources included confidential interviews and official BIS, EC/EU, IOSCO, EU member-state, and US Federal Government testimonies and reports. Secondary sources consisted principally of newspaper and magazine reports including, *inter alia, The New York Times, The Wall Street Journal*, *Financial Times*, *The Economist*, *International Securities Regulation Report*, and *Dow Jones* news retrieval services. Additional secondary sources included scholarly books and articles from refereed journals. These are listed in the bibliography and footnotes.

Twenty confidential research interviews were completed in New York and London.[172] The interviews were conducted under "Chatham House" rules.[173] Most of the interviewees had been prominently engaged in the EU and IOSCO negotiations; they included senior officials from British and American government and securities regulatory agencies, the European Commission, Directorate General XV, and the Basle Committee. Several senior private sector officials with significant roles in the

[171] See also footnote 106 in this chapter and related text discussion of "complex analyses." This analysis was suggested by Prof. G.R.D. Underhill.
[172] Prior to interviews, each interviewee received a letter explaining the general objective and confidential nature of research and containing an outline of both the reasons why an interview was sought and topics for discussion. Each interview was recorded with the prior approval of the interviewee. Interviews lasted from one to three hours in length, were conducted in English and took place in interviewees' offices. Interviewees agreed to respond to follow-up questions. With one exception, all requests for interviews were accepted.
[173] The Royal Institute for International Affairs, London, ("Chatham House") has established research interview guidelines that preclude revealing information developed during interviews that might permit identification of interviewees or their professional affiliations.

negotiations were interviewed as well. No employees of IOSCO were interviewed, although several IOSCO member-state representatives were.

The Case Studies and Conclusions

The case study chapters[174] assess specific aspects of the EU and IOSCO negotiations, focusing on elements that provide insight into policy-making authority. The EU chapters begin with an examination of state regulatory institutional structures; they provide a summary of the negotiations; and finally, they assess EU and private sector authority specifically. The IOSCO chapters begin with a summary of the negotiations, provide an assessment of IOSCO and private sector authority, and conclude with an examination of the SEC's authority and response to globalisation.

The conclusion assesses findings against hypothesised relationships, addresses the core questions, and evaluates the relative explanatory value of each perspective. The conclusion also addresses contributions that this analysis makes to the international political economy literature and to regulatory evolution.

[174] Chapters 4 – 11.

Chapter 4

State Authority in the UK, Germany and France

Introduction

This chapter examines the historical background and structure of regulatory authority in three prominent EU member-states.[1] It specifically defines the consequences for actor regulatory preferences of different national and sectoral histories and structures. The chapter's objective is to identify how and why state actors and institutions were influential in the evolution of the CAD and ISD and the character of the authority they may have exercised in the negotiations. The chapter focuses on the UK, France and Germany, as these were the principal states involved in the negotiations. The specific details of the negotiations are provided in Chapter 5.

This chapter provides historical and institutional background information necessary to assess the accuracy of the hypotheses and of the theories used to compose the hypotheses. The analytical perspectives defined in Chapter 3 consider, in varying degrees, the potential significance of state or domestic institutional histories, and political and economic structures, in explaining the evolution of public and private actor regulatory preferences. This background helps us to understand the structure and interaction of actor preferences in the evolution of the CAD and ISD.

EU integration, state/market and domestic perspectives all stress the significance of national and institutional histories in locating authority and influence. Structural and bargaining approaches do the same, but to a lesser extent. This history, juxtaposed with the negotiations, helps clarify the sources of preferences and the location of authority and influence. It also reveals the reasons behind significant preference divergence among

[1] See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, for an extended discussion.

private sector firms, pointing to the absence of a single, unified private sector voice on capital adequacy standards.

United Kingdom

The structure of domestic markets and regulations

The restoration of London as a major international financial centre was a principal objective of the British government in the post WWII period. To help achieve this policy, the government and central bank had encouraged institutional and market self-regulation, leading to the monopoly operative status of domestic financial services sectors. But, by the early 1960s, these sectors were under intensifying competitive pressure from the growth of the Euromarkets, particularly the Eurodollar market.[2] New markets encouraged closer economic and, eventually, political ties between currency host and home countries such as the UK, US and other countries whose currencies facilitated the development of offshore markets.[3] These developments juxtaposed national regulatory and financial systems, encouraging arbitrage and regulatory change.[4]

In British markets corporate lending and deposit-taking were conducted by a small group of "clearing banks,"[5] named for their role in executing government monetary and credit policies. Regional building societies and saving institutions carried out mortgage lending, and investment banking services were provided by thinly capitalised, predominantly private, discount houses.[6] These latter decided not to accept deposits, focusing instead on corporate finance and investment advice. As a result, despite the relative absence of legal impediments to universal banking, British financial services

---

[2] Eurodollar markets represent capital markets comprised of US dollar deposits and securities in circulation outside the US. Euromarkets measure their significant growth and nascent influence from the early 1960s with the development of the tradable Eurodollar certificate of deposit. However, "technically" these markets existed much earlier. Euromarkets in other currencies also flourished.

[3] Widely circulated currencies enabled the development of offshore markets.

[4] Adapted from Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*. See also, Chapter 2. Note also that the Euromarket, headquartered in London, competed with British domestic markets but was also an important component of the UK domestic economy. Consequently, it is incomplete to refer to the Euromarkets simply as competitors to, particularly British, domestic markets.

[5] Comprised of Barclays, National Westminster, Lloyds and Midland banks. Scottish banks handled Scottish clearing separately.

[6] Also referred to as "accepting houses."

until the 1990s resembled the US system of separated financial powers rather than continental Europe's universal banking system.[7]

Two aspects of the structure of the UK financial services industry distinguished it from continental Europe; these were the provision of investment advice to individuals and the use of equity markets by corporations.

In much of continental Europe large universal banks provided investment advice to both institutions and individuals. However, in the UK investment advice was provided to individuals by over 8,000 investment advisors, typically small firms. Their role in channelling investment funds in the British economy gave them considerable economic and political clout, which was reinforced by FIMBRA, an SRO created by FSA 1986.[8] Advisory firms, despite carrying limited capital, were initially subject to provisions of the CAD and ISD.

The UK economy did not have the influential industry and bank ties that characterised the French and, particularly, German markets. Post-WWII UK fiscal and monetary policies discouraged bank lending, with the consequence that private companies used domestic equity and debt capital markets to raise capital. This encouraged the growth of the London Stock Exchange as well as domestic and Euro capital markets.

Euromarket growth was centred in London. This was a consequence of many factors including London's well-developed market infrastructure,[9] a stable, liquid local currency, a long tradition of international openness and market activity, and a market-oriented regulatory perspective. The rapid development of the Euromarkets in London in the 1960s and 1970s had the consequence of increasing their significance to Britain's domestic economy and its international prestige.

---

[7] British laws did not distinguish between commercial and investment banking but the broker/jobber distinction prior to the "Big Bang" (see below) inhibited the development of universal banking.
[8] See Glossary and below for definitions of "SROs" and "FSA 1986."
[9] "Infrastructure:" refers to the physical structures, trained, specialised personnel and technical requirements necessary to operate large dynamic capital markets.

As noted, globalisation and Euromarket growth also sensitised UK regulators to the importance of their domestic regulatory environment, its institutional infrastructure and operating language in defining the attractiveness of London for international capital raising.

However, increased capital and market participant mobility also served to highlight archaic UK organisational and regulatory structures, most significantly the LSE's. By the mid-1980s, the growing importance of continental capital markets and clients prompted international securities firms to consider relocating their EU securities headquarters from London to other European financial centres. If migration had occurred it would have decentralised European securities trading and would have represented a significant blow to City prestige and the UK economy.

The economic importance of international financial services to Britain prompted a governmental review of financial services regulation, focusing attention on competition between European banking capitals for financial services and raising public and private sector concern with the potential risks of changing London's regulatory regime.

The "Big Bang"

London's "City" had a long tradition of *laissez-faire* self-regulation. The Bank of England, supported by the Treasury and Department of State for Trade and Industry ("DTI"), was London's senior regulator of financial services. Prior to 1986, regulation was based on traditional practices, rules and "consultation" between the Bank and practitioners. However, as noted in Chapter 2, changes over the preceding two decades in the context and scope of trading executed in London forced a re-examination of its regulatory environment.[10]

The UK's initial response was to deregulate its fixed-commission, segmented stock market on October 27, 1986.[11] Simultaneously, the LSE adopted an automated equity price quotation system, called "SEAQ,"[12] for domestic equities, and an affiliate,

[10] Adapted from: Denise M. Leydon, "International Securities - London's Dominance in the Emerging Integrated International Market," *Suffolk Transnational Law Journal* 11 (1987).
[11] Under new rules, brokers and jobbers were allowed to perform each other's functions and to own each other. See: Supplement, "The City Revolution," *Financial Times*, 27 October 1986.
[12] The Stock Exchange Automatic Quotation system ("SEAQ"). See Glossary.

"SEAQ-International," for international equities, and opened its membership to foreign-owned companies. The "Big Bang" led to a rapid increase in foreign institutional ownership of British brokers[13] and permitted banking institutions, both domestic and foreign, to operate as universal banks, encouraging institutional evolution toward the continental European universal banking model.

Several days later, on November 7, 1986, Britain adopted the Financial Services Act 1986 ("FSA 1986"), revolutionising domestic securities regulation.[14]

The Big Bang and FSA 1986 had important consequences. London became the first European market to substantially deregulate financial services, establishing a regulatory precedent for other European domestic securities markets and reinforcing London's regional and international market stature.[15] The new regulations incorporated recent market developments, including new product and hedging technologies. Finally, deregulation encouraged the continued expansion of London-based markets, especially the lightly regulated Euromarkets.[16] The Big Bang also authorised the DTI to establish a regulatory board, the Securities and Investments Board ("SIB"),[17] to regulate and monitor investment businesses in Britain. The SIB, in turn, was authorised to recognise Self-Regulatory Organisations ("SROs")[18] responsible for policing members of individual market segments.

The regulatory changes dramatically altered existing public/private regulatory arrangements, by introducing multi-level regulation predicated on state control over regulatory evolution and decision-making. The government's adoption of the Big Bang,

[13] These changes are commonly referred to as the "Big Bang."
[14] The regulatory revolution was based on political compromises engineered between Labour and Tory ministers over a six-year period beginning in 1979. FSA 1986 had a difficult legislative gestation and confronted deep opposition from affected parties in London's City. Nevertheless, the powerful Tory majority government pushed the legislation through Parliament See: Leydon, "International Securities - London's Dominance in the Emerging Integrated International Market." Also, J. Pimlott, "The Reform of Investor Protection in the UK - an Examination of the Proposals of the Gower Report and the UK Government's White Paper of January, 1985," *Journal of Comparative Business and Capital Market Law* 7 (1985).
[15] Vogel categorises the Big Bang and adoption of FSA 1986 as "re-regulation" rather than deregulation as more rules eventuated from its adoption than were discarded. See: Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries.*
[16] In both market share and product terms. The rapid development of Euro commercial paper and medium-term note markets in the late 1980's can be traced to FSA 1986. See Glossary.
[17] See Glossary.
[18] See Glossary.

over City opposition, effectively asserted the state's pre-eminent role in the development of financial services regulation, in place of the City's earlier self-regulatory regime, and acknowledged the significance of City activities to the state.

The SIB resembled the US Securities and Exchange Commission ("SEC") – but with significant differences. The SIB reported to a government department (the Treasury) rather than to the President and Congress. More significantly, the SIB and FSA 1986 were intended to preserve the non-legalistic, consultative approach that historically characterised British financial services regulation, in sharp contrast with the US regulatory regime. However, FSA 1986 established an additional state-mandated layer of regulatory authority between banks and state regulators.

SROs represented specific product markets and set capital adequacy requirements for members. Nevertheless, regulatory guidelines were expected to be broadly similar across market sectors. Importantly, SROs were created to expand communication between regulators and market participants and to encourage market participation in regulatory evolution.

The new regulatory structure created jurisdictional overlaps. While the Bank retained sole responsibility for commercial bank supervision, areas of overlap with the SIB were created, including regulation of integrated banking and securities businesses and the gilt-edged[19] and wholesale markets. The regulatory objective of developing a domestic capital standard for financial institutions with both banking and securities businesses highlighted these overlaps. In order to address this, a complex formula was developed for capital calculation, based on the amount of securities-related business an institution transacted. This UK domestic model set a conceptual precedent for the "trading book" approach eventually established by the CAD.

A final regulatory change designed to strengthen London-based markets was the November 1986 merger of the London Stock Exchange, a self-regulating institution, with the International Securities Regulatory Organisation ("ISRO"), which was responsible for "governing" the largely unregulated London-based Euromarkets. The merger

[19] See Glossary.

acknowledged the migration of international bond market activity from Switzerland to London, where, by 1985, over 80% of new international bond issues were offered.

These rule changes buttressed London's international market stature, but they also created anxiety among City institutions over the potentially negative implications of regulatory change. In New York, the 1975 elimination of fixed commissions by the New York Stock Exchange reduced brokerage commissions and increased equity trading volumes but had lowered revenues. This had forced securities firms to diversify business and revenue streams, favouring well-capitalised firms and resulting in a few large firms dominating securities underwriting.[20] A similar development in London could make less-well capitalised, private City institutions vulnerable to acquisition; it might also encourage business migration or new concentrations of market authority.[21]

London's regulators were also aware that the complexity and juridification of their new regulatory regime might encourage firms to leave. Reflecting this uncertainty, Andrew Large, Chairman of The Securities Association ("TSA"), the newly-created securities industry SRO, commented "I just don't know" when asked what additional costs new capital adequacy regulations would impose on London securities firms. Replying to another question about potential jurisdictional conflicts between the Bank and SIB, Large noted, "Obviously where you have two securities regulatory agencies...there is potential for complication."[22]

The Big Bang increased private and public sector investment in financial services regulation. This was reflected in the political commitment of the Thatcher government to regulatory reform and in the economic cost of compliance with new regulations. This investment also increased government and private sector resistance to further regulatory change, whether arising from domestic or international sources. The Big Bang made London markets more competitive for investors but more costly for bankers. The potentially negative consequences of higher compliance costs and a more competitive

---

[20] Six firms, First Boston, Goldman Sachs, Lehman Brothers, Merrill Lynch, Morgan Stanley, and Salomon Brothers, the so-called "Bulge Bracket," dominated securities underwriting in the US in the 1980s.

[21] This is, of course, what happened. By the late 1990s, only one independent discount house, Cazenove, remained, and London's markets were dominated by foreign, mainly US and Swiss, firms.

[22] Neil Osborn, "TSA Chief Admits Big Will Benefit," *Euromoney*, September 1987., p. 462-463

marketplace were clear; when asked about a potential move to continental Europe, the London head of Salomon Brothers[23] commented, "we always maintain our flexibility."[24]

The Big Bang reflected formal acceptance by UK regulators and legislators of universal banking and sophisticated, market-driven regulation. It reflected as well the UK's decision to have specialised securities regulators, rather than bank regulators, supervise investment firms, departing from common practice on the Continent. SROs also reflected the regulators' intention to have regulation substantively incorporate private market views and developments even while creating a separate layer of state bureaucracy between bankers and regulators. Finally, it acknowledged the need to have explicit regulation addressing securities market activities.

These dramatic changes decentralised domestic regulatory authority, increased state involvement in regulatory development, increased the potential for domestic institutional conflicts, and encouraged private sector involvement in regulatory evolution. The new SIB shared regulatory responsibilities with the Bank but could not match the Bank's independence or institutional clout. Further, the SIB, DTI and Treasury all represented the UK in international regulatory negotiations, eventually complicating efforts to develop consistent policy positions.

The City's importance to the UK economy

The British economy benefited greatly from large invisibles earnings balances generated by its financial services sector. Euromarket activity in London represented a significant contribution to Britain's balance of trade, helping to redress trade account imbalances and providing concomitant domestic economic benefits. These conditions provided London regulators and legislators with major incentives to promote the City's regulatory regime. A 1991 study commissioned by the Corporation of London[25] analysed statistics released by British Invisibles, a major UK financial services lobbying group. The study confirmed the important contribution made to the UK current account by invisibles balances generated by City activities. It re-emphasised the City's vulnerability to EU directives and the domestic economic importance of maintaining London's market

---

[23] A leading US securities firm.
[24] Martin French, "Doing the Continental," *Euromoney*, July 1987., p. 28
[25] Executed by the London Business School.

position.[26] The report's leader, Professor Richard Brearly, addressed threats to London's status and regulatory authority, "EC directives and intervention give us the most to worry about."[27]

British invisibles earnings[28] had increased consistently since the 1970's at a rate approximately 50 percent faster than visible earnings, largely due to growth in investment income. Investment income growth was attributed to financial deregulation and liberalisation; in particular, to the removal of exchange controls, increasingly open global markets and the Big Bang. Invisible earnings made a significant positive contribution to the current account balance. Invisibles balances were in surplus every year from 1970 to 1992 except one (1990), whereas visible balances had been in surplus in only four years since 1970 (most recently 1982).

A decline in the UK invisibles balance from 1987 to 1989 reflected a fall in City earnings.[29] The decline was a sensitive matter for then Tory Chancellor Nigel Lawson as the government's economic policies had come under increasing Labour criticism. The Labour Party pointedly noted that the 1989 trade figures indicated Britain was losing world market share in services as well as manufacturing.[30]

UK Current Account (in billions of Pounds Sterling)

Period	Current Balance	Visible Trade Balance	Exports	Imports	Invisibles Balance
1987 (FY)	+3.7	-10.9	79.4	90.4	+7.7
1988 (FY)	-14.6	-20.8	80.6	101.4	+6.2
Qtr. 3	- 3.4	- 5.7	20.9	26.6	+2.3
Qtr. 4	- 5.4	- 6.6	20.2	26.7	+1.1

[26] 1990 net overseas receipts of UK financial institutions had risen to £14.1 billion, a 10 percent increase over 1989. Fully 50 percent came from the banking sector whose individual earnings alone had risen 16 percent above their 1989 level to reach £7.2 billion See: Peston, "The Challenge to the City from Continental Centres Is Intensifying," for descriptions of the studies cited.
[27] ISRR, "London School Warns EC Regulation Threatens London Financial Center," 7 April 1992.
[28] Trade in services, transfers and income from overseas assets.
[29] Their contribution to the overall invisibles balance of the current account had declined from £9.7 billion in 1986 to £7.4 billion in 1988.
[30] Simon Holberton, "City's Foreign Earnings Fall Sharply," *Financial Times*, 2 August 1989.

UK Current Account (in billions of Pounds Sterling)

(continued)

Period	**Current Balance**	**Visible Trade Balance**	**Exports**	**Imports**	**Invisibles Balance**
1989					
Qtr. 1	- 4.8	- 5.9	21.6	27.6	+1.1
Qtr. 2	- 4.9	- 5.9	22.6	28.5	+1.0
Qtr. 3	- 5.9	- 6.8	23.0	29.8	+0.9

Source: UK Central Statistical Office, quoted in the *Financial Times*, 27 September 1989, p.8.

The dismal economic statistics highlighted the important role of the City's earnings and regulatory regime in domestic politics. London's international market authority and invisibles earnings success were tied directly to the City's regulatory regime. Challenges to London's market status, particularly from Frankfurt or Paris, carried potentially dire political, economic and precedential consequences. No other EU domestic economy mirrored the UK's dependence on invisibles earnings generated through financial services.[31] This highlights the political and economic significance of City institutions' policy-making preferences and encouraged protection of City institutional regimes, especially regulatory precedents.

UK Authority

Market Stature

Several factors favoured Britain's potential regulatory authority and leadership. London was home to the Euro and domestic Sterling markets. Together, these markets exceeded Continental markets in size, depth, liquidity, trading turnover and product diversification. The attractiveness of London's regulatory and operational institutions had encouraged the migration of securities trading, both debt and equity, from continental bourses to London exchanges. London, as a result, accommodated a greater diversity of institutions than other European markets. The City's success was confirmed

[31] Rather than a broader services sector. See generally: UK Government, "Invisible Earnings: The UK's Hidden Strength," (London: HM Treasury, 1996).

by the release of a 1989 Bank of England study, which indicated London had a 20 percent market share in international banking and was a global leader in foreign exchange, foreign equity,[32] derivatives trading, insurance and international bond trading. The LSE had a substantial lead over other national bourses in the number of foreign companies listed. The City was also a leading international centre for bank lending, funds management, futures and options trading, and commodities trading. Not surprisingly, the City was responsible for a major portion of the UK's overseas earnings.[33]

Regulatory Standing

British regulators had more experience developing regulation for dynamic international markets and institutions than other Continental regulators. Domestic markets that had made regulatory adjustments to accommodate globalisation, market growth, new technology and products were more likely to benefit from EU regional harmonisation initiatives designed to facilitate increased competition and reduce regulatory arbitrage.[34] More importantly, these markets had greater experience and better-established regulatory and technical infrastructures necessary for the management of sophisticated markets. These conditions encouraged the broader use of regulatory precedents developed by these markets, giving states, such as the UK, potentially greater authority in the creation of regional regulation.

Both EU and UK regulators acknowledged that British experience and market standing resulted in British regulatory preferences being given greater weight than those of other EU member-states.[35] Because of their expertise, British officials held senior positions in both EU institutions responsible for developing the CAD and ISD: Directorate General XV ("DG XV")[36] and the EU Commission's financial services "cabinet."[37] This was a unique arrangement within the EU that went against the established practice of discouraging nationals of a single country from heading related EU institutions. A senior member of Leon Brittan's cabinet, responsible for negotiating

---

[32] SEAQ-I was the largest international centre for trading in foreign equities.
[33] Peston, "The Challenge to the City from Continental Centres Is Intensifying,".
[34] See Chapter 6 for discussion of EU financial services principles.
[35] Confidential interviews, London, May 2000 and February 2001.
[36] Headed by Geoffrey Fitchew.
[37] The group headed by Leon Brittan that was responsible for developing and drafting EU financial services legislation .

the CAD and ISD, noted that, irrespective of nationality, EU officials were painstakingly independent and non-nationalistic in their work. Their credibility and professionalism would be compromised if they were perceived as biased.[38]

Asserting regulatory authority

The Bank of England's generally successful efforts to maintain market order during late 1980s stock market crises, combined with London's progressive regulatory reforms, prompted Sir George Blunden, the Bank's Deputy Governor, to recommend that the Bank assume a regional regulatory role in the post-1992 EU similar to the FRBNY's domestic role.[39] Subsequently, during a June 1989 London fact-finding trip, the EU's Economic and Social Committee was advised that the ISD needed to be harmonised more closely with existing UK regulatory legislation.[40]

In a further effort to promote British institutional precedents, LSE Chairman Andrew Hugh-Smith proposed twice, in 1990 and 1991, that his EU counterparts join him in developing a pan-European wholesale equity market to supersede national markets. His comments were taken seriously because the LSE's trading volume and listings greatly exceeded those of its continental counterparts. But Hugh-Smith's emphasis on the need for regulatory distinctions between wholesale and retail markets remained alien to European regulators. And, while his proposal accurately highlighted British domestic regulation as the major reason for the growth of institutional trading on SEAQ-I, European exchange managers saw his comments as little more than a bald attempt to steal further equity trading from continental bourses.[41]

These exchanges underline an element of Britain's strategy in negotiating the CAD and ISD. They connected the City's growth and prominence with Britain's experience in developing and enforcing regulation for complex, international markets. As noted earlier, DG XV and EU staffing reflected Brussels's high regard for Britain's

[38] These same officials observed that British preferences were given "greater weight" as a consequence of their deeper and more sophisticated regulatory expertise. Setting aside EU staff attitudes toward British preferences, UK preferences were vigorously promoted in directive negotiations, through governmental lobbying and by private actors, with both market and experiential grounds highlighted for their consideration. There is no evidence of national bias on the part of EU officials.
[39] See: David Lascelles, "Order in the Marketplace - the Blue Arrow Affair Brought Credit to the Bank of England," *Financial Times*, 25 September 1989.The FRBNY implements monetary and foreign exchange policy decisions taken by the Federal Reserve Board.
[40] "City Faces up to Europe," *Financial Times*, 17 August 1989.
[41] ISRR, "LSE Chairman Makes New Bid for European Wholesale Market,"19 November 1991.

regulatory expertise. In addition, British negotiators argued that deviation from UK regulatory precedents would diminish EU markets' international competitiveness.

London's negotiators also wanted to avoid changes to the FSA 1986, especially in response to EU decisions. The FSA 1986's development had been domestically contentious. As the 1992 general election approached, the domestic UK political climate became increasingly tense, with Margaret Thatcher's government split over the issue of EU monetary union. Labour could exploit the situation by parlaying any Tory back-peddling on domestic regulatory precedents into political weakness. Conversely, the Tories could promote regional adoption of UK regulatory standards as an endorsement of Conservative policies.

John Redwood

John Redwood exemplified the close association of domestic political concerns and the regional promotion of UK regulatory interests and authority. Redwood, the senior UK DTI representative on the EU's internal market council and ECOFIN, was responsible for negotiating the CAD and ISD.[42] His single-minded focus on British domestic interests in regional harmonisation negotiations underscores his limited appreciation of Cockfield's original vision. Redwood caustically noted that he preferred no directive to one with which he disagreed.[43]

[42] Redwood was acknowledged as a brilliant but abrasive politician, firmly committed ideologically to Thatcher's vision of an entrepreneurial Britain; commercially allied with – but politically and monetarily independent of – the EU. This made him a staunch advocate of British interests, even if it meant derailing EU harmonisation negotiations. In November 1991, the EU Commission proposed language for the CAD that would compel non-bank securities firms to increase their capital in line with commercial banks. Redwood objected. The language appeared to be influenced by the German universal banks' level-playing-field preferences. Small British securities firms opposed the language, arguing that capital rules should only apply to trading positions. The Commission's proposal would make capital guidelines for banks and securities firms the same, applicable to all securities businesses and penalising Britain's smaller investment advisors, many of whom did not position securities. It would have applied specific capital guidelines to both securities firms and the securities trading operations of commercial banks. A critical compromise, meeting broad approval, was proposed in December 1991. Nevertheless, British/French disagreements over the ISD slowed progress on both directives. Early in 1992, rumours circulated that the UK was prepared to abandon ISD negotiations when Britain assumed the EU Presidency in July. It is not implausible Redwood started the rumours to encourage closure on outstanding issues, although this remains unconfirmed. Press attention did focus on Redwood, who summed up his negotiating perspective; "Too many people have seen the Single Market as a legislative programme whereas I see it as about getting more cross-border trade." (See: Ralph Atkins and Andrew Hill, "UK Plans to Put the Brake on the Single Market: British Presidency under the Conservatives May Put New Legislation in Jeopardy," *Financial Times*, 10 February 1992.

[43] Ibid.

Redwood's perspective was also influenced by the Tories 1992' election platform. Conservatives focused on implementing agreed SEM measures. Of Cockfield's original 282 proposals, 232 were approved. Newspaper articles indicated the Tories planned to drop up to ten pending measures from the EU's agenda (during their upcoming Presidency) in favour of implementing those already approved. As the dispute between France and the UK over trade transparency[44] appeared irresolvable, speculation centred on the ISD as a prime candidate for elimination.

Redwood's uncompromising advocacy of UK interests and authority was a source of irritation for British negotiators from DG XV, the UK Treasury and SIB, all of whom were less politically motivated. Confidential interviews confirm this observation. Redwood's obduracy would be resolved only when British responsibility for EU negotiations was moved from the DTI to Treasury.[45] Redwood's departure, according to members of the UK negotiating team, helped "move the negotiations along."[46]

Factors Undermining Potential UK Regional Regulatory Influence

Domestic politics and the City

Despite clear incentives to understand and promote City institutional interests, the Tories failed to demonstrate a meaningful understanding of City preferences or institutions. Ironically, the Labour party appeared more willing to promote City interests than the Tories.[47] This became clear in the run up to the 1992 election.

Late in 1990, Labour's spokesperson for City and Corporate Affairs, Marjorie Mowlam, announced a series of proposals for financial services regulatory reform.[48] City

[44] See Chapter 6. Transparency related to the timing of publication of trade pricing information.
[45] In March 1992, the Conservative Party called a general election for April 9th. Part of the Conservatives' election platform was to streamline the UK's financial regulatory apparatus by consolidating securities regulatory responsibilities at Treasury. This meant removing responsibilities from the DTI, including shifting responsibility for negotiating EU directives from John Redwood to the Treasury under Norman Lamont and Anthony Nelson. Following their election victory, the Tories fulfilled their manifesto pledge and moved investment regulation to Treasury. As the Treasury had little expertise in investment services, the majority of DTI's 50-person financial services division also moved to the Treasury - without Redwood. The CAD and ISD remained on the EU agenda and were agreed over the summer.
[46] Confidential interviews, London, April 28, 2000, May 8, 2000 and May 18, 2000.
[47] Confidential interviews, London, April 2000 and February 2001
[48] She advocated simplifying the domestic regulatory bureaucracy, promised to review FSA 1986 and to promote London as a "major European and international financial services centre." ISRR, "SIB Undergoes Major Reshuffle; New Executive Committee Set Up," 28 January 1991.

executives responded positively, noting that Mowlam's unambiguous Single Market endorsement contrasted sharply with Tory waffling. She also attacked DTI capabilities, timing her comments to follow the release of a House of Commons Select Committee report highly critical of DTI market oversight.[49]

Mowlam's comments encouraged City bankers to believe that a Labour government would support their interests in EU negotiations. The same could not be said of the ruling Tories, who had historically maintained a cool relationship with the City.[50] City bankers were concerned about the Thatcher government's limited appreciation of recent market developments and product innovations. They were concerned as well about the Tories' strident opposition to monetary union, which weakened Britain's (and the City's) ability to promote its regulatory preferences in EU negotiations.

Major City firms sought out political figures who appeared to understand the City's regulatory preferences. Mowlam and other Labour frontbenchers were courted by senior bankers, particularly from the US and UK, who felt they would effectively represent their interests domestically and in the EU. Interviews with City officials confirm their low regard for Tory officials' understanding of City institutions and interests. A Labour victory in the 1992 general election might have increased the vigour with which the City's regulatory authority was promoted. However, while both political parties were aware of the importance of the City to Britain's economic health – and election platforms made recommendations to amend specific City regulations – neither party wanted to become deeply entangled in a complex EU regulatory debate that could negatively affect the City. As a result, the City's domestic and regional institutional significance – and its influence on the structure of the CAD and ISD – had to be promoted by individual firms and bankers, rather than by political actors.

---

[49] Mowlam noted, "after the affairs of Guinness, Barlow Clowes, Blue Arrow, Ferranti and, more recently, Dunsdale, there is plenty of evidence to support that contention [that fraud was increasing]." Ibid.

[50] The Conservative Party was rooted in the countryside and suspicious of City businesses and support for the Single Market. Traditionally, the City was politically independent although it's most significant growth had occurred during Labour, rather than Conservative, governments. The Tories had been suspicious of the City for years. Recent Conservative Prime Ministers, including Edward Heath in 1974 and Margaret Thatcher in the late 1980s, were offended by the City's political independence. Heath felt his government had been weakly supported by the City during a crisis of confidence and Thatcher had been concerned City scandals would taint her administration. See: Peter Lee, "Who's Afraid of a Labour Government?," *Euromoney*, December 1991.

Discord over monetary union

Domestic political debates over monetary union and commitment to EU objectives further undermined British authority in the CAD and ISD discussions.

In February 1988, representatives from the FRBNY, the SEC, the Bank of England and the SIB met to examine the capital adequacy of US securities firm branches operating in London. Also attending was Sir Nicholas Goodison, LSE chairman, who called for central banks to become the principal regulators of the securities industry.[51] At the same meeting, the Bank Governor, Robin Leigh-Pemberton, called for the formation of a new international group to harmonise national approaches to securities regulation.[52] Leigh-Pemberton's recommendation appeared a logical extension of the successful Cooke Committee formula used in developing the Basle Accord. While the meeting did not develop formal recommendations, further meetings were scheduled and the group indicated its intention of examining capital adequacy separately from either ISOCO or the EU. Notably absent were continental European representatives.

Goodison and Leigh-Pemberton's recommendations highlight conflicting UK domestic preferences and potential conflicts between UK, US and other EU member-states' preferences. Goodison's recommendation was at odds with British and French domestic practices and was not endorsed by the UK SIB or TSA. Leigh-Pemberton's proposal was puzzling in light of the EU's (and IOSCO's) on-going effort to develop regulatory standards. His comments reflected his personal scepticism regarding the potential success of the EU negotiations and his perception that the UK's experience with the regulation of sophisticated capital markets far exceeded that of other EU member-states. These statements underline preference conflicts within the British domestic regulatory bureaucracy and arrogance toward EU regional discussions.

Opening a 1990 Commons debate on Financial Services and the Single Market, Peter Lilley, the DTI secretary, expressed his government's concern that EU member-states were negotiating to insulate home markets rather than to promote regulatory

---

[51] His comments echoed a controversial conclusion of the US Brady Commission Report on the 1987 stock market crash that called for the Federal Reserve to assume responsibility for domestic US regulatory co-ordination.

[52] Andrew McCathie, "US, UK Move on Joint Regulation of Banks, Securities," *Australian Financial Review*, 2/12/88.

harmonisation. But Lilley's remarks glossed over domestic debate concerning Britain's EU role.

Leigh-Pemberton disagreed with Prime Minister Thatcher over the UK's relationship with the EU. In 1990 remarks to French bankers, he echoed Goodison's 1988 remarks[53] by noting that the future EU central bank should be responsible for monetary policy and bank regulation. Previously, the implementation of bank regulation had been the exclusive responsibility of national authorities, with the EU or Basle Committee providing regulatory guidance.[54]

Leigh-Pemberton's comments were significant for three reasons. First, his announcement indicated the readiness of a senior UK government official to discuss external regulation of London's financial markets, a significant alteration of the British government's historic attitude toward regulation of the world's leading international financial centre. The Governor's comments reflected an apparent willingness to concede some degree of British regulatory sovereignty – the first time this would have happened. Second, the Delors Committee of central bank governors examining monetary union had created a special sub-committee, chaired by Brian Quinn of the Bank of England, to examine supervisory matters. This put the Bank in a position to influence financial services regulatory developments in the EU. Finally, the Governor's remarks further underscored disagreement within British domestic institutions responsible for regulatory policy. The Governor's opinion was shared by Whitehall officials, including Geoffrey Howe, and by the City, where support for the Single Market had been consistently robust – but not by the Prime Minister.

While the Governor's logic was criticised,[55] his comments raised the temperature of British domestic debate over financial supervision and the Single Market and underlined Britain's delicate domestic relationship with Single Market objectives.[56]

[53] On the possibility of central bank regulation of securities firms.
[54] Leigh-Pemberton noted two reasons for supporting an expanded EU central bank role. First, a Single Market logically implied a single regulatory authority. If banks and markets were integrated, then regulation should follow. Second, his professional judgement argued that the institution responsible for monetary policy should also be responsible for financial services regulation. The two activities were so closely connected that distinguishing them by country or institution would impair the application of monetary policy and regulatory objectives.
[55] Both Germany and the US (partially) segregated monetary and regulatory authority.

Highlighting the domestic schism over Britain's role in the Single Market, Mrs. Thatcher restated her vision of Britain's role in Europe in a 1990 speech at the Lord Mayor's Banquet. She claimed that London's culture of integrity and innovation would ensure that it remained the pre-eminent European financial centre, irrespective of developments affecting the Single Market or the Pound.[57] Her comments were widely seen as a rebuke to Leigh-Pemberton and to her Chancellor's support for monetary union. Chancellor Howe's resignation the next day did not resolve domestic debate.

Mrs. Thatcher's remarks catalysed her opponents, and she herself was compelled to resign shortly afterwards. These developments were significant in the context of the CAD and ISD because they reinforce the observation above that British regulatory preferences were not uniform and that domestic political disagreements undercut British regional authority. Despite Mrs. Thatcher's inveighing against monetary union on political grounds, many British politicians and business people remained committed to Single Market objectives for economic and commercial reasons. Leigh-Pemberton's willingness to concede British regulatory sovereignty was conditioned by his assumption that EU standards would reflect British (and City) regulatory preferences – and by the hope that Britain would have a senior role in developing and operating any new regulatory institutions. In remarks at a 1991 UK conference, Leigh-Pemberton urged EU negotiators to adopt "permissive" British regulatory principles. He observed that EU drafting often began with British values, following "the grain of the market," but that it "often proves difficult to maintain this ideal as each member-state seeks to make the text conform to its way of seeing things. The elaborate versions which finally emerge, instead of being open and liberating, often run the risk of being protectionist."[58] His arguments, seen as self-serving and insensitive to continental concerns, shed further light on domestic UK political division over regulatory direction.

While many Britons remained strongly in favour of Single Market economic objectives, domestic political debate over monetary union and external challenges to the

---

[56] David Lascelles, "Flaw in the Argument: The Governor of the Bank of England's Views on Banking Supervision," *Financial Times*, 7 November 1990.
[57] Philip Stephens, "Parliament and Politics: Thatcher Denies Isolation over Europe - Prime Minister's Guildhall Address," *Financial Times*, 13 November 1990.
[58] ISRR, "Bank of England Chief Urges Liberal Regulatory Regime," 5 November 1991.

City undermined the ability of British negotiators to effectively promote the superiority of British regulatory preferences.[59] This series of political events highlighted the powerful juxtaposition of conflicting domestic regulatory preferences, powerful market positions, domestic political conflicts and domestic regulatory concerns. The combination undermined British state authority and ability to influence other EU member-states' regulatory preferences.

FSA 1986

An internal 1991 Bank of England study highlighted domestic developments potentially threatening London's international regulatory pre-eminence.[60] The report, which examined the legal setting for financial transactions in London, noted the importance of London's regulatory environment and infrastructure. However, it also indicated that FSA 1986 appeared to have altered Britain's historically successful regulatory approach and, more damagingly, did not appear to work very well.[61] These observations increased public and private sector concern with maintaining London's stature and they undercut arguments that the British regulatory system should serve as a model for the EU.[62]

The study noted that FSA 1986, though predominantly domestic in scope, represented a comprehensive overhaul of UK financial services regulation and negatively affected the wider constituency of international firms operating in London. Bankers complained that the complicated legislation was bureaucratic, expensive and legalistic – potentially discouraging firms from expanding their London operations. London's regulators were accused of creating a UK regime with uncomfortable similarities to the

---

[59] In a 1991 year-end interview, Howe's replacement as Chancellor, Norman Lamont, noted conflicting perspectives on London's EU role. Reflecting British ambivalence to closer monetary ties and fears over loss of influence should London's stature diminish, Lamont highlighted the UK's retention, together with Denmark, of an opt-out clause on a single EU currency by 1997 or 1999. Lamont, however, quixotically reaffirmed his belief London would be an excellent permanent location for the European Monetary Institute (the ECB's predecessor), basing his claim on London's pre-eminence as a financial centre, glossing over Britain's negative views on monetary union. Norman Lamont, "Interview with the Chancellor," *Financial Times*, 31 December 1991.

[60] The Bank's interest came as a consequence of a 1990 House of Lords decision invalidating hundreds of millions of pounds of interest rate and currency swap contracts between London-based banks and local UK authorities, mutual insurance companies and building societies. The Lords ruled the transactions illegal, as the banks' counterparties did not have authority under English law to enter into the transactions. The ruling threatened millions of pounds in losses, heightened uncertainty over the validity of English law contracts, the principal legal standard of the Euromarkets, and discouraged transactions with UK entities.

[61] ISRR. "London Attracts Most Foreign Equities Trading BoE Says," 17 June 1991.

[62] For studies cited see: Peston, "The Challenge to the City from Continental Centres Is Intensifying."

lawyer-dominated US. Additionally, subsequent development of the SBD, ISD and CAD encouraged comparisons with FSA 1986. UK regulators were keenly aware of the additional costs and complexity imposed by FSA 1986 and of the potential political cost of amendment in reaction to EU directives. Also in 1991, the SIB released the "Clucas Report," which further criticised London's regulatory regime.[63]

FSA 1986 had four significant, though conflicting, consequences: first, City regulation was juridified, ending informal regulation based on Bank "guidance." This increased the state's role in City regulation. Second, and conversely, the creation of SROs increased private sector input into discussion of operational and regulatory issues, even while potentially diluting private input with the creation of the SIB. Third, the Big Bang reconfirmed London's progressive regulatory and institutional environment, particularly in comparison with its continental peers. Fourth however, the Big Bang exposed British regulatory and institutional sensitivities and vulnerabilities. These consequences highlight an expansion in domestic regulatory authority that did not, however, unambiguously enhance Britain's international regulatory influence.

Scandals

A series of bungled domestic regulatory investigations in London's markets between 1987 and 1989 raised further concerns with the UK regulatory regime, damaging UK international influence. The County Nat West/Blue Arrow affair was the most notable.[64] Delays in investigating the scandal raised questions about FSA 1986's ability to balance statutory enforcement and self-regulation. Additional scandals included a 1987 Guinness PLC stock manipulation scandal[65] and the 1988 collapse of Barlow

[63] This report advocated merging two SROs (LAUTRO and FIMBRA) and consolidating Britain's retail financial services regulatory apparatus. Following consolidation, IMRO and SFA (the SFA was successor to the SIB) would look after institutional investors' interests and a new organisation would supervise retail activities. These recommendations came in part in response to the collapse of the London-headquartered bank BCCI, but also in response to the scandal surrounding Robert Maxwell's misuse of company pension assets. A House of Commons Social Security Committee report on the Maxwell affair had been heavily critical of IMRO. ISRR, "IMRO Take a 'Thumping' over Maxwell Scandal," 21 April 1992. See also: Dan Granirer, "A Modern Great Power Concert: New York, Tokyo, London and the Political Economy of Transnational Regulatory Cooperation" (Ph.D. dissertation, Princeton University, 1994).
[64] Competitive pressures had encouraged County Nat West, the securities subsidiary of National Westminster Bank, one of Britain's largest banks, to bid aggressively to underwrite Blue Arrow's rights offering (see Glossary) and, subsequently, to fail to disclose their unsuccessful placement with investors. Embarrassingly, the affair was brought to light by a non-UK bank.
[65] The scandal did not come to trial for over two years.

Clowes.[66] These events occurred at a time when UK regulators were increasingly concerned that their opinions be given precedence in the EU's early regulatory negotiations.[67]

Domestic financial scandals were not unique to the UK. Both France and Germany had their share during the same period. However, the scandals weakened the position of the UK by raising questions about the precedential value of the UK regulatory system and about the UK's regulatory authority.

The scandals highlighted the diversification of UK banks into securities underwriting and the increasing involvement of non-UK banks in critical areas of the UK's financial system. The participation of commercial banks in securities underwriting had grown dramatically since 1986, exposing banks to greater, and different, risks from those previously regulated. The incidents focused attention on the failure of the new regulatory regime to anticipate or prevent financial scandals. Even the Bank had misgivings about London's regulatory environment. Brian Quinn, the Bank's Executive Director for supervision, publicly noted the difficulty of obtaining cooperation between various UK regulatory bodies and of establishing a level regulatory playing field between the lending and securities activities of financial institutions. He also commented that the UK's specialised regulatory regimes appeared incompatible with regulation adopted in continental Europe to fit dominant universal-banking regimes.[68]

Competitive regulatory trends

The Bank's 1991 study also highlighted worrisome international competitive trends. These included contemporaneous market deregulatory actions in the United States,[69] Japan,[70] France[71] and Germany,[72] which could potentially dilute London's

---

[66] Barlow Clowes, an investment management company, continued to operate despite the DTI being aware of concerns about the firm beginning in 1985 David Manasian and Craig Forman, "Confusion, Duplication Hamper British Market-Regulation Effort," *The Wall Street Journal*, 5 January 1989. and "County Natwest: Anatomy of Cover-Up," *The Economist*, 28 January 1989.

[67] Confidential interview, London, February 2001

[68] Lascelles, "Order in the Marketplace - the Blue Arrow Affair Brought Credit to the Bank of England."

[69] In the US, liberalisation of the Glass-Steagall Act, which mandated the institutional separation of lending and underwriting, was being actively debated.

[70] In Japan, reform of Article 65, Japan's Glass-Steagall Act, was under review. The reform of either Glass-Steagall or Article 65 could encourage a series of mergers between powerful commercial and investment banking institutions, challenging European financial institutions and, potentially, prompting the migration of European lending and trading businesses to US or Japanese markets.

presumptive regulatory influence. These trends reflected states' re-examination of uncompetitive domestic practices in light of disintermediation,[73] which prompted financial institutions across Europe to focus on securities issuance, profitability and operational consolidation – uncharacteristic concerns in "domestic" industries that had, until recently, not been subject to external competitive pressures.[74] The Bank concluded that these structural changes challenged Britain's financial leadership and authority in negotiating the CAD and ISD.

A fall 1991 survey conducted by the London Chamber of Commerce fuelled these concerns. A poll of 109 foreign banks with London operations indicated that continental European cities were more likely than London to attract new financial services businesses – and possibly exert greater regulatory influence – as a result of their geographic proximity to the newly opened East European markets. Additionally, the report noted that EU efforts to harmonise regional financial services regulation might neutralise London's regulatory authority. London's liberal, market-driven regulatory regime had attracted foreign bank operations and encouraged Euromarket growth. Removing London's regulatory "advantage" through harmonisation could weaken Britain's regulatory influence.[75]

Constraints on regulatory authority

In any attempt to assess authority, a critical consideration is determining whether member-states successfully asserted regulatory preferences. The course of EU negotiations indicates that no state's preferences dominated even though interviews indicate British regulatory "opinions" were given greater weight. British institutional structures and market experience contributed to the final form of the directives. However, a persuasive case cannot be made that these factors alone – or even predominantly – determined the directives' final form or its adoption. London's international authority was challenged by developments in other EU markets as well as

---

[71] In France, the 1989 removal of fixed commission rates threatened a repatriation of French equity business transacted in London. See below.
[72] In Germany, the 1992 process and reunification costs were expected to bring competitive pressure for change in German banks' operations. See below.
[73] See Chapter 2.
[74] Richard Lambert, "The City Finds Its Head Start under Attack: A Far-Reaching Study of London's Prospects as a World Centre," *Financial Times*, 1 June 1989.
[75] Peston, "The Challenge to the City from Continental Centres Is Intensifying."

by disagreements among domestic UK regulators, domestic market scandals, political considerations, and by complications arising from implementation of the FSA 1986.

Summary - UK

London's regulatory institutions were critical to the growth of the Euromarkets, to the UK economy, and to UK international regulatory influence. They also represented a potentially successful model for the EU. In 1986, over private sector opposition, the British government dramatically amended market regulation, asserting a pre-eminent status in domestic regulatory development. The UK's potential regional regulatory hegemony was prompted by several additional factors; London's consistent international market stature and institutional expertise, aggressive state promotion of the UK's potential regional leadership role and its regulatory views, the presence of Britons in senior EU decision-making positions, the UK's relative success in dealing with late 1980s market crises. Nevertheless, financial scandals, Tory ambivalence over the City, increasing international competition, and domestic political disagreements undercut the UK's international regulatory influence. The British government did preserve its autonomy and regulatory sovereignty throughout the EU negotiations. Additionally, in the early stages of negotiations they managed the mobilisation of sub-national interests.

Germany

During the period in which the CAD and ISD were negotiated, market globalisation, reunification pressures, and competition between Federal and *Land*[76] interests influenced German regulatory objectives. In addition, the prospect of increased competition for traditional domestic financial services cartels forecast significant change in the structure of German banking. These developments reflected predominantly external events, not federal or state initiatives. Traditional federal and *Land* regulatory preferences were shaped by Germany's economic and political history and the critical role of banks in financing the government. However, Germany's reaction to globalisation and reunification reflected more recent changes: a abrupt need to attract savings after reunification and a desire to shield long-standing bank and corporate relationships from rapidly intensified competition brought about by EU regionalisation. Germany's role in the development of EU financial services directives reflected a tension between

[76] *Land* is translated as a federal "state."

preserving a distinctive form of "German" capitalism, characterised by concentrated corporate ownership and conservative business practices, and, on the other hand, the challenges of globalisation, reunification and EU expansion.

German bank history[77]

Despite poorly developed domestic securities markets, Germany's financial services industry was highly differentiated and competitive. It was comprised of universal banks,[78] regional *Land* banks,[79] savings and Giro banks, and credit cooperatives. This complexity meant that bank market shares were small relative to total bank revenues and that domestic competition for deposits and lending opportunities was intense. Bank trade associations and individual banks were thus encouraged to develop close relationships with state and federal constituencies responsible for allocating bank business. Reinforcing this emphasis was the traditionally close relationship between German banks, industry and government expressed through cross-share ownership and directorships and the exemption of German banks from competition laws. The government encouraged close relationships between banks and industry because bank capital was critical in underwriting government borrowing. This relationship discouraged the development of domestic, particularly retail, securities markets.

The German form of "capitalism" derived from Germany's experiences with hyperinflation and economic depression prior to WWII and with the prominent involvement of the "big three" banks in rebuilding the domestic economy and banking system, through lending, after 1945.[80] German domestic banking regulation dated from the 1930s and focused on bank safety and soundness, not on riskier securities-related businesses or investor protection.[81] With an emphasis on lending, Germany's regulatory focus also emphasised credit, rather than market, related risks. Portfolio credit quality and high institutional capitalisation were more important than asset liquidity or hedging to regulators conditioned by the experiences of the 1930s and 1940s. These

[77] Adapted from Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*. See pp. 166ff.

[78] The "Big Three" universal banks were (and remain) Deutsche Bank, Dresdner Bank and Commerz Bank.

[79] Including, *inter alia*, Bayerische Landesbank and WestDeutsche Landesbank

[80] Alfred Steinherr and Christian Huveneers, "Universal Banking in the Integrated European Marketplace" in *The New European Financial Marketplace*, ed. Alfred Steinherr (London: Longman Group, 1992).

[81] Michael Moran, "Regulatory Change in German Financial Markets," in *The Politics of German Regulation*, ed. Kenneth Dyson (Aldershot: Dartmouth, 1992).

characteristics were accompanied by Germany's active discouragement of foreign bank entry into its domestic markets.[82]

The German regulatory system set high minimum required capital levels for banks involved in securities or lending. This satisfied German regulators' prudential objectives and resulted in a high cost of domestic market entry.[83] German banks, which would had benefited from lower capital requirements for their international securities activities, were more focused on protecting their lucrative domestic market positions than with expanding into new businesses - securities trading - with which they were still largely unfamiliar and for which there was little domestic demand.[84] German regulators recognised that their conservative capitalisation policies would not be supported by other member-states. They also prioritised the insulation of domestic markets and market relationships from a dramatic increase in external competition. Having achieved a primary objective through the adoption of the SBD (single passport), German negotiators developed a negotiating strategy based on ensuring their institutions would face a level regulatory playing field.

This position contrasted with the situation in the UK and France, where domestic regulatory precedents reflected functionally distinct market sectors. It also contrasted with the international business perspectives of UK and French financial institutions. These basic differences also characterised negotiations over the CAD and ISD, particularly when initial CAD discussions sought to develop less onerous rules for securities firms than existed for banks under the SBD. German arguments reflected their conservative regulatory approach and their concern that a single passport and more flexible securities regulation might harm their domestic banks. German negotiators initially attempted to promote German capital standards regionally in order to insulate domestic markets. Facing stiff opposition, competitive pressure, and concern over the financing and regional implications of reunification, Germany subsequently backtracked and negotiated to ensure that functional regulatory equivalence existed between securities firms, banks and universal banks.

[82] This was achieved primarily by restricting the scope of bank activities available to non-German financial institutions.
[83] Richard Waters, "EC Amends Proposals for Capital Adequacy," *Financial Times*, 16 November 1989.
[84] See related discussion in Chapter 5 addressing EU structural analytical hypotheses.

Germany's regulatory structure

Germany's financial services regulatory regime mirrored the structure of its domestic markets. As in other universal banking countries, there was effectively no distinction between banks and securities firms and, as noted, German domestic capital markets were poorly developed. Corporate capitalisation relied on internally generated funds and bank borrowing rather than equity. German corporate entities, unlike their British counterparts, were uncomfortable with public ownership and the scrutiny and pressure that shareholders imposed on boards and corporate managers. This meant the infrastructure associated with a capital markets industry was also poorly developed – the issuers, underwriters, investors, regulations, and related industries. Not surprisingly, German financial services, dominated by universal banks and reflecting poorly developed capital markets, produced a domestic regulatory environment with a lending orientation. Commercially, unlike the UK or US, Germany was a nation of industries and industrialists rather than shareholders.[85] German stock exchanges were small, equities, both retail and institutional, were unpopular investments, and domestic securities markets were thin and illiquid.

The German Banking Act (*Kreditwesengesetz*) stipulated that securities-related activities were considered banking businesses. This meant that securities businesses required banking licenses from the Federal Banking Supervisory Authority, which further discouraged the development of independent securities firms. Unlike the UK and France, Germany had no comprehensive body of national securities law prior to 1993. There were no explicit rules for the offering and sale of DM-denominated debt securities. Rules protecting investors were limited; rules addressing insider trading did not exist.[86] Domestic securities activities were transacted through small regional bourses.

To encourage domestic regulatory preference harmonisation, regional exchanges established the *Arbeitsgemeinschaft der Deutschen Wertpapierbörsen*[87] in 1986. The

[85] Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*, p. 174.
[86] Robert J. Dilworth, "Germany," *University of Pennsylvania Journal of International Business Law* 13, no. 4 (1993).
[87] Translated as Federation of German Stock Exchanges.

Federation represented bourse interests and was a full IOSCO member.[88] Its initial approach to market regulation was to focus on procedural issues and encourage self-regulation. This was in sharp contrast to the UK's FSA 1986.[89] The Federation's approach also reflected an explicit emphasis on supporting the country's economic and political policy objectives. Generally accommodative rather than confrontational, Germany's regulatory stance prioritised the protection of universal banking and existing domestic regulatory interests from external and internal competition.[90] This stance was challenged by EU financial services directives that increased regional competition for the big German banks, which, at the time, had less than 4 percent of the EU's deposit market. This development, coupled with reunification funding pressures, led Germany, in 1989, to initiate defensive steps designed to grow its domestic capital markets and its regulatory infrastructure in order to compete more effectively with regional financial centres.[91]

Prior to 1990, Germany had no principal securities market regulator or federal securities supervisor. Regulatory supervision was the responsibility of either the *Bundesbank*[92] or the eight regional stock exchanges, which were supervised by individual *Länder*. The Frankfurt exchange was the largest, representing 50% of domestic equity trading turnover. Individual *Länder* were very protective of their exchanges, which led to frequent commercial and political conflicts when proposals for centralisation of securities trading in Frankfurt increased in the context of modernising German capital markets. These conflicts were exacerbated by regional bourses being subject to both local and federal laws.

Reunification encourages regulatory and strategic change

The *Bundesbank's* ambivalence toward its domestic securities markets was already evident in the mid-1980s. Unlike French regulators and despite Deutsche Bank's relocation of its investment banking headquarters from Frankfurt to London in 1984, the *Bundesbank* ignored the significance of the migration of domestic securities trading to

---

[88] This was an unusual arrangement contrary to IOSCO's practice of extending full membership exclusively to "national" securities regulators. However, in Germany's case, no national regulator existed until the early 1990s.

[89] Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics.*

[90] Ibid.

[91] This program was eventually referred to as *"Finanzplatz Deutschland,"* see below.

[92] The German central bank.

London. After reunification in 1989, regulators became more sensitive to Germany's international capital markets' lagging competitiveness. While Germany had the largest European government bond market, 60% was traded offshore among London-based banks. This anomalous situation arose for two reasons. First, a strong domestic currency, the result of domestic trade surpluses throughout the 1980s, made German government bonds attractive to international investors. Second, lower London transaction costs made "*Bunds*"[93] cheaper in the UK than in Germany. The *Bundesbank* was largely indifferent to this situation, as it had no mandate to develop domestic securities markets, had not encouraged the development of domestic futures or short-term securities ("CP" and "repo")[94] markets, and did not have national concerns about losing control over its government debt. Germany's strong currency and economic performance encouraged this ambivalence. Because of its huge U.S. Treasuries portfolio, the *Bundesbank* was *de facto* an influential investor and market maker internationally, irrespective of the status of its domestic securities markets. Private and public sector investors and underwriters were careful not to trade or legislate overtly against German interests.[95]

However, in the early 1990s German domestic economic growth slowed, largely due to reunification costs and recession. The resulting lower domestic interest rates encouraged the relocation of Germany's huge pool of domestic savings to higher interest rate environments outside of Germany.[96] This promoted the migration of German banks into neighbouring markets and led them into new businesses, including international lending and securities underwriting and trading, particularly in London.[97] The focus of German banking was reoriented from domestic to international, producing dramatic increases in both on and off-balance sheet international assets.

The expansion of German banking was accompanied domestically by the centralisation of regulatory powers and a greater focus by banks and regulators on the consequences of Single Market regulation. Domestic bank operations converged to a

---

[93] German government bonds.

[94] Agreements to repurchase securities – a borrowing/funding technique. See Glossary.

[95] A 1985 project to develop a futures contract in German Bunds on London's Liffe was abandoned after the *Bundesbank* objected that the market belonged in Germany.

[96] See discussion below regarding competition between Germany and France for deposits.

[97] German banks, particularly the big three universal banks, had, of course, been active in syndicated lending and securities businesses in London and domestically prior to 1989. However, despite their large asset and capital bases, they had been second tier actors in London's competitive, and lucrative, securities underwriting, trading and derivatives businesses.

universal bank model. However, German "mercantilism" conflicted with EU directives affecting competition law. The 1988 adoption of the SBD, which endorsed the universal bank model, had simultaneously exposed domestic markets to increased competition, and regulatory standards to the vagaries of qualified majority voting. This compelled German banks to defend their extensive industrial shareholdings and pressured Bonn to oppose EU insider-trading regulatory proposals.[98] These factors heightened regulators' awareness of the need for domestic market reforms.

Germany had three primary motivations for reform. First, reunification imperatives superseded domestic efforts to oppose EU regulatory harmonisation. The German financial system was forced to re-examine its antiquated capital-raising infrastructure to meet this new challenge.

Second, German banks' historic emphasis on long-term lending, close corporate relationships and confidential cross-shareholdings had been penalised by the Basle Accord.[99] High capital ratios characterised Germany's regulatory approach. However, increasing disintermediation had tightened lending margins, directing interest to funding through securities underwriting. But underwriting was a weak area of German banking. Typically, German companies raised only 20 percent of their capital through equities, as compared with 80 percent for British companies.[100]

Third, the strong DM had become a key European and international currency. Over 20 percent of the world's foreign exchange reserves were held in DM; it was the second most important international lending currency (after the US dollar); and it was the key currency in the EMS. In addition, Germany contributed 28 percent of the EU budget and had the largest EU population and economy. Not surprisingly, Chancellor Helmut Kohl considered it appropriate for Germany to exert its authority regionally. To achieve his objectives, Kohl needed to enhance German regulatory influence. This meant reforming domestic capital markets. His ambitions were most obvious in German

---

[98] See: Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, p. 172, fn. 23 and Joseph McCahery, "Market Regulation and Particularistic Interests: The Dynamics of Insider Trading Regulation in the US and Europe," in *The New World Order in International Finance*, ed. Geoffrey R. D. Underhill (London: Macmillan Press Ltd., 1997).
[99] The Accord required the maintenance of large capital positions against German bank's enormous and (relatively) illiquid equity positions.
[100] Ian Johnson, "Frankfurt Fights to Be Europe's Wall St.," *The Baltimore Sun*, 5/31/92.

lobbying for the ECB and in pressing for domestic stock market reform to encourage a reverse migration in German equity trading from London.[101]

Reunification and market modernisation

Reunification significantly increased the pool of German savings available for domestic investment.[102] The increase stimulated a search for domestic and international investment options and encouraged the expansion of domestic capital market instruments. Germany's DTB and OTC markets also experienced rapid growth.[103] This was paralleled by growth in Germany's longer-term domestic capital markets and by expanded international usage of Euro-DM instruments. In the early 1990s, the opening of German offices by several prominent international securities firms reinforced the importance of German capital markets.[104]

These factors boosted the attractiveness of DM financing and of German markets and institutions, but they were a mixed blessing in promoting German interests in negotiations over financial services directives. As happened in the UK, domestic market reform had positive and negative consequences. One goal of reform (ultimately unsuccessful) was to make German regulatory preferences more influential. However, reform did highlight Germany's market and regulatory shortcomings. Domestic market expansion increased international scrutiny of Germany's regulatory environment. Over the summer of 1991, a domestic bond underwriting scandal at Germany's largest banks, the Deutsche and the Dresdner, underscored the rudimentary state of insider trading regulations. Further, regulation of Germany's regional exchanges by their respective *Länder* had complicated the development of uniform securities regulation and enforcement. This had already been made difficult by the lack of a central federal regulatory authority and by the historic tension between Federal and *Land* governments.[105]

[101] SEAQ-I handled up to 30 percent of German companies' equity trades. See: B. von Ribbentrop, "Frankfurt Throws Down the Gauntlet," *Euromoney*, October 1990.
[102] An incremental DM115 billion from the former East Germany.
[103] This occurred principally in derivatives and was accompanied by the introduction of new, innovative products. See Glossary.
[104] Including Goldman, Sachs, the large US-based securities firm.
[105] Katherine Campbell, "Roles Are Reversed for City of Bankers," *Financial Times*, 28 October 1991.

The decision to modernise German domestic capital markets actually began in 1984 with the removal of restrictions on the composition of domestic bond underwriting groups.[106] The 1986 creation of the Federation of German Stock Exchanges was designed to stimulate the use of equities in corporate financing. However, centralisation of securities trading, especially trading computerisation, consistently ran into *Länder* objections. This was typified by the contested passage of a 1988 law to create a DM futures market (see below) and of a 1989 law to promote financial markets, both of which adopted EU financial services directives previously passed by the Council and Parliament. Over *Länder* opposition, the laws rescinded a domestic turnover tax that had restricted the development of new capital market instruments. Also in 1989, Germany adopted the EU unit trust directive, UCITS, which helped direct funds into the new domestic futures market, the DTB.[107]

In January 1990, Germany opened a new, high-tech, futures and options trading system in Frankfurt, the *Deutsche Termin Börse* ("DTB"), to compete directly with the long-established London-headquartered Liffe. The French had also opened a competitor to Liffe and the DTB, the *Marché à Terme Internationale de France* ("MATIF"). The new exchanges were designed to help Frankfurt and Paris catch up with London in developing innovative financial instruments and in attracting new trading activity. The DTB's development of a contract for German government securities futures was designed to challenge Liffe's dominance in internationally traded futures contracts. The DTB was also the first electronic futures market to compete against a traditional open-outcry system such as Liffe's. The DTB and MATIF challenged Liffe's dominance in futures trading in DM and French franc denominated instruments and were seen as indicators of Frankfurt and Paris' increasing market influence.[108]

Reunification made the *Bundesbank's* historic distrust of money markets obsolete, paving the way for a package of financial services measures presented by Finance Minister Theo Waigel in January 1992. These reforms reflected the big banks' support for a central Frankfurt exchange competitive with London and Paris and

---

[106] Non-German banks were permitted to lead domestic DM offerings.
[107] See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, p. 180.
[108] Katharine Campbell and Deborah Hargreaves, "Frankfurt Fights to Regain Bunds: A Liffe Contract under Fire," *Financial Times*, 26 November 1990.

incorporated further EU directives. They also demonstrated political support for new technology, national supervision of securities markets,[109] investor protection and insider trading laws, as well as money market reform. Chancellor Kohl threw his considerable weight behind these proposals and added a promise that Frankfurt would be the location of the new EU central bank. Negotiations over the reforms between Federal and *Land* authorities took two years, although the 1992 adoption of the ISD compelled many reforms.

Domestic business migration to London and Paris, pressure from the Federation of German Stock Exchanges, the adoption of EU directives and anticipated governmental capital needs following reunification forced German regulators to take steps to incrementally modernise Germany's domestic market infrastructure. These changes were accompanied by reform of insider trading rules following pressure from the US and other EU member-states. However, these changes did not represent a German "Big Bang" as significant domestic obstacles to regulatory reform persisted, including *Länder* opposition to exchange consolidation and bank interest group opposition to deregulation. As a result, reform came about reactively rather than proactively and in response to reunification and external competitive pressures.[110] In particular, there was little domestic support for Anglo-American style financial services deregulation.[111]

Finanzplatz Deutschland

Helmut Kohl and Theo Waigel's *Finanzplatz Deutschland* plan, announced in January 1992, defined German domestic market development preferences.[112] Kohl's objective was the creation of a domestic financing and regulatory environment that would effectively compete with London's. His announcement acknowledged that the quality of domestic regulation bore a direct correspondence to the efficacy and attractiveness of domestic capital markets and to national standing and authority in negotiations over EU regulation and institutions – a conclusion that London had also reached. Prior to Kohl's announcement, international securities firms assumed that EU

[109] The *Bundesaufsichtsamt für Wertpapier*, Germany's first securities regulator, was created.
[110] Moran, "Regulatory Change in German Financial Markets."
[111] Stephen Woolcock, Michael Hodges, and Kristin Schreiber, *Britain, Germany, and 1992* (New York: Council on Foreign Relations, 1991).
[112] Garry Evans, "Bundesbank Clings to Power," *Euromoney*, April 1992. Dating the start of the *Finanzplatz Deutschland* programme is difficult as it encompassed a series of regulatory, structural and legislative changes commencing in the early 1980s. See: Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*, p. 172ff.

securities regulation would generally follow London precedents. However, German reunification encouraged Kohl to expand Germany's modest program of market liberalisation, with more extensive market deregulation and new product introductions, all designed to make Frankfurt a more attractive and influential financial capital.[113] International bankers were forced to consider the possibility that Frankfurt would replace London and come to dominate EU capital market activity.[114]

In January 1992, the Frankfurt Stock Exchange announced another step to enhance Frankfurt's stature and international authority. The exchange, Germany's largest, declared it was considering a proposal for a fully electronic trading system (as opposed to a floor-based, open-outcry system) to be in place by 1995. Such a step would transform Germany's markets by consolidating into one exchange the trading that had been transacted through four separate systems.[115] This would stimulate the centralisation of securities trading in Frankfurt.[116]

Summary - Germany

Historic ties between Germany's banking, corporate and government sectors shaped German regulatory preferences and its regional authority and influence. The preservation of national business practices and control over national industries shaped the reform of German capital market practices, institutions and regulations.[117] The modernisation of domestic markets and institutions, the facilitation of reunification, the assertion of domestic regulatory preferences outside Germany and response to globalisation were all subordinate to the preservation of national business practices.[118]

---

[113] Andrew McCathie, "Germany Moves to Bring Financial Markets into Line," *Australian Financial Review*, 2/19/92.

[114] This was, of course, unlikely as London had well-established regulatory, language, infrastructure, technological, market, personnel and institutional advantages over Frankfurt that would take years to duplicate or surpass.

[115] At the time, Frankfurt carried more than 50 percent of trading executed over Germany's eight regional stock exchanges.

[116]The move reflected an expansion of Frankfurt's IBIS screen-based trading system, which had grown significantly following its introduction in April 1990. IBIS' success contrasted sharply with London's experience with the introduction of TAURUS, a similar paperless settlement system. TAURUS had been plagued with repeated implementation delays, acutely embarrassing the London Stock Exchange. See: David Waller, "Frankfurt Considers Electronic Trading," *Financial Times*, 18 January 1992. and ISRR, "Another Delay Hits Taurus; Launch Set for Spring 1993," 5 November 1991.

[117] Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*. p. 185.

[118] The opening of the DTB in Germany confirms state ambivalence (if not hostility) to efforts to develop harmonised regional regulatory regimes and capital markets. Accommodation of divergent national interests characterised the EU's approach to resolving regional debates. Nevertheless, as EU negotiators

Historic German concern with potential market threats to domestic political stability limited the extent to which national regulators or legislators were prepared to embrace domestic or EU regulatory reforms. However, German regulators recognised that they would not be successful in persuading other EU member-states to adopt German capitalisation preferences. As a result, they shifted their objective to securing a level playing field for German financial institutions, which would require a minimum of change to existing domestic regulatory norms and domestic franchises. German international influence arose largely indirectly, through QMV and their insistence on safeguarding domestic regulatory norms. Their success can also be traced to Germany's institutional emphasis on universal banking and lending, which was reflected in consistent state, corporate and bank regulatory preferences, and to European concerns with German *revanchisme*. Public and private preferences are impossible to untangle.

The absence of either a federal securities supervisor or a coherent securities regulatory regime placed regulatory evolution predominantly in the hands of like-thinking state and bank interests. As CAD and ISD negotiations evolved, competition between member-states' domestic market preferences complicated regulatory harmonisation, illuminating the need to balance the authority of member-states. This explains the inability of Germany (and other EU member-states) to comprehensively assert their domestic preferences on other states. Reacting to these constraints, German negotiators pursued a level playing-field policy, insulating German domestic practices and institutions, and preserving German mercantilist interests. Consequently, no broad shift in German regulatory authority away from the state is evident from these developments.

---

laboured to accommodate disparate national preferences, member-states (including France through the MATIF, the UK through the Liffe and Germany through the DTB) pursued strategies designed to frustrate EU objectives. Despite agreed harmonisation objectives, the DTB's creation reflected an effort to redirect to German domestic markets business transacted in London and Paris. The aggressive promotion of national markets conflicted with EU harmonisation objectives. Moreover, it reflected the conflicting influences of powerful domestic constituencies, regional ambitions and member-states' desire to assert their interests. Member-states adopted regulatory reforms designed to preserve or enhance national trading practices, regulatory regimes and markets while, simultaneously, aggressively negotiating harmonised regional regulations.

France

Regulatory authority in France was centralised in state agencies and institutions in Paris. Members of an elite cartel sharing common educational and social backgrounds typically headed government agencies and major commercial enterprises. This encouraged the government to promote state involvement in domestic economic development with the result that *dirigisme*[119] characterised the relationship of the state with commerce. However, globalisation and increasing EU regionalisation challenged the statist French model, highlighting domestic capital market parochialism and flawed state-sponsored corporate and economic strategies. These weaknesses strained commercial and political loyalties, encouraging independent private sector initiatives and strengthening the influence of the French private sector in certain areas, principally through the *Patronat* and ERT.[120]

The Structure of Authority

After WW II, the dominant concept guiding the development of French financial services regulation, domestic capital market development and EU regulatory perspectives was central state authority; state authority alone was deemed capable of productively and beneficially transforming "short-term savings into long-term investments."[121] This model generated two critical objectives for post-war French regulatory development. First, state administrators attempted to position Paris as a financial centre capable of competing with London and Frankfurt. Second, the state worked to create an optimal development and regulatory model that promoted its control over industrial production and growth.

Relationships between state agencies and corporations were very close, due in part to 1981 nationalisations of major industries, but also due to the common backgrounds of public and private sector executives. This was particularly prevalent in financial services where, for many executives, early training in the *Tresor* preceded

---

[119] Reflected in the frequent intervention of the state in commercial activity.
[120] See Glossary. The European Round Table ("ERT") is described in Chapter 6.
[121] See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, from which this section is adapted, and p. 190.

senior positions in government and the private sector. These factors further facilitated *dirigisme.*

Economic institutions and government strategy

State involvement in industrial production reached a high point in 1981 with the nationalisation of 49 industries by the new, socialist, Mitterrand government. Government objectives called for export-led economic growth and the development of large, state-owned industrial enterprises. These enterprises, and the government agencies providing industrial direction – principally the French *Tresor,* were staffed by graduates of the *Grandes Ecoles*, representing an elite policy network that shared common economic, social, and educational backgrounds. These individuals moved back and forth between government and commercial positions over the course of their careers, and they had dominated French industrial management and planning since the 1930s. In France after 1981 the public sector so completely controlled industrial organisation that the democratising aspects of globalisation, evident in London financial services, did not penetrate the elites already dominating French commercial and political activity. *Dirigisme* enhanced the authority of domestic policy networks, including networks such as the *Patronat*, which was populated by corporate leaders, many appointed by the state. *Dirigisme* also facilitated the entry of elite French networks into regional policy networks such as the ERT.[122]

The French "statist" model was disrupted in the late 1980s by EU-led regionalisation efforts. Inadequate public-sector strategic planning and weaknesses in state-owned enterprises were revealed by regionalisation. Wallace argues that in the early 1980s France endeavoured to dominate certain EU sectors politically and economically by expanding statist control over domestic economic policy into regional authority through EU programs promoted by French state interests.[123] Initially, France was successful; several major EU programs, including the SEA and the SEM, were inspired by predominantly French initiatives.[124] But, despite initial success, many of these initiatives faltered in the early 1990s. EU regionalisation revealed poor French public-sector planning and structural weaknesses in French state-owned industries. These weaknesses were exacerbated by economic recession in the early 1990s. The results were

[122] See below and Chapter 6 for discussion of the ERT and *Patronat.*
[123] William Wallace, ed., *The Dynamics of European Integration* (London: Pinter, 1990).
[124] This list also includes commercial initiatives including Esprit, Brite, Euram, Race, Eureka, Jessi, etc.

seen in the near collapse of the state-owned bank Crédit Lyonnais, in France's persistently uncompetitive industrial infrastructure, and in the necessity for massive German support of the French franc, all of which came to public attention in 1992. These factors highlight France's inability to assert regional authority consistently.[125]

Story and Walter trace the unimaginative French economic development plans of the 1980s and early 1990s to the insularity of French corporate and government interests and officials.[126] This narrowness of French economic and political thinking delayed constructive responses to market developments and encouraged a reactive rather than proactive stance toward domestic and regional regulatory evolution. The *dirigiste* business model failed in comparison with market-led regulatory developments in the UK and Germany, adversely affecting French regional regulatory authority.

Dirigisme *and state influence*

Schmidt explains weak French regional influence differently. As noted, the involvement of French government officials in the formation of EU policy was initially strong, particularly on macro issues. Schmidt argues, however, that changes brought about by increased EU integration weakened the traditionally strong ties between the French government and business, changing the character of French regional authority, particularly after 1985.[127] Despite its key role in promoting such EU strategic policies as the 1992 and monetary union objectives, France was less effective within the EU Commission. French ministers accused Leon Brittan's DG IV, the Competition Directorate, of an "Anglo-Saxon" bias hostile to large French industrial conglomerates. French corporate executives were also concerned with the Commission's apparent focus

---

[125] Following reunification, German interest rates rose to attract international savings into government debt instruments. In the late 1980s, as part of its "hard franc" policy - structured to discourage French savings from leaving the country for higher interest rate, or better exchange rate, environments - France had refused to allow Germany to revalue the DM. This resulted in intense competition for savings between French and German institutions, spurring an increase in short-term French interest rates. This shrank French banks' lending margins as 70 percent of bank lending was short-term. This forced several French banks, notably state-owned Crédit Lyonnais, close to bankruptcy. When President Mitterrand announced a June 1992 domestic referendum on the Maastricht Treaty, the *Bundesbank* (encouraged by Helmut Kohl) and the *Banque de France* massively intervened to support the franc. The Pound, of course, was not so fortunate. Kohl's support for the franc can be traced to his support for the Maastricht Treaty and his interest in French endorsement. Support for the British Pound was absent, owing largely to Thatcher's disparagement of closer British ties with the EU. See: Wallace, W., ed., ibid., and Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*

[126] Ibid.

[127] Vivien A. Schmidt, "Loosening the Ties That Bind: The Impact of European Integration on French Government and Its Relationship to Business," *Journal of Common Market Studies* 34, no. 2 (1996).

on competition policy rather than "creating the conditions for [industrial] development."[128] But Schmidt indicates that French accusations cannot be traced to any overt bias by DG IV.[129] Instead, the dilution of French authority is traced to the long-term failure of French government administrators to cultivate their EU counterparts and their failure to staff discretionary EU administrative positions with French nationals who shared the views of French government administrators.[130] The failure of French ministers to educate their international civil servants in EU policy and law further diluted French influence. Additionally, French government negotiators were unable to exploit either their early EU policy successes or their close ties to EU administrators. This hampered the promotion of French preferences, frustrating state and non-state actors and straining the historically close ties between the French government and business. In turn, this encouraged French private sector elites to develop independent relationships with the EU bureaucracy. Principally through the ERT, these relationships exploited their close contacts with influential EU ministers such as Davignon and Delors.[131] Eventually, the private sector in France carried greater authority in Brussels than did many French government officials for two reasons. They recognised the significance of cultivating relationships, and they appreciated the differences between the hierarchical French government bureaucracy and the consensus-driven Brussels administration.[132]

Contributing as well to the dilution of French regional authority was the state's refusal to recognise that concentration and transparency were not supported by major international trading markets, particularly the pace-setting Euromarkets, nor by the *Patronat*. They were instead contributing to the continuing migration of French equities trading to London.

French state cultivation of bureaucrats in Brussels finally increased in the early 1990s as French ministers and staffers spent more time working in Brussels on EU

[128] Ibid.
[129] Ibid., p. 230ff.
[130] J. De la Gueriviere, *Voyage a L'interieure De L'eurocratie* (Paris: Le Monde Editions, 1992)., in Schmidt
[131] C. Lequesne, *Paris-Bruxelles: Comment Se Fait La Politique Europeenne De La France* (Paris: Presses de la Fondation Politique Nationale des Sciences Politiques, 1993)., in Schmidt
[132] See Schmidt, "Loosening the Ties That Bind: The Impact of European Integration on French Government and Its Relationship to Business," *Journal of Common Market Studies* 34, no. 2 (1996).

matters and as they joined ministerial policy networks.[133] The French government also began encouraging French businesses to assert their commercial interests directly in Brussels – as UK firms had been doing for many years. They also began to educate domestic businesses, in a limited fashion, on the implications of the Single Market.

France's difficulty in asserting its authority within the EU derived from cultural factors as well. French administrators, raised in the hierarchical, autocratic, and argumentative style of French policy-making, were initially uncomfortable with the EU's consensus building approach to policy construction. In France, policy-making authority was concentrated at the top of organisations, whereas in the EU the lobbying of lower-level bureaucrats, particularly on technical issues, was critical to success. The longstanding relationships that facilitated access to high-level officials in France did not exist in the EU where technocrats were responsible for up to 80 percent of the final content of directives.[134]

Schmidt cites the EU's disallowed acquisition of de Haviland by Aerospatiale and Alena as an example of the gap between French and EU policy influencing practices.[135] French business and government officials perceived the EU's de Havilland decision as largely political, when in fact it was substantially technical. French lobbying had ignored critical technical concerns of EU officials. The proposal was the only EU merger refused between 1991-1994. This type of miscalculation did not characterise British relationships with the Commission.[136]

---

[133] C. Lequesne, *Paris-Bruxelles: Comment Se Fait La Politique Europeenne De La France* (Paris: Presses de la Fondation Politique Nationale des Sciences Politiques, 1993).
[134] See: M. Donnelley, "The Structure of the European Commission and the Policy Formation Process," in *Lobbying in the European Community*, ed. S. Mazey and J. Richardson (Oxford: Oxford University Press, 1993). and C. Grant, *Delors: Inside the House That Jacques Built* (London: Nicholas Brealey, 1994). cited in Schmidt, "Loosening the Ties That Bind: The Impact of European Integration on French Government and Its Relationship to Business".
[135] In the early 1990s, EU competition officials denied the acquisition of French aircraft manufacturer de Havilland by Aerospatiale and Alena. The French government complained that the decision was based on incomplete analysis. They argued that the EU had examined the consequences of merger approval, but not the equally important consequences of denial.
[136] Schmidt, "Loosening the Ties That Bind: The Impact of European Integration on French Government and Its Relationship to Business".

Crédit Lyonnais

The negative consequences of *dirigisme* were further demonstrated by the state's use of banks, especially the Crédit Lyonnais, as agents of industrial policy.[137] During the late 1980s and early 1990s, under the leadership of Mitterrand-ally Jacques-Yves Haberer, Crédit Lyonnais pursued a bold strategy, endorsed by the state, that was based on four objectives: rapid regional growth; regionalisation;[138] the development of so-called "comprehensive" corporate relationships;[139] and the maintenance of close ties with the French government as provider of capital and lender of last resort.[140] Initially, the strategy was successful, but weaknesses became evident in the early 1990s when, through poor lending decisions, the bank's capital deteriorated. Additionally, the government was accused of interfering with regional competition and the bank failed to anticipate the growth of securitisation.[141] After years of steady decline, the French government was forced to expensively bailout the bank in the late 1990s. The Crédit Lyonnais story exemplified the risks inherent in state-centred authority and strategy. Crédit Lyonnais' commercial strategy proved incapable of responding rapidly or effectively to changes in capital markets and bank lending risks.

French regulatory influence

The deleterious effect of *dirigisme* on French regional regulatory influence is evident in the development of French banking regulation and economic policy from the 1960s through the 1980s. In 1966, the Finance Ministry announced that domestic commercial and investment banks could compete on an equal footing. This created *de facto* universal banks, established formal reserve requirements for banks, helped diversify bank' corporate ownership and increased the availability of banking services to the general public. Further significant reform did not come, however, until the mid-1980s.

---

[137] *Dirigisme* did have some successes, particularly in the encouragement of regional commercial enterprises.

[138] Crédit Lyonnais pursued a strategy of competing directly with entrenched local financial institutions in European domestic markets. Its goal was, eventually, to be recognised as a "European," rather than simply French, institution.

[139] Typically involving commercial and investment banking services plus significant, controlling share ownership – "German-style" universal banking.

[140] Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*

[141] There was, of course, no "bright line" separating government and bank strategies. What is clear, is that government objectives "inspired" the bank's strategy.

France was adversely affected by the oil crises of 1972/73 and 1979. Balance of payments deterioration highlighted the country's economic reliance on state-subsidised exports.[142] Higher oil prices weakened the trade account and led to a dramatic decline in foreign currency receipts. Policies adopted following the 1981 accession of Mitterrand's Socialist government spurred a decline in national savings.[143] These events, together with French banks' reluctance to lend to nationalised industries, encouraged government deficit spending. In turn, this increased external debt[144] and led to a rapid decline in major industries and government funding difficulties.[145]

In 1983-84, the *Tresor* and *Banque de France* embarked on a series of financial system reforms designed to enhance regional and national capital markets. French securities markets lacked the liquidity and breadth of London's markets and were uncompetitive alternatives to bank funding. The reforms (a series of bank law changes) did result in the growth of domestic capital markets. However, initiatives were neither as proactive as London's FSA 1986, nor as defensive as Frankfurt's later efforts.[146] This set the stage for a clash over regulatory principles in the ISD and CAD negotiations.

France adopted the Banking Act in 1984. It adopted homogeneous regulations for financial institutions and concentrated bank supervision in the *Comité de la Réglementation Bancaire*.[147] The new law officially acknowledged universal banking. The new law's objective was also to increase funding resources available to the state and to promote Paris as an international financing centre. To do this, a centralised, comprehensive capital market was needed.

The new rules set up stringent capitalisation and financing rules for banks, increasing domestic competition. This intensified further when quantitative credit restrictions were discontinued in 1986. These developments stimulated banks to expand

[142] Mainly to Soviet-bloc and developing country markets.
[143] See Story and Walter, pp. 194ff. Mitterrand discontinued the Conservatives encouragement of savings.
[144] External debt rose from US$34 billion in 1979 to US$80 billion by 1984.
[145] A 1980s relaxation of capital controls had encouraged French cross-border corporate investment, causing a current account deficit. The government had responded by encouraging inward portfolio investment, leading, by the late 1980s, to a significantly higher percentage of foreign corporate ownership of French industrial assets than was the case in either the UK or Germany (as measured by national turnover and employment). See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, pp. 194 –195.
[146] Keith Dill Nunes, et. al., "French & SEC Securities Regulation: The Search for Transparency and Openness in Decision-making," *Vanderbilt Journal of Transnational Law* 26, no. 2 (May 1993).
[147] Headed by the Director of the *Tresor* and the central bank Governor.

into new and riskier businesses in search of revenues and profits, a move already underway in anticipation of 1992. These changes, combined with the 1986 opening of the MATIF, the Paris futures market, were designed to encourage the growth of domestic capital market instruments and trading. However, growth was constrained by government ownership of corporate assets and by a shortage of other investment assets.[148]

In 1991, Mitterrand began re-privatising state-owned enterprises. This further highlighted the lack of liquidity in Parisian capital markets.[149] This deficit, and the government's abysmal economic planning record, overshadowed domestic regulatory reforms and weakened France's ability to influence the structure of the ISD and CAD.

French securities regulation

France was the first European country to enact a legislative prohibition against insider trading and the first to develop a national securities commission. Despite these achievements, in the mid-1980s, securities trading in France remained a traditional guild monopoly, restricted to a narrow circle of brokers. The development of contemporary French securities regulation can be traced to a 1967 government decision to establish a domestic securities regulator, the *Commission des Opèrations de Bourse* ("COB"), responsible for oversight of domestic securities markets.[150] The COB stimulated the development of securities regulation, but the agency had limited powers and established only basic rules.

Between 1987 and 1989, France liberalised domestic securities regulation in response to long-term domestic economic decline, to London's Big Bang, and to its

[148] Principally so-called "funded pension assets." The government addressed this problem by transferring state funding powers to provincial authorities to encourage local support of regional business initiatives. This created other problems, however, by increasing credit problems. This compelled the *Tresor* to re-establish control over funding in 1988. At the same time, it consolidated regional bourses into the Paris bourse. See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, pp. 197-198. See: "France Presses Ahead with Liberalisation," *Financial Times*, September 26, 1991.

[149] The absence of a large pool of domestic assets, brought about by nationalisation policies, hindered the development of a domestic capital market that was competitive with Frankfurt and London. See: Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*

[150] The COB had regulatory authority for specified market functions, including information verification, investigations and enforcement. See: Cara Familet, "Improving Securities Regulations in the EC: The French Example," *North Carolina Journal of International Law and Commercial Regulation* 17 (1992).

desire to promote Paris as an international financial centre.[151] In 1988, private French stock brokerage firms were recast as *Sociétés de Bourse* and the Finance Ministry liberalised bourse cartel procedures. A 1989 law, "Security and Market Transparency," implemented an EU directive on insider trading. Also in 1989, the French legislature reorganised the COB, increasing its powers and independence. Reflecting its increased importance, the COB's budget quadrupled between 1985 and 1992 to US$17 million, and its staffing doubled to 210 employees.[152]

The reforms enabled domestic and foreign banks to purchase stakes in brokerage firms and encouraged the growth of the Paris-based French franc debt and equity markets.[153] France had more individual shareholders than any other European country[154] and, in the early 1990s, had the fastest growing government bond market.[155]

Securities reforms were based on three state objectives: the replacement of brokers by *Sociétés de Bourse*, which diversified securities trading; the continuation of centralised ("concentrated") trading, which ensured that trading took place on organised, supervised exchanges; and the creation of the transparency rule, which mandated immediate disclosure of all trade terms.[156] The transparency reforms were designed to assure small investors that their trading activities would be treated the same as those of larger institutional investors. The reforms may have reassured small investors, but they also limited market liquidity and encouraged institutional trading to move to London. Concentration and transparency were, of course, major points of contention in the CAD and ISD negotiations. The COB enforced these provisions.

---

[151] New laws stipulated that the COB remain responsible for investor protection, but a new governmental agency, the *Conseil des Bourses de Valeurs* ("CBV"), was established to maintain exchange discipline. The CBV developed rules regarding exchange functions and supervised compliance. In early 1987, an auction system for distributing domestic bonds was instituted, but the government allowed only one foreign firm to be admitted to full membership in the auction group, the US commercial bank Morgan Guaranty Trust Company of New York.

[152] Familet, "Improving Securities Regulations in the EC: The French Example." By way of comparison, the US SEC had 3,000 staff and a budget of over $170 million in the early 1990s.

[153] Which, based on 1991 market capitalisation, ranked as the fourth largest in the world, trailing only Tokyo, London and New York.

[154] Nunes, "French & SEC Securities Regulation: The Search for Transparency and Openness in Decision-making".

[155] Gilbert Durieux, Michel Serieyssol, and Patrick Stephan, *French Financial Markets* (Cambridge: Woodhead Publishing, 1995).

[156] See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*, pp. 215-216.

French market reforms reflected government objectives: reversing long-term declines in French industry by increasing the availability of capital and boosting French influence in international markets. France's delay in industrial restructuring until the mid-1980s had caused French industrial growth to lag seven percentage points behind the EU's 1980's national average.[157] Industrial employment had decreased, and economic reliance on a few large industrial concerns with government ties had increased. In 1986, for the first time in France, imports of manufactured goods exceeded exports. These trends underscored the shrinking international competitiveness and influence of the French commercial sector.[158]

The COB's mandate was to regulate and expand French securities markets and to represent France in international regulatory negotiations. Despite different mandates, the COB and CBV overlapped functionally. This resulted in a general ambiguity over the allocation of domestic regulatory authority. A French newspaper noted, "In France, unlike in foreign systems, there exists no hierarchy that defines the powers of the agencies responsible for regulating the financial markets."[159] Of course, real authority lay with the *Tresor* and the central bank.

French emphasis on governmental control of market evolution resulted in little responsibility being given to SROs or provision being made for market feedback on regulatory evolution. The small role of SROs limited market feedback to unofficial vehicles such as the *Patronat*. The French Stockbrokers Association (*La Société des Bourses Françaises* or SBF) included all French securities brokers, but their role in regulatory evolution was very limited.[160] This contrasted with more consistent SRO and private actor participation in market and regulatory evolution in the UK and Germany.

In France, as in Germany, capital market growth objectives reflected, in part, a desire to hinder the internationalisation of government bond trading. French regulators wanted government debt traded domestically. There were two reasons behind this: first, to enhance domestic capital market expertise and depth, and second, to keep government

[157] The first French bank de-nationalised was Société Génerale in 1986. See Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems.*
[158] Richard L. Holman, "The Decline of French Industry," *Wall Street Journal*, August 23, 1991.
[159] *Le Monde*, February 25, 1992, cited in Nunes, "French & SEC Securities Regulation: The Search for Transparency and Openness in Decision-making."
[160] It was confined to examining listing applications.

debt under domestic control.[161] Only 5% of French government debt was held abroad (versus over 30% for Germany), but over 30% of French equity turnover was executed through SEAQ-I. To stimulate domestic markets, regulators encouraged securities underwriting by French banks, the development of French franc financial futures, and the standardisation of domestic securities issuance procedures. French regulators even went so far as to institute international promotional "road shows" in the early 1990s to increase the appeal of French government bond markets to international investors. However, the absence of investment assets continued to inhibit the development of a domestic capital market. Funded pension plans, a typical investment pool, were unavailable in France until 1993, when the Conservative government's privatisation program facilitated their development.[162]

Summary - France

Concentrated public sector domestic policy-making – *dirigisme* – resulted in a series of unsuccessful economic and commercial policies over a 25 year period. Mitterrand's 1991 capitulation on re-privatisation finally acknowledged the failure of *dirigisme*. This history constrained the state's ability to influence EU policy-making processes. The state's insularity and ineffective relationships with EU bureaucrats, encouraged private sector initiatives through institutions such as the *Patronat* and the ERT.[163] Also affecting French state negotiating influence was recognition that Euromarket, not recently adopted French, market reforms were preferred by market participants. Additionally, French capital markets, lacking investment assets, had little negotiating leverage against British regulatory preferences. As a result, state efforts to preserve domestic market reforms took policy priority over opposition to the CAD and ISD. Influence and authority were represented predominantly by state preferences and structural concerns. Private sector influence was pervasive but was predominantly filtered through the state, whose policy failures undercut its effectiveness.

---

[161] In the late 1980s, Japanese institutional positions in US government securities were enormous and speculation was widespread it could result in increased Japanese leverage over US fiscal and monetary (not to mention political or commercial) policies.

[162] Before that time they were discouraged as a threat to state interests because they introduced shareholders into corporate and social governance policy-making. Story and Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*.

[163] This is discussed in Chapter 7. The private sector's close ties with French government elites, EU administrators and their commercial peers in Europe facilitated their influence over state negotiating positions on the CAD and ISD, as well as over broader EU industrial policies. The ERT's support for the SEM encouraged resolution of directive debates and the opinions of the *Patronat* were influential in swaying French positions on transparency. See Chapter 7 for discussion.

Conclusion

Each national market instituted securities regulatory reform during the 1980's to insulate domestic market franchises from foreign encroachment and to respond to international market evolution. Reforms reinforced domestic regulatory regimes and market practices. They also increased the political and economic investment by governments and in some cases, by private actors, in the preservation of national regulatory regimes. This made regional harmonisation more difficult. For the UK and, to a lesser extent, for France, these steps increased the potential for domestic conflicts and ambiguous bureaucratic authority. In Germany, close ties between banks and the state impeded regulatory reforms that were designed, in part, to increase the use of securities in capital-raising. More generally, these developments inhibited regional harmonisation by entrenching national regulatory regimes and prioritising domestic market protection and growth.

Chapter 5

The CAD and ISD Negotiations

This chapter describes the evolution of the CAD and ISD negotiations. The chapter's objective is the identification of critical steps, issues, and actors involved in the development of the directives.

The Genesis of the CAD and ISD

For EU bureaucrats, the evolution of international economic and market relationships after WWII created regulatory challenges and opportunities. Three events in the 1970s and 1980s encouraged development of the CAD and ISD. First, the successful negotiation of the Basle Accord established a precedent for international financial services regulatory harmonisation. Second, the 1987 stock market crash graphically demonstrated the capacity of securities firms to generate systemic risks. Third, the intense international competition between Japanese and US financial institutions and markets threatened to relegate EU institutions and markets to "also-ran" status. While the Euromarkets were internationally pre-eminent, US and Japanese institutions increasingly dominated them. EU officials and member-state regulators wanted EU markets and affiliated institutions to be subject to European leadership. The decision to develop a harmonised EU regulatory regime was a central element in retaining control over domestic and regional markets and in asserting EU regulatory perspectives internationally.

EU Financial Services Legislation[1]

In 1985, the European Commission released a "White Paper,"[2] (also referred to as the "Cockfield Report") detailing the steps necessary for the creation of a European

[1] See also Chapter 6.

common financial market by year-end 1992. The paper proposed the adoption of almost 300 directives, including the ISD.[3] In 1986, to facilitate adoption of directives, member-states signed the Single European Act ("SEA").[4] The SEA implemented "qualified majority voting" ("QMV")[5] and defined a "cooperation procedure" for review of proposed EU legislation.[6] The subsequent release of the Cecchini Report in 1988 reinforced the benefits of regional integration and buttressed support for the EU's harmonisation agenda.[7]

The ISD Negotiations

The ISD was the third financial services legislative initiative outlined in the Cockfield report, following directives for banking and insurance.[8] As a result, the ISD, initially released in draft form by the EU Commission in 1988, was influenced by coincident debates over related directives.[9]

The release of the initial ISD proposal immediately highlighted potential conflicts between member-state regulatory principles. These conflicts were identified by David Barnard, a prominent UK securities lawyer, and by a separate legal study.[10] Barnard noted that the ISD required national implementation, which provided opportunities for domestic debate, revision and delay. Second, Barnard observed that using banking directives as precedents for investment services was "totally inappropriate." The activities pursued by banks and securities firms were very different. Finally, Barnard indicated that Britain's post-FSA 1986 regulatory regime, emphasising a growing

---

[2] "Completing the Internal Market: White Paper from the Commission to the European Council" (COM No. 85) 310 (June 14, 1985), also referred to as the "Cockfield Report."
[3] The CAD was added later.
[4] Single European Act of 17 February 1986, 30 O.J. European Commission (No. L. 169) 1 (1987). The Single European Act is not a legislative act but rather an amendment to a treaty, as quoted in Wolff, 1991, p.103.
[5] In "qualified majority voting" voting weights are assigned to each member-state based generally on its population and economic power. However, social and tax matters still required unanimous approval under the SEM. See Appendix B.
[6] Barbara Campbell Potter, "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward," *Vanderbilt Journal of Transnational Law* 26 (1993).
[7] Wayne Sandholtz and John Zysman, "1992: Recasting the European Bargain," *World Politics* 42 October (1989).
[8] See Chapter 5 for discussion of these directives.
[9] The Commission first proposed ISD legislation in December 1986.
[10] The study was executed by Norton, Rose, a British law firm. Their report, "Banking in the European Community – 1992", Norton Rose, London, is cited in ISRR, "U.K. Financial Services Legislation May Conflict with EC Banking Directive," 1 March 1989.

regulatory preference for investor protection, was incompatible with the market-opening objectives of early ISD drafts.

There were broader conflicts in the conceptual foundations of EU regulatory development.[11] The principle of "competition among rules" was intended to promote regional regulatory convergence. This was to be achieved in part by promoting regulatory arbitrage. However, this objective conflicted with regime characteristics intended to promote regional cooperation. These characteristics, "mutual recognition" and "minimal harmonisation," were both intended to minimise changes to national regulatory regimes. This conflict was identified by U.S. GAO report.[12] These inconsistencies compelled EU negotiators to choose between regional cooperation and regulatory convergence in structuring broadly acceptable directives by the Single Market deadline. Barnard noted that David Walker, head of the UK's SIB, had already suggested amending the FSA 1986 to prevent the UK from being "over-regulated," a perception that might encourage firms to move their operations from London to cities with friendlier regulatory environments.[13]

Early Differences

From 1989 through the first half of 1991 little progress was made in resolving deeply embedded member-state differences over the structure of the ISD. Disagreements reflected powerful national preferences and the desire of negotiators to protect domestic market practices, franchises and firms. A Dutch Finance Minister termed disagreements "cultural differences."[14] At a November meeting of the EU Council, disagreements split negotiating countries along well-defined lines. On one side were countries with open regulatory traditions, advocating market-oriented, institutionally driven, less formal regulatory regimes. This included the UK, the Netherlands and, on certain issues, Germany. This group came to be called the "Northern Europe" group. Opposing them were France, Belgium and the southern EU states, Italy, Portugal, Spain and Greece, who represented more traditional, smaller, closed markets. This latter group, called the "Club-Med" group, argued for explicit rules, determined through negotiation rather than by

---

[11] See Chapter 6 for discussion.
[12] GAO, "European Community: U.S. Financial Services' Competitiveness under the Single Market Program," (Washington, D.C.: United States General Accounting Office, 1990).
[13] ISRR, "Transparency May Not Come with 1992, Attorney Warns," 10 May 1989.
[14] ISRR, "Investment Services Directive Remains Stalled among Ministers," 15 July 1991.

market forces. Not surprisingly, each group argued for the creation of a regulatory regime that required it to change as little as possible.[15]

Debates contrasted institutional perspectives on three critical issues: concentration, transparency and exchange admission.[16] The lack of progress caused negotiators to worry that the ISD would not be in place by January 1993 – or that it might be deferred indefinitely. Their concerns were heightened by comments of London-based US investment bankers, who expressed their concern that the SBD might be adopted before the ISD, placing investment banks at a competitive disadvantage in regional expansion.[17]

Early ISD debates were intensified by the success of London's SEAQ-International ("SEAQ-I") over-the-counter ("OTC")[18] equity market, founded in 1986. SEAQ-I had successfully encouraged the migration of continental European equity trading to London. The trading and operational procedures, and liquidity of SEAQ-I's largely unregulated market resulted in securities being traded more cheaply in London than on their tightly regulated "home-country" markets. SEAQ-I's success had prompted Frankfurt and Paris to take steps to protect the viability of their domestic capital markets by, *inter alia*, developing their own domestic futures exchanges[19] and by advocating ISD language restricting how and where equity trading should take place. The ISD also proposed unrestricted bourse admission, which threatened to overwhelm smaller domestic exchanges by increasing trading volumes (and operational demands). This proposal could also put local firms at risk. These concerns caused national positions to harden as successive ISD drafts were circulated in 1989 and 1990.

Concentration

Disagreements over "concentration" centred on whether securities trading should be restricted to (concentrated in) regulated, as opposed to OTC, exchanges. This issue

---

[15] See Appendix B.
[16] See below for definitions of "Club-Med" and "Northern Europe" groups.
[17] The Second Banking Co-ordination Directive ("SBD"). Directive 89/646, "On the Co-ordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780", O.J. (No. L 386) 1 (1989). See also: See: Brown, "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives."
[18] Over the counter or unregulated exchanges. See Glossary.
[19] The DTB and MATIF, respectively, discussed below and in Chapter 6.

brought British OTC and French regulated market interests into conflict.[20] Regulated continental bourses also, of course, wanted to reverse trade migration to SEAQ-I.. They argued that off-market trading was risky, that it afforded little regulatory oversight or investor protection, and that it was contrary to the public interest.[21]

If Club-Med proposals were adopted as then drafted, they would effectively have ended OTC markets. French regulators urged that securities trading be permitted only on regulated exchanges such as the Paris bourse. British negotiators responded that Club-Med arguments were an attempt to insulate French domestic capital markets from international competition. At the time, over 30 percent of trading in French equities was done on SEAQ-I. British negotiators pointed out that the recent collapse of Polly Peck International, which had been listed on the "regulated" London Stock Exchange ("LSE"), ironically proved that regulated markets did not provide superior investor protection.[22] Attempts to structure compromise language raised complex definitional questions: "How should a 'regulated' market be defined?" "What types of securities should be covered?" One French compromise proposal would have permitted OTC share trading but only when an investor agreed in writing before trades were executed. But establishing a procedure to substantiate agreement proved difficult to negotiate. British negotiators wanted a tacit understanding, in line with traditional Euromarket trading practices; the French, with more formal domestic market practices, wanted an explicit contract.

Transparency

A related argument over the "transparency" of trade pricing terms highlighted fundamental structural differences in the way securities trades were executed in the EU. French negotiators wanted the terms of any securities trade executed over an exchange to be published simultaneously with its execution. The French domestic trading system, an "order" or "trade" driven system, differed fundamentally from the British "quote" driven system.[23] British and Euromarket practice immediately published the pricing terms of trades, but not their size. The French system put a premium on the immediate "transparency" (or publication) of the full terms for any trade, irrespective of client or trade size. This practice arose, in part, because the French did not have a significant

[20] Although Club-Med EU member-states broadly supported France.
[21] Steil, *Competition, Integration and Regulation in EC Capital Markets.*
[22] William Murray, "Polly Peck's Fall Signals Banking Shift," *The Wall Street Journal*, 2 November 1990.
[23] See Glossary.

institutional market. British negotiators argued that their disclosure procedures were designed to facilitate the execution of large, institutionally generated trades; terms were immediately disclosed to market authorities, but not to the public. They maintained that large trades were penalised under the French system, where trade size was broadcast to potential investors. As evidence they pointed to SEAQ-I, which specialised in large, block trades, attracting institutional equities trading from continental bourses.

The debate also highlighted differing domestic regulatory histories. French capital market practices, though liberalised in 1988/89, still reflected their history as a closed guild where information was narrowly held and market access and institutional trading were limited. The absence of a domestic institutional market made it possible for the French to be unconcerned about the competitive aspects of transparency. London's larger and more competitive markets followed practices that were designed to accommodate the trading preferences of institutional investors and firms.[24]

Open Bourse Admission

A third ISD disagreement concerned admission of new members to domestic exchanges. A basic premise of the ISD and the SBD, was that trading membership on one national exchange would act as a "passport," permitting membership privileges on all EU exchanges. This regulatory objective was attacked on several fronts. A number of European national bourses had not changed their admission practices significantly since their founding. They were physically small, had limited memberships and facilities, and followed antiquated procedures. This was particularly the case for Italy, Spain and Portugal. It was considered unrealistic to compel them to absorb many new members and a rapid increase in trading volume. Additionally, privately owned exchanges, such as London's Liffe,[25] agreed that requirements mandating the admission of new members and necessitating increased trading capacity were unrealistic. A proposal to admit new members over a designated time period ran into disagreement over who should be afforded membership and under what terms. In six of the twelve EU states, banks were not permitted to be members of exchanges, despite an SBD provision allowing banks to

[24] Durieux, Serieyssol, and Stephan, *French Financial Markets*.
Nunes, "French & SEC Securities Regulation: The Search for Transparency and Openness in Decision-making".
Benn Steil, "Equity Trading IV: The ISD and the Regulation of European Market Structure," in *The European Equity Markets*, ed. Benn Steil, et. al. (London: European Capital Markets Institute, 1996).
[25] London's highly successful futures exchange. See Glossary.

pursue investment activity. It was subsequently proposed that banks be required to establish separately capitalised local trading subsidiaries before being allowed to trade on exchanges.[26]

Progress on open admission, stalemate elsewhere

A late 1990 ISD draft still proposed a narrow definition of regulated markets, excluding OTC, derivative and futures markets. The draft also contained a French-sponsored provision that gave member-states the right to require that certain securities be traded only on regulated exchanges. Market participants, principally London-based US and UK investment firms, advised EU negotiators and national regulators that the language was unworkable; investors would find it impractical to provide explicit prior permission for trades on unregulated markets.

On trade reporting, UK negotiators continued to object to price transparency on all trades, irrespective of trade size. Germany and the Netherlands also opposed revised language on trade reporting, claiming the structure of their exchanges made compliance impossible.

Despite these disagreements, minor progress was made. A compromise on open admission of banks to exchanges, which permitted Spain to delay compliance, was reached.[27] This agreement deferred until after the next Spanish general election any decision on the politically sensitive issue of bank admission to exchanges. Revised ISD proposals were presented at a December 1990 ECOFIN meeting, which permitted negotiators to tell domestic audiences that progress was being made. Although the main protagonists on concentration, French Minister Pierre Beregovoy and the UK's John Redwood, were "talking positively," an observer called the December meeting a "shambles." ISD negotiating blocs remained unchanged and parallel CAD negotiations had stalled.[28] The intergovernmental COREPER[29] had discouraged presentation of new proposals to ECOFIN, arguing that agreement was premature. The Council President,

---

[26] However this proposal contradicted the SBD provision that home country capital count for capital requirements throughout the EU. See: Lucy Kellaway, "International Equity Issues: Many Rows on the Way to Market," *Financial Times*, 21 November 1990. See also discussion of SIMs in Chapter 7.
[27] Lucy Kellaway, "Single Market Deadline Threatened," *Financial Times*, 19 December 1990.
[28] Brown, "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives."
[29] See Glossary and Appendix for definitions.

unconvinced and wanting to show progress, forwarded proposals to ECOFIN. The resulting discussions were unproductive.[30] The exchange illustrated the strong desire of EU negotiators to be seen to be making progress despite the persistence of national preferences.

In one important respect the CAD and ISD were linked. For the CAD to be effective, the ISD had to be simultaneously adopted. Otherwise, the CAD would impose new rules on securities firms that would, however, still be excluded from the regional operating passport already available to commercial and universal banks. This was a particular concern for aggressive, US multinational securities institutions based in London, but it was of little concern to universal banks or more provincial Club-Med institutions whose securities expertise was limited. Nevertheless, ISD debates continued to focus on transparency and concentration.

Germany supports British ISD preferences

Britain, together with Germany, continued to argue that transparency would impede market liquidity and inhibit institutional market-making. Germany's support for Britain was attributed, in part, to the fact that British negotiators, urged by London-based private-sector bankers,[31] had explained to their German counterparts the trading and regulatory implications of differences between securities and lending risks.

This was a novel concept for German regulators, accustomed to narrowly credit-related risks.[32] These discussions would subsequently operate more broadly once "trading book" and "building block"[33] capital calculation methodologies were developed in later CAD drafts.

Germany was, in any event, more concerned with the CAD's potential domestic impact than with that of the ISD. German banks' securities expertise and regional market penetration were limited. But German support for UK ISD preferences indicates that UK

[30] Brown, "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives."
[31] Principally US and UK investment banks, as well as UK regulators, Confidential interviews, London.
[32] Confidential interviews, London, May 2000 and February 2001.
[33] See below for a discussion of the "trading book" and "building block" proposals.

negotiators (and the bankers advising them) had been successful in persuading German negotiators of the benefits of British/Euromarket securities trading practices.[34]

Also encouraging German endorsement of UK ISD preferences was a desire to make their own domestic capital markets more competitive and attractive to international investors and firms. This reaction was similar to that of many Club-Med regulators to globalisation, although Germany went further in reforming its domestic markets.[35] Germany was motivated in making reforms principally by reunification funding pressures and the related need to improve domestic capital markets. However, Germany's actions were conditioned by its desire to insulate domestic markets and actors from external competitive encroachment. These two incentives would translate into German concessions on the ISD (and eventually on the CAD) in exchange for assurances that its domestic financial institutions would not be disadvantaged by the directives. This became known as Germany's "level-playing-field objective."[36]

Germany's endorsement marked a turning point in ISD negotiations. It also marked the initiation (beginning in 1990) of private sector educational initiatives on the market implications of the directive's structure. London-based private sector interests focused on "better regulation, not just less...a preference for a single regulator and

[34] UK and US bankers' positions on the CAD and ISD reflected their preference for preserving UK domestic and Euromarket practices, which benefited the UK economically and exploited those firms' operating and experiential advantages. This observation is reinforced by the fact that capital calculation methodologies permitted in London were already more sophisticated than the proposed CAD and that British and US public and private interests were, as a result, more focused on obtaining the ISD's single passport – and greater access to continental European markets. UK and US securities firms dominated the Euromarkets by virtue of their superior marketing, product, risk diversification and trading expertise. These advantages could be exploited with a single EU operating passport.

[35] Germany was also compelled to make reforms because of reunification and because its domestic capital markets were less developed than other EU member-states.

[36] Club-Med regulators were generally more concerned with insulating domestic markets and actors from external competitive encroachment. The success of Liffe (and the Euromarkets generally) had encouraged Deutsche Bank, the largest German universal bank, to move its securities operations to London in 1984. This spurred recommendations for a centralised securities exchange in Frankfurt over powerful German *Land* objections. It also encouraged a 1989 amendment to the Stock Exchange Law, which led to the creation of the first German futures exchange, the *Deutsche Termin Börse* ("DTB"). Additionally, under pressure from other countries, these developments were accompanied by the reform of Germany's rudimentary insider-trading laws. (Pressure came mainly from the US, See: McCahery, "Market Regulation and Particularistic Interests: The Dynamics of Insider Trading Regulation in the US and Europe").These developments were also a function, as mentioned, of German reunification, which forced Germany to access external funding sources and to develop a domestic capital market that was more attractive to foreign investment. These changes raised the visibility of the German Federation of Stock Exchanges and of its Director, Rüdiger von Rosen of the Frankfurt Exchange. See: Moran, "Regulatory Change in German Financial Markets". See also Chapter 6.

transparent, liquid (order-driven) markets."[37] These objectives were not altruistic; they would permit UK and US firms to better exploit their market advantages and expertise. Private sector initiatives included seminars and one-on-one meetings with EU and national representatives, designed to educate officials on market developments and to ensure that bankers were "...part of the process" of policy-formation. Their efforts also included aggressive intervention through lobbying.[38]

Continued disagreement over concentration

As ISD debates evolved, France continued to seek SEAQ-I's exclusion from the group of permitted "recognised" trading markets. UK and EU financial services officials continued to argue for the preservation of existing Euromarket trading practices, squaring off against the Club-Med group. Underlying these arguments was the continuing migration of domestic continental securities trading to cheaper and more liquid UK OTC markets.[39] The UK Treasury's position remained inflexible: "We will not countenance protectionism from other markets."[40]

A further reason for British intractability was the FSA 1986. If French preference for immediate trade data publication were adopted it would compel a re-examination of recently implemented UK domestic trading rules. London Stock Exchange representations to the DTI and UK Treasury, objecting to French preferences, reflected this concern. UK regulations permitted a 24-hour delay in publication of terms for large trades on the LSE. Revised rules were to take effect in 1991, shrinking the time delay but still permitting market makers to reduce inventories without signalling their intentions. John Redwood, head of the DTI, had only approved the new rules after a lengthy review by the DTI and the UK Office of Fair Trading. Redwood was reluctant to re-open a contentious domestic issue. An LSE official warned, "We do not want to get drawn into a similar debate in connection with the EU directive."[41] French negotiators argued that fairness and investor protection were enhanced by immediate pricing transparency. But

[37] Confidential interviews, London, February 2001.
[38] As an example of aggressive lobbying; in 1993/94, the European Parliament developed the concept of taxing all derivative transactions. A private US investment bank got wind of the idea, produced a seminar for 12 critical MEPs and outlined the "perils" (i.e., difficulties) of taxing derivatives. The idea never got off the ground.
[39] Steil, *Competition, Integration and Regulation in EC Capital Markets.*
[40] Frank Kane, "Shaky Foundations May Leave the Cad Tottering with a Single European Securities Market on the Horizon," *The Sunday Telegraph*, 14 June 1992.
[41] ISRR, "Off-Exchange Trade Compromise Unlikely to Succeed Quickly," 14 January 1991.

they were also defending nationalised industries and domestic market practices against the growth of lightly regulated markets such as the Euro and SEAQ-I markets.

Brittan proposes ISD compromises

To jump-start the ISD discussions, Leon Brittan presented a compromise concentration proposal to ECOFIN in early April 1990. His proposal called for mutual concessions by member-states and eliminated earlier language that had defined whether the EU or member-states had jurisdiction over the determination of appropriate securities trading markets. In earlier drafts, investment companies would have determined whether shares would be traded on or off regulated exchanges for transactions exceeding low thresholds.[42] France had argued that this language undermined French bourses.

An accommodation to French preferences on transparency would require investment companies to report price and volume of off-market transactions. However, in a balancing concession to British interests, Brittan insisted that an investor's right to trade freely would be emphasised. France was also asked to grant investors the right to authorise blanket approval for off-exchange trades, rather than make approvals on a trade-by-trade basis.

In a further attempt to break the impasse, the Council President recommended that terms of all transactions be reported within 24 hours of execution. But the UK insisted on a 48-hour delay and the French continued to argue for same-day reporting.[43] While stalemates had been broken in one area, they remained in others.

Pressure to show progress resulted in further resolution of the issue of open access to domestic bourses. Language that delayed open access to domestic bourses was circulated and adopted.[44] The compromise represented the EU's adoption of an expedient solution to harmonisation disagreements. Previously, the EU had vacillated in addressing disagreements, switching between different national preferences instead of resolving fundamental issues. The new approach reflected the pressures on negotiators: public

---

[42] Either ECU 10,000 or ECU 40,000.
[43] ISRR, "EC Commissioner Seeks Compromises from UK, France on Investment Services Directive," 22 April 1991.
[44] Andrew Hill, "Compromise Proposed on EC Investment Services," *Financial Times*, 25 June 1992.

commitment to the Single Market deadline, institutionalised compromise enforced through voting procedures, and market participant lobbying.

Deadline pressure

In early 1992, EU officials' concern with meeting the 1992 deadline intensified. Hopes that the ISD draft would be placed on the December 1991 agenda of ECOFIN had been dashed by continuing failure to make headway on transparency issues. ECOFIN had not reviewed the ISD since the previous summer. A task force assembled to resolve ISD disagreements met in December 1991, separately from ECOFIN, but made no progress. UK and German concerns with proposals for faster publication of trade information and unrestricted bank access to bourses were still unresolved, as were French concerns over off-market trading.

Britain was scheduled to succeed Portugal as Council President in July 1992. The prospect was viewed as a mixed blessing by negotiators. London's financial stature lent greater weight to British views in ministerial debates and, of course, British negotiators considered financial services to be their area of specialised expertise.[45] As a result, Whitehall viewed optimistically the prospect of ISD debates being resolved during Britain's presidency. Despite the tradition of EU presidents operating as neutral ciphers in deliberations during their terms in office, the UK Treasury was looking forward to a proactive presidency. A UK Treasury official, referring to the ISD, was quoted as saying, "Things tend to progress in Europe through compromise, but it is not safe to assume that Britain will compromise on this one."[46] EU negotiators hoped, however, that recent progress made on the CAD would have a positive effect on the development of broadly acceptable resolutions to remaining ISD issues.[47]

ISD compromise

In the first half of 1992, the Portuguese Council President engineered a compromise on the ISD. Language was drafted on the issue of concentration that

---

[45] Confidential Interview, London, May 8, 2000.
[46] Kane, "Shaky Foundations May Leave the CAD Tottering with a Single European Securities Market on the Horizon."
[47] International Reports, "United Kingdom Second Thoughts on Maastricht?", (New York: IBC USA (Publications) Inc., 1992). Even though progress initially appeared unlikely. The Chairman of the French *Société des Bourses* noted that a new SEAQ-I electronic market for institutional investors in non-UK shares would be considered an unregulated market and, as a consequence, would, like SEAQ-I, be a target of France's restrictions on off-market, screen-based trading.

supported French preferences for restricting trading to regulated exchanges. The drafters incorporated sufficient ambiguity into the text, however, to ensure that SEAQ-I would be able to continue operating as a "regulated" exchange. Club-Med negotiators thought they had successfully excluded SEAQ-I from the definition of a regulated market on the grounds that it could not comply with stipulated listing and transparency requirements. However, the vague language and many permitted exceptions in the final directive made it possible for SEAQ-I to continue to operate successfully after the directive was adopted, without changing either its OTC status or its trading procedures – an outcome welcomed in London by both domestic and foreign firms. In addition, investors from EU member-states that followed concentration rules were offered the opportunity to "opt out" of the requirement. This language ensured agreement but weakened consistent regional compliance with concentration provisions.[48]

The final ISD text allowed significantly different interpretations. It permitted the continuation of current domestic market practices while adding certain reporting requirements. Differing interpretations were likely to stand because challenging a member-state's interpretation required engaging the EU's protracted legal processes, a daunting prospect for any member-state contemplating a protest.[49]

The text split the difference between opposed positions on transparency by suggesting that trade information be released over a period of hours after a trade, rather than days, but it avoided a definitive statement on trade reporting. Agreed language required regulated markets to publish weighted average prices, high and low prices and aggregate trading volumes at the commencement of trading and on a rolling basis thereafter. However, opt-out clauses allowed "competent" local authorities to suspend transparency rules for "very large" or "illiquid" trades or for "exceptional" market conditions. Determination of these conditions was left to the competent local authority.

With respect to open access to bourses, as mentioned, final agreement was achieved through the delay ("derogation") of open access to 1996 and 1999. These delays gave member-states a grace period within which to prepare domestic markets for expanded membership.

---

48 Steil, *Competition, Integration and Regulation in EC Capital Markets*.
49 Benn Steil, "Regional Financial Market Integration: Learning from the European Experience," (London: Royal Institute of International Affairs, 1998).

In resolving the debates, EU negotiators proposed compromises that preserved deeply embedded national preferences. Compromise on the ISD was achieved without overtly favouring any member-state. State preferences, shaped by the advice of private-sector actors and institutions, dominated the agreed language of the directive. Compromises facilitated the preparation of a final draft that would be presented to the European Parliament shortly after the Single Market deadline of January 1993.

The CAD Negotiations

Early EU discussions on capital adequacy harmonisation spotlighted differing national regulatory regimes.[50]

Regional consistency in the application of capital adequacy rules to all types of financial services firms was critical for German regulators. They did not want to see one set of rules for universal banks and a separate, potentially more lenient, arrangement for securities firms. Since the SBD had provided a single regional passport for universal banks' lending and securities trading activities, the ISD, which also contained single passport language, was unnecessary for German banks. However, they privately expressed concern that the UK's FSA 1986 might serve as a precedent for the CAD, which would negatively affect German banks. German regulators considered the capital rules in FSA 1986 to be overly flexible and feared that the CAD would apply similar rules selectively to securities firms, potentially advantaging them over universal banks.

For British regulators, both the CAD and ISD were critical because of the UK's more highly differentiated domestic financial services institutional structure. British negotiators were sensitive to draft CAD language on capital calculation for three reasons. First, British regulators argued that the FSA 1986 reflected state-of-the-art securities firm capital management practices and technology. UK regulators' Euromarket regulatory experience provided them with a knowledge advantage over their EU peers. Reflecting this, the FSA 1986 permitted the use of sophisticated hedging techniques to manage required capital levels. Second, the FSA 1986, though criticised domestically as cumbersome and legalistic, still represented current UK regulation. British regulators

[50] See Chapter 4 for discussion of domestic economic and political structures.

were loath to amend recently adopted domestic legislation. Third, any EU regulatory development that could threaten London's market superiority was of critical concern.

French regulators generally supported British regulatory preferences on the CAD. France had a relatively well developed domestic securities market, which created interest in minimising capital costs. But French regulators focused their initial attentions on the ISD. The French economy had languished over the preceding decade and domestic regulators were concerned with the continued migration of French securities trading to London's markets. Rebuilding French domestic markets was a priority. Moreover, negotiators were concerned initially with ISD language that permitted foreign institutional access to previously insulated French domestic markets.

Domestic approaches to capital

In determining securities capital, the UK pursued a sophisticated formula approach, based on calculating specific market and position risks. Hedging was permitted to minimise capital requirements. Continental European countries used simpler lump-sum approaches based on balance sheet totals. Reflecting different domestic financial services structures, member-states also evinced differing attitudes towards the role of capital, with Germany and the UK representing the extremes.[51] Germany, with a poorly developed domestic capital market, viewed capitalisation in traditional credit terms - the more capital the better. Britain, with a highly differentiated financial services industry and capital market, viewed the risks and capital requirements of banks differently from those of securities firms. In particular, securities firms focused on portfolio liquidity while banks focused on borrowers' ability to repay. Reconciling differing capital adequacy calculation methodologies with different domestic banking and industry structures represented a significant task. And, as mentioned above, EU directives affecting commercial banking and investment services needed to be adopted simultaneously if the EU was to avoid unfairly advantaging one industry over another.[52]

These distinctions provide an opportunity to assess whether and how member-states' regulatory or industry organisational preferences influenced EU negotiations.

---

[51] See Chapter 2.

[52] David Buchan and Tim Dickson, "The European Market: EC Gears up for Financial Services Christmas Rush," *Financial Times*, 28 November 1988.

Early CAD discussions

Not surprisingly, early comments on CAD drafts focused on the impact of evolving regional standards on existing domestic regimes. The White Paper had not contemplated a CAD,[53] and early ISD drafts did not address harmonisation of securities capital adequacy standards. However, the absence of a CAD created opportunities for regulatory arbitrage by securities firms enjoying a "single passport."[54] Conversely, an EU directive that "re-regulated" domestic capital standards would encourage additional arbitrage.[55]

Creating a regional securities regulatory regime prompted additional concerns. Gernot Ernst, chairman of the Berlin Stock Exchange, commented on the EU's growing supranational powers. He announced that Leon Brittan's Internal Market financial services cabinet[56] was "going beyond the objective of opening up the markets and that a supranational supervisory body is developing in Brussels behind a flood of individual regulations."[57] Ernst argued that market internationalisation required greater coordination but not necessarily greater harmonisation. He bluntly stated, "The German stock exchanges reject any form of a national or supranational supervisory authority."[58]

German universal banks continued to be concerned with the competitiveness of their nascent securities operations, particularly if no capitalisation distinction was made between securities and lending functions. As a result, German regulators initially resisted any proposed dilution of their existing domestic regulatory standards.[59]

UK securities firms were concerned that stringent German universal bank capital standards not be applied to their operations. Such standards would put them at a disadvantage relative to non-EU (mainly US) securities firms and would necessitate rewriting the FSA 1986.

---

[53] The CAD was added shortly after the introduction of the ISD when it was recognised that, though they were obviously linked, the original directive addressed sufficiently complex issues to justify independent, separate directives.
[54] "Well-Mannered Watchdogs," *Financial Times*, 6 March 1989.
[55] This was noted by a director of the International Stock Exchange in London who called capital adequacy "one of the most important and difficult problems" facing the EU. See: ISRR, "European Exchanges Look to 1992, Some Question Commission's Role," 18 January 1989.
[56] The EU Commission group leading the development of the CAD and ISD.
[57] ISRR, "European Exchanges Look to 1992, Some Question Commission's Role."
[58] Ibid.
[59] Dale and Wolfe, "Capital Standards."

In the spring of 1989, UK domestic debate was focused on the Thatcher government's rejection of the Delors Plan for monetary union. Yet, despite its disagreement with EU monetary objectives, Thatcher's government was committed – at least commercially – to the Single Market. The UK government also viewed movement toward the Single Market as "irreversible."[60] Since the 1985 Single Market decision, 275 directives had been implemented. The opposition Labour Party also supported the Single Market but criticised Tory concern that it threatened British "sovereignty." Labour argued that the Conservatives wanted trading benefits without the necessary regional harmonisation concessions.[61] The British domestic debate was carried through to the CAD and ISD debates where member-states' disagreements revolved around changes in domestic market practices required by regulatory harmonisation.

Permeating the early debate on the CAD was a basic question: "Should banks and securities firms be treated alike?" While banks and securities firms were subject to different risks and engaged in different activities, the EU had concluded that their businesses would increasingly overlap, either through securitisation or the growth of universal banking. The SBD, by granting commercial banks a "passport" encompassing securities activity, effectively endorsed the development of a universal bank model. German regulators saw no regulatory distinctions arising from the fact that universal banks engaged in both lending and securities underwriting. UK regulations were, however, functionally based. Domestic securities activity was segregated into separately incorporated firms or subsidiaries of commercial banks and, as a result, regulation could be tailored by institutional function. The CAD regulatory debate placed EU members, financial institutions, and national economic structures in competition.

Early discussions of the draft CAD had two additional consequences: they publicised the proximity of the 1992 Single Market deadline, and they raised the public profile of EU discussions on other directives.

---

[60] Richard Donkin, "Europe Losing Sight of Single Market Goal, Says Lord Young - Challenge of 1992," *Financial Times*, 4 May 1989.
[61] Ibid.

EU precedential ambitions

The EU Commission was certain that its regional regulatory precedent would be the first international standard to define capital adequacy for investment firms. This achievement would advance the Commission's international authority just as the Basle Committee and IOSCO were working on capital adequacy. IOSCO had begun related research but had yet to publish findings. Once promulgated, an EU capital standard would resist dislodgement, particularly as most member-states were members of IOSCO and the Basle Committee, unless newer standards were shown to be superior. A contemporaneous study issued by the US GAO acknowledged this observation, noting that standards defined by the EU could become *de facto* international standards.[62]

The establishment of an EU precedent ahead of the Basle Committee or IOSCO would help allay EU concern that their regulatory standards not be dictated by either of the other two institutions. The release of the Basle Accord had surprised the EU, pre-empting their regulatory deliberations on bank capital and effectively determining the structure of related EU directives.

But the Commission downplayed any precedent-setting ambitions. In October 1989, Leon Brittan discussed the difficulty of establishing capital standards that covered both universal banks and securities firms. He indicated that the Commission's goal was to set a standard that gave neither institution an advantage over the other. Nor did the Commission want regulatory compliance to require changes to current operating methodologies. While recognising the difficulties inherent in establishing such an even-handed system, Sir Leon indicated the Commission's belief that "broad equivalence" could be achieved. Jose Fombellida, of DG XV, indicated that the EU's approach was "open-minded."[63] Early CAD drafts included these objectives.

Early drafts of the CAD

Despite heavy British representation in DG XV and the Commission's Financial Services cabinet, and despite arguments for the superiority of London's regulatory regime, early drafts of the CAD did not reflect FSA 1986 regulatory norms. Instead, they

[62] GAO, "European Community: U.S. Financial Services' Competitiveness under the Single Market Program."
[63] Richard Lambert, "FT Conference: World Leadership in Financial Services 'within Grasp of EC'," *Financial Times*, 17 October 1989.

reflected capital calculation practices of universal banks and the institutional structure of continental European markets.[64] British complaints over the "European bias" of these early drafts did produce subsequent amendments.

In November 1989, responding to criticism that it was developing tougher capital standards than those operating outside the EU, the Commission circulated amended language to the first CAD draft. Required capital was reduced from an initially proposed 20% to 8% of outstanding market risk exposure, paralleling the 8% capital level established by the Basle Accord. But, responding to British private and public sector complaints that the draft was still tougher than UK domestic standards, the EU allowed reduction in the 8% *de minimus* rule through portfolio diversification and hedging.[65] These changes stirred up controversy in Germany, where regulators argued that the new proposed standards were too low and too flexible. Germany's bankers agreed, concerned that securities firms would have operating advantages over universal banks.

In December, the EU reversed itself and, in an unpublished third draft, disallowed risk-based capital calculation methodologies used by securities firms in the UK. UK investment firms responded by ominously noting that the new language would force them to move their operations out of London to less expensive financial centres. For UK firms, an inflexible 8% capitalisation approach effectively doubled required domestic capital levels.[66] The TSA[67] warned that new language would require large increases in required capital as well as changes in the composition of capital.[68]

A fourth draft was rapidly prepared and circulated in January 1990. But it paralleled the third draft and drew further fire from British regulators and London bankers. The Bank of England's executive director, Penn Kent, reiterated that the latest

---

[64] "Adequacies Inadequate (Capital Reserve Regulations for Securities Firms)," *The Economist*, 30 September 1989.

[65] This change reflected UK and US firms' comfort with increasingly sophisticated, proprietary portfolio risk management models. These models evolved into the proprietary "VaR" (value at risk) models endorsed several years later by the Basle Committee and the DPG.

[66] Richard Waters, "EC Directive on Capital Rules Could Hit UK Firms," *Financial Times*, 22 December 1989.

[67] See Glossary.

[68] ISRR, "TSA Warns Member Firms on Latest EC Draft Capital Adequacy Directive,", 31 January 1990. The TSA warned about the level of required capital, position risk requirements, increased reserves against settlement failure and the low level of subordinated debt permitted in the calculation of capital.

draft threatened to drive securities businesses out of the EU. The DTI's John Redwood[69] warned that non-EU financial centres would benefit if the draft was allowed to stand. He stressed that higher capital requirements would drive smaller investment firms - the type prevalent in the UK - out of the EU to more attractive financial centres such as New York or Zurich.[70] Kent and Redwood also objected to the rejection of hedging, which they interpreted as supporting German regulatory preferences. The British lobbying effort against the draft now comprised the TSA, the Bank of England, the DTI, and private sector bankers.[71]

Sir Leon responded in a London speech: "A more detailed treatment of securities positions than has so far been agreed is desirable to reflect the risks of such positions, and also to produce a similar level of requirements for banks and investment firms."[72] EU officials indicated that a further CAD revision would not be released until the spring. However, they commented that British concerns were likely to be addressed in more flexible language, permitting position-netting in the calculation of capital and differentiating types of risk.

The aggressive response of public and private sector City institutions to the third and fourth drafts and the Commission's favourable response mark a pivotal point in the negotiation of the CAD. The Commission was made keenly aware of the directives' significance to the future of the City, to the UK economy and to the stature of European capital markets more generally. The Commission's objective was to promote regulatory harmonisation, but not if it would retard regional domestic markets or damage European regulatory precedents. Brittan's sensitivity to City private and public sector reaction to Commission regulatory proposals had been previously demonstrated by the reciprocity debate.[73] His decision to reconsider the directive's language indicates the leverage of the City in the CAD and ISD negotiations.

---

[69] Under-Secretary of State for the Department of Trade and Industry.
[70] David Barchard, Richard Waters, and Lucy Kellaway, "Bank Opposes Brussels Capital Directive," *Financial Times*, 5 February 1990.
[71] A veto, under the Luxembourg Accord, of the CAD or ISD was not seriously considered by the British delegation. However, removing the directives from active consideration, which the UK could do during its tenure as Council President, was contemplated. This, among other factors, encouraged compromise on the final form of the directives.
[72] Lucy Kellaway and Richard Waters, "Brittan Pledges Flexibility in EC Financial Services Rules," *Financial Times*, 6 February 1990.
[73] See Chapter 6. The reciprocity debate was about an early EU proposal that "mirror-image" reciprocity define regulatory elations between EU and non-EU states. This would mandate equivalent permitted

Confidential interviews indicate that the principal reason for the UK's leverage with the Commission was not the City's market size, but its technical expertise. No other member-state could match the City's experience or regulatory infrastructure. While there is no evidence that UK negotiators ever explicitly threatened to try to veto the negotiations, the City's leverage was widely acknowledged by interviewees.[74]

German concerns remain

While the UK successfully lobbied for more flexible language, the German Finance Ministry indicated its displeasure with the fourth draft. In a memo to the EU Banking Advisory Committee, the Finance Ministry stressed that regulations covering banks and investment firms should be the same – no distinctions should be made based on business activity. Their memo stated, "We think that any limitation to equal treatment is quite unacceptable. If banks were to be disadvantaged vis-à-vis investment firms, this would throw the switch to changes in the banking structure which are not acceptable."[75]

The comment underlined continuing German institutional concerns. The EU's previously negotiated Solvency and Own Funds directives, targeted at banks, addressed themselves to credit risk and paralleled the language of the Basle Accord. The SBD included language that expressly incorporated securities trading as a permitted activity. German negotiators had insisted on this to ensure that the SBD captured the full range of universal bank activities. The Finance Ministry's comment raised the possibility that the CAD (or ISD) could require changes in the structure of German banking.[76]

In comparison with the SBD, the latest CAD draft proposed a lower minimum level of capital, permitted a broader variety of financial instruments to count as capital (principally shorter-term instruments) and encompassed a broader definition of risk.[77]

---

capabilities between states for financial services institutions. This threatened London's status, was vociferously opposed and, ultimately, altered. Brittan's sensitivity to City preferences was based on its size and modern regulatory regime, its institutional scope and scale, its experience regulating institutional and retail markets, and its familiarity with contemporary capital management techniques.

[74] Confidential interviews. See also Chapter 7.

[75] Richard Waters and Lucy Kellaway, "Europe's Investors Seek a CAD with Sense of Fair Play: EC Plans for Capital Adequacy," *Financial Times*, 9 February 1990.

[76] By requiring different standards for securities activities from those established under the SBD.

[77] German concerns echoed their disagreement with capital adequacy proposals voiced in a September 1989 IOSCO meeting. German representatives had argued that the proposed standardised language disproportionately reflected the preferences of UK regulators and securities firms. (See: Richard Waters,

A fifth draft of the CAD was circulated in March 1990. The draft made changes in response to criticisms from British and US bankers and from regulators, but encountered continued German opposition over inconsistencies between securities and banking directives. The draft had reversed itself again and now paralleled British capital rules, deducting hedged trading positions from the determination of required capital. The new draft also permitted a five-day grace period[78] on counter-party trading risks. Earlier drafts had permitted a two-day grace period.[79] The British TSA expressed relief that the new draft was responsive to their concerns.

German negotiators did win a concession that, it was speculated, was granted to facilitate their agreement to other changes. The new draft allowed member-states to exempt bank securities subsidiaries from bank solvency rules. This meant that bank securities subsidiaries would be subject to the more flexible CAD rather than the more stringent Solvency and Own Funds directives. But German regulators were still concerned that universal bank asset portfolios, which combined securities and banking assets in one entity rather then segregating them in subsidiaries, would be subject to tougher bank guidelines.[80]

Conjecture about side agreements between negotiators peppered public discussion of progress on the draft directives. However, officials interviewed in confidence did not confirm that negotiated tradeoffs took place.

A breakthrough

At the end of March 1990, a breakthrough appeared possible. The British were still criticising high minimum capital levels for individual firms. The Germans felt that they could live with proposed language but expressed concern that the *Bundesbank*

"German Action Threatens Capital Adequacy Accord," *Financial Times*, 21 September 1989.) The German delegation eventually backed off its opposition to an IOSCO working party report on capital but only because they had earlier mistakenly approved the offending language, not because their opinion had changed. (See: Richard Waters, "IOSCO Conference - Germans Back Down on Capital Plans," *Financial Times*, 22 September 1989.).

[78] The grace period defined the time permitted to elapse before capital needed to be calculated against counterparty trading positions.

[79] "Counterparty trades" are trades executed with securities firms rather than end-investors.

[80] Peter Lee, "Securities Houses Face Capital Clampdown," *Euromoney*, April 1992., "A Passport to Strife," *The Economist*, 28 April 1990.

would not accept liberalised capital requirements for German banks' trading activities.[81] Nevertheless, a joint statement issued by Germany and Britain at an insurance conference raised hope that a compromise could be found. The release contained an agreement "that capital requirements for those providing investment services should be related to the risk involved in trading financial instruments, whatever the nature of the institution."[82] This alluded to an evolving compromise solution; to segregate – in a "trading book" – trading assets from bank assets in the calculation of capital. This would allow for the development of CAD guidelines more closely based on UK standards while preserving bank credit standards acceptable to German regulators.

The draft defined a range of risks against which non-banks were to allocate capital, lowered the initial level of required capital, and provided for hedging in the calculation of capital.[83] By moving closer to British positions on a number of issues in the final draft, Sir Leon risked accusations of favouritism. One German negotiator noted that the proposal had "a distinctly British flavour." But the Germans also realised they didn't have enough votes in the Council to overturn British preference for the incorporation of hedging in capital calculation. The technique was already widely utilised in many major international centres. As a result, German regulators agreed to the "trading book" proposal.[84] The Commission acknowledged that the CAD regulatory regime they proposed was not directly comparable to the regime applicable to banks. Consequently, it was impossible to determine whether it was more or less onerous. Despite the new draft's initial support, it was expected that further negotiation was likely in the next Council meeting due to begin in June. Some observers speculated that the latest draft actually represented an EU negotiating gambit, establishing a precedent for parallel discussions at IOSCO and the Basle Committee.[85]

After eighteen months of negotiation and six rounds of drafts, the EU published the CAD for comment on April 25, 1990. Acknowledging the importance of minimising disruption to domestic economic structures, Sir Leon noted that the draft attempted to

---

[81] ISRR, "Latest EC Draft Capital Rule Wins Qualified U.K. Approval,", 26 March 1990.
[82] Tim Dickson, "Anglo-German Boost for Single Insurance Market," *Financial Times*, 31 March 1990.
[83] See Appendix C for a detailed description of the CAD. See also: ISRR, "EC-Adopted Capital Adequacy Rule Gets Low-Key UK Approval," 7 May 1990.
[84] "A Passport to Strife," *The Economist*, 28 April 1990.
[85] Tim Dickson, "Capital Adequacy Directive: Compromise with More Changes Likely," *Financial Times*, 26 April 1990.

bridge "widely divergent traditions."[86] Negotiations were characterised by a conscientious effort to avoid dramatically altering existing domestic regulatory/operating norms. These debates also highlight the balancing of national preferences that was characteristic of EU resolution of harmonisation disagreements. EU officials hoped that attention could be turned back to moribund discussions on the ISD.[87]

Observers speculated that the EU would adopt a "building block" approach to securities capital calculation, paralleling an approach being considered by the Basle Committee and by London market participants and regulators.[88] This approach complemented the EU's developing view on differentiating trading and non-trading assets in calculating capital and accommodated both universal banks and securities firms, as capital would be calculated on defined pools of assets. Assets not devoted to securities trading would have capital calculated using the SBD methodology.[89] The operations of conventional securities firms would be subject to the CAD. The latest draft provided for three distinct levels of required initial capital – depending on the nature of a firm's trading operations – and, in a concession to British interests, exempted investment advisors from any specified capital requirements.[90] The compromise position was developed by John Carr, a British member of DG XV on secondment from the UK Treasury.

[86] Tim Dickson, "EC Unveils Capital Adequacy Plans," *Financial Times*, 26 April 1990.
[87] The UK actually continued to hammer away at outstanding technical issues. In September 1990, John Redwood reiterated his Government's continuing unhappiness with a provision that required investment firms to deduct illiquid assets when calculating capital. In remarks made in connection with the release of a DTI consultative document on the CAD, he noted that if the CAD was adopted in its present form, UK investment firms would need to raise their capital by as much as 70 percent. While satisfied with proposals applicable to position and counterparty risks, Redwood echoed arguments originally advanced by FIMBRA, which had argued for changing the illiquid assets provision and removing minimum capital requirements. The UK's capital requirement for its 8,000 independent UK financial intermediaries was a token £1. These firms, unique to the British market, provided advice and investment services but did not trade securities. They would be required to carry minimum capital of ECU 50,000 under the draft CAD. They might avoid the requirement under a "grandfathering" provision but any subsequent changes to their capital structure or ownership could trigger the higher requirement. See: Department of Trade and Industry, "EU Capital Adequacy Directive: A Consultative Document", September 1990, cited in Richard Waters, "International Capital Markets: Brokers Face 70% Capital Rise under EC Plan," *Financial Times*, 27 September 1990.
[88] See below.
[89] Richard Waters, "The Quest for a Capital Adequacy Directive," *Financial Times*, 5 April 1991.
[90] There were three levels of minimum initial capital: a basic ECU500,000 level, a reduced level of ECU100,000 where firms act only as agent or portfolio managers and do not hold trading positions of their own and, lastly, ECU50,000 where firms are additionally not authorised to hold customer's money or securities.

Technical disagreements remain

Despite subsequent drafts, the remaining German and UK disagreements over the CAD were still unresolved in early 1992. The possibility of German bank capital requirements being "weakened" by EU securities directives still represented a threat to German universal banks' domestic market dominance. Close corporate and government ties with universal banks ensured that German economic and political interests presented a united front in EU negotiations.

The negotiating posture of German regulators was also influenced by domestic debates over the centralisation of German securities trading in Frankfurt. The centralisation of securities trading in one location would enhance the stature of German domestic markets generally, an objective of the Kohl government. It would also enhance the ability of domestic markets to meet the capital demands of German reunification, also a government objective. However, conservative German *Land* interests continued to resist centralisation efforts; they were concerned by the potential for diminution of commercial revenues and economic clout. As a result, German negotiators had a strong incentive to finalise the CAD in a manner that would both protect the domestic franchise of their universal banks and permit them to focus their energies on building domestic markets.

In the UK, marginally capitalised institutional brokers continued to oppose minimum capital requirements. The precise components of a "trading book," that element of a bank's balance sheet devoted to securities trading, still needed to be determined. The current CAD draft proposed that assets falling outside the trading book be subject to higher, less flexible, bank capital requirements than those inside the book. The language of the directive would influence how capital financing would evolve in the EU.[91]

Opinion amongst observers and negotiators was mixed. Media speculation suggested that the EU's work on capital adequacy might be rapidly pre-empted by contemporaneous work being undertaken by IOSCO and the Basle Committee. This possibility was also predicted in a study issued by accountants Coopers & Lybrand for

[91] Firms would favour financing techniques that resulted in lower capital charges.

IPMA.[92] In early 1991 Sir Martin Jacomb, chairman of the private British Bankers Association, had stated that the EU's work should proceed in tandem with other international forums. George Zavros, writing the EU Parliament's CAD report, responded that it was critical that the EU lead capital adequacy regulatory development and that harmonisation with competing international forums was a secondary concern.[93] Negotiators asked rhetorically, "Why would the EU adopt directives that risked being superseded by new language developed by other regulators?"[94]

An EU precedent

On January 27, 1992, just one day before a Geneva meeting between IOSCO and the Basle Committee to discuss capital adequacy,[95] the EU published a revised version of the CAD that clarified several controversial technical issues including the type of capital that investment services firms and bank trading departments would be required to carry. The subsequent IOSCO/Basle Committee meeting – to which the EU was an observer – unsuccessfully attempted to establish its own international capital adequacy standard. As a result, the CAD became a *de facto* regional capital precedent and potential international standard. The new CAD draft carried 26 amendments. Article 3 described a range of minimum required capital levels for firms engaged in securities businesses. It also contained an important "grandfather clause" that permitted a firm to carry less than the prescribed level of capital if it was authorised to do business before the directive was implemented. The new draft generally excluded from its jurisdiction credit institutions, "local firms," and investment advisors and brokerage firms that did not hold funds or securities on behalf of customers. This addressed a major concern of UK brokers.

The directive also explicitly adopted a "building block" approach to calculating required capital for portfolio risk positions, which permitted different capital allocations for specific and general risks. Earlier drafts had generally not differentiated among the various components of position risk.[96] Additional risk components in the CAD included

[92] Report cited in Richard Waters, "Capital Questions for EC Investment," *Financial Times*, 22 May 1992.Consultation between IOSCO and the Basle Committee on related proposals was scheduled to begin during summer of 1992. See Chapter 9.
[93] Lucy Kellaway, "Bankers Cautious over EC Capital Backing Proposal," *Financial Times*, 10 January 1991.
[94] Richard Waters, "Capital Questions for EC Investment," *Financial Times*, 22 May 1992.
[95] See below.
[96] Position risk, the principal focus of the CAD, was the risk that a change in market conditions could affect the value of a securities portfolio. See: Underhill, "Private Markets and Public Responsibility in a Global System: Conflict and Cooperation in Transnational Banking and Securities Regulation."

changes in foreign exchange prices, delayed or failed settlements and credit risk. The Commission made these modifications after consultation with both private and public sector representatives in London. The building block approach based capitalisation requirements partly on the net value of the trading book and partly on the gross value. This approach allowed for a reduction in required capital through the ability of long and short risk positions to offset each other.[97]

The wisdom of the EU's decision to release a new CAD draft before the Basle Committee and IOSCO took formal action became evident following their meeting in Geneva. One journalist commented that the Basle Committee/IOSCO meeting "had a distinctly US feel."[98] That may also account for the dissension among participants described in the European press. But other factors promoted European concerns as well. Two agreements reached at the largely private Geneva meetings annoyed European bankers; a decision to increase capital for equity positions and a decision to fix the ratio of subordinated debt to other capital at 2.5:1. It was subsequently revealed that British and French regulators had objected to these "meeting conclusions." European securities firms and commercial banks were also distressed by the announcements. Securities firms were dismayed at having to increase capital levels, with no distinction made amongst types of risks. Commercial bankers were worried by a proposed level of subordinated debt that was significantly higher than allowed by the Basle Accord (but still lower than UK SFA rules permitted, i.e., 4:1).[99]

Final text

Following the Geneva meetings, the CAD moved rapidly to a final compromise text. A subsequent meeting in Brussels strove to develop new language based on understandings reached in January, particularly on the ratio of subordinated debt for calculating capital. This was expected to establish a benchmark for further EU discussions,[100] which would, at 250 percent, be higher than the 150 percent level initially proposed by Brussels; it would still be lower than the level then permitted in Britain.[101]

---

[97] Steil, ed., *International Financial Market Regulation.*
[98] Stemming in part from Basle Committee Chairman Corrigan and IOSCO Chairman Breeden's prominent roles. See: Richard Waters, "An Emotive Topic for International Regulators - the Development of Capital Rules for Securities Traders," *Financial Times,* 31 January 1992.
[99] The Basle Accord permitted a ratio of 1:1 for subordinated debt to capital.
[100] Andrew Hill, "EC Closer to Accord on Capital Adequacy," *Financial Times,* 3 February 1992.
[101] The EC's then current CAD proposal included a 150 percent limit on subordinated debt in the calculation of capital. The UK's SFA regulations permitted 400 percent and the Geneva discussions had focused on a level of 250 percent. Under SFA rules, core capital could be supplemented up to 400 percent

Nevertheless, were the UK to accept the level discussed in Geneva, negotiators might compromise on other outstanding issues. The UK had backed the ratio proposed at the Geneva meeting, motivated by concern that less flexible standards discussed earlier would require multinational securities firms operating in London to raise new capital. The 250 percent level would be easier for UK-based firms to accept than the originally proposed level.

Should the EU wait for Basle/IOSCO?

Discussion of the CAD was severed from the ISD. At an ECOFIN meeting in March, ministers approved broad compromise language covering five technical areas. Their goal was to establish a framework for continuing CAD discussions. Reports indicated that the language was "heavily influenced" by the unsuccessful meeting of IOSCO and the Basle Committee in Geneva.[102] But further technical issues remained unresolved.

It was also unclear to what extent the EU was prepared to establish guidelines when the Basle/IOSCO group had not announced its position. The EU noted that the slowly evolving Basle/IOSCO discussions had not provided clear definitions of equity or capital. Nor had a specific perspective on the level of required capital for position risks been developed. The EU was caught between developing its own standard and trying to accommodate the thinking of the Basle Committee and IOSCO.[103] They opted not to wait for Basle.

A compromise was fashioned, based on John Carr's trading book proposal, which refocused regulation on function – lending and securities trading – rather than on institutions.[104] A proposal was made to apply CAD capital guidelines solely to securities portfolios, functionally distinguishing capitalisation for credit and securities activities. Bank asset portfolios, aside from their securities trading components, would be subject to

---

by subordinated loans made to a securities subsidiary by its parent corporation. The amount of capital required to offset a bond position was determined by the value of the securities held, their currency, maturity and credit quality. The result was that capital requirements for short maturity, high credit quality bonds could be less than 1 percent versus a 30 percent level for long-term, low quality securities denominated in a volatile currency. This was the essence of the building block approach to calculating capital.

[102] ISRR, "Compromises Sought to Move Capital Adequacy Rules Ahead," 24 March 1992.

[103] "EC's Capital Adequacy Directive Toned Down for Securities Industry," *American Banker*, 24 February 1992.

[104] Dale and Wolfe, "Capital Standards."

different capital regulations. Institutions could elect which set of guidelines they applied to securities portfolios, the CAD or the SBD guidelines. German regulators grudgingly agreed to the compromise. It addressed German level playing field concerns but also required German banks to operate and structure themselves differently.[105] If they adopted revised CAD guidelines for trading activities, they would need to segregate an asset portfolio representing their "trading book" from other assets. How this was to be accomplished was unclear. The proposal called for a potentially costly change in traditional German balance sheet composition and in the way German banks were operated and managed. The expense of modifying accounting and business practices was also likely to be high. More importantly, the revised language did change the regulatory playing field by creating different capital standards for securities and credit portfolios, which could affect the growth of lending and securities businesses.

Compromises negotiated on technical issues in the final form of the CAD effectively "split the difference" on contentious issues or established specific national preference exceptions. Among the latter were provisions exempting non-trading firms and third-country firms from the requirements of the CAD.

In May 1992, the EU released compromise CAD language formally incorporating the "trading book" concept. The prospect for agreement was strong enough that British Economic Secretary Anthony Nelson actually warned against fixing an agreement that might conflict with any subsequent agreement reached by the Basle Committee or IOSCO.[106] The *Financial Times* editorialised against the EU setting capital adequacy rules which the Basle Committee and IOSCO were "better placed" to develop.[107] Foreign bankers in London disagreed, noting that the revised CAD could serve as a model for other regulatory negotiations. "It appears to be a sensible compromise between the interests of banks and the interests of securities firms. It is certainly an advance over the system of regulation which applies in the US,"[108] said one US banker.

[105] David Lascelles, "Capital Adequacy Directive: EC Battles to Create a Level Playing Field for Banks and Securities Houses," *Financial Times*, 26 April 1990.
[106] David Owen, "UK Plays Down Capital Adequacy Hopes," *Financial Times*, 4 June 1992.
[107] "The Lex Column: Capital Adequacy," *Financial Times*, 9 June 1992.
[108] Simon London, Alice Rawsthorn, and Andrew Hill, "Muted Cheers for the Single Market: Attempts to Unify European Securities," *Financial Times*, 11 June 1992.

Agreement

Final agreement was achieved by the development of compromises, brokered by the Netherlands and UK Council Presidencies, on the remaining technical issues. The EU determined not to wait for resolution of the IOSCO/Basle Committee discussions before setting their own regulatory precedent. Time pressure contributed to the resolution of these debates: pressure to complete the directives ahead of the launch of the Single Market (which they missed) and, in the case of Germany and the UK, pressure to accept compromises before Britain assumed the EU Presidency.[109]

As noted above, press speculation focused on the possibility of a *quid pro quo* between UK and German regulators that would enable resolution of CAD and ISD debates.[110] Although the allegation was never confirmed during confidential interviews, powerful domestic preferences, public and private, clearly operated. British preference for the inclusion of hedging in capital calculation was accepted. Germany's agreement indicated their conclusion that the CAD would sufficiently protect German universal banks' domestic franchise. It also reflected Germany's preoccupation with financing reunification, its lack of votes in the Council, and its desire not to antagonise EU partners who were already anxious over a powerful, reunified German state. The compromise also permitted Germany to focus on Chancellor Kohl's *Finanzplatz Deutschland* program.[111]

In CAD debates, private and public sector concern with the continuity of the UK's domestic capital adequacy regime was juxtaposed with German regulators' concern over capitalisation standards and the domestic competitiveness of universal banks. Progress on the CAD during 1990 came about through accommodation of German and British public and private sector preferences. During 1991, a general consensus was reached among ECOFIN negotiators on the trading book and building block approaches, as a result of which, it appeared possible that the CAD could be

[109]Brown argues the UK would be constrained from aggressively promoting British preferences during its Presidency. However, British negotiators indicated they looked forward to promoting UK-devised compromises during their Presidency. These conflicting perceptions would have created uncertainty and acted as an incentive to complete the negotiations as soon as practicable. See: Brown, "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives."
[110] Lee, "Securities Houses Face Capital Clampdown".
[111] Aimed at enhancing the attractiveness of domestic German securities markets and facilitating reunification financing. See Chapter 4.

finalised by year-end.[112] The resolution, which strove to minimise changes to domestic financial services regimes, institutional practices and relationships, demonstrated the EU's sensitivity to member-state and private sector preferences and ensured that the resolution would be endorsed under the EU's QMV rules. Competition to set a multilateral regulatory precedent led the EU to publish a revised version of the CAD just before the IOSCO and Basle Committee Geneva meeting. On technical issues, such as starting capital and subordinated debt permitted in capital, the final version of the CAD reflected additional compromises.

Conclusions

This review of the CAD and ISD negotiations highlights the diverse sources of influence and authority that produced the directives.

On a supranational level, the EU focused on balancing regional authority and national sovereignty. This was demonstrated through the series of compromises on the directives proposed by EU officials and in their desire to establish an international regulatory precedent.

State preferences were influenced by the wish of state negotiators to insulate the historic structure of national markets and institutions, and to avoid domestic political conflicts brought on by dramatically changing domestic legislation or business practices. Private sector influence, on both state and supranational negotiators, was seen in lobbying: in France, where it was marginally successful; and in the UK, Germany and EU where it was more successful. France's *Patronat* was significant but did not compel modification of French state regulatory preferences. The state's concern with protecting a nationalised industry took precedence over trading preferences held by international institutions.

The UK's market and regulatory influence was sufficient only to encourage compromise language. The back and forth of debates and drafts, and the structure of compromises agreed to in the directives, demonstrated the inability of any EU member-state or private sector interest to impose its preferences unilaterally. It also demonstrated

[112] Simon London, "Fresh Try on Securities Directive," *Financial Times*, 16 July 1991.

the Commission's sensitivity to member-state preferences. The Commission's laborious efforts to broker compromises indicate the powerful motivation of QMV and the 1992 deadline - and the EU's efforts to alter existing national regulatory practices as little as possible.

These observations confirm state-centric hypotheses. Preservation of national sovereignty was evident in compromises in the directives brokered by the Commission. Dramatic regulatory convergence was not evident. Private sector interests did mobilise directly in the supranational arena. However, the final structure of the directives indicates that member-states were able to ensure their sovereignty by imposing national preferences.

In fashioning regulatory compromises, EU Commission and DG XV negotiators permitted a variety of national preferences to flourish, despite acknowledged advantages accruing to British regulatory norms. Domestic preferences; in Germany for a level playing field, in France for protection of national institutional champions, and in Britain for domestic regulatory precedents, all shaped the directives. Preferences derived predominantly from states, but they also reflected private actor influence. More significantly, the EU's approach incorporated substantial differences between major member-states, contradicting an assumption of state/market theorists that financial services firms will converge on unified governance or regulatory standards to minimise compliance and operating costs. However, it confirms theses addressing the significance of structure and institutions. Domestic institutional preferences were inelastic, market evolution threatened the viability of national champions, of long-established domestic operating methodologies, and public/private sector relationships. As a consequence, it is unsurprising that the directives reflected a series of awkward accommodations rather than best market practices.

Chapter 6

EU Policy-making Authority

Introduction

This chapter examines the history, structure and authority of key EU policy-making institutions. In particular, it examines their role in the development of the CAD and ISD. The chapter also examines the EU's interaction with external private and public sector authority and their impact on EU policy-formation and its ability to shape international regulatory development.

Background to the EU

During and after WWII, prominent Europeans encouraged the development of a federal Europe, in part to enhance European influence on international political and economic discussions that were increasingly dominated by the US and Soviet Union. Their efforts met with mixed success.[1] The difficulties they encountered and the solutions they proposed were reflected in the subsequent development of the EEC[2] and in the CAD and ISD negotiations.[3]

Early regional integration

Early efforts to promote a united Europe[4] failed to achieve unanimity on proposals to reduce national sovereignty.[5] In response, Jean Monnet proposed an

---

[1] "Prominent Europeans" included Jean Monnet and Winston Churchill.
[2] The European Economic Community, precursor to the EU.
[3] See: S. Hix, *The Political System of the European Union* (New York: St. Martin's Press, 1999), Robert A. Jones, *The Politics and Economics of the European Union*, 2nd ed. (Cheltenham: Edward Elgar, 2001), Helen Wallace, "The Institutional Setting," in *Policy-Making in the European Union*, ed. Helen Wallace and William Wallace (Oxford: Oxford University Press, 2000), Helen Wallace and William Wallace, eds., *Policy-Making in the European Union*, 4th ed. (Oxford: Oxford University Press, 2000). for detailed descriptions of the origins and development of the EEC.
[4] A 1948 European assembly called the International Committee of the Movements for European Unity. Established to promote a "united Europe."

alternative route to supranationalism, based on functional,[6] rather than intergovernmental, integration. An early proposal by Monnet to harmonise national regulatory regimes resulted in the creation of the European Coal and Steel Community ("ECSC").[7]

The ECSC[8] established a supranational (regional) bureaucracy and High Authority,[9] which were balanced by an intergovernmental Council of Ministers representing member-states.[10] This became the archetype for the European Economic Community.

Following the 1954 failure to establish the European Defence Community,[11] foreign ministers of ECSC states met to discuss the formation of a customs union.[12] The meeting led to the signing by six states of two treaties in Rome in 1957, the European Economic Community ("EEC") and the European Atomic Energy Community treaties (collectively referred to as the "Rome Treaty"). By 1990, 12 countries had joined.[13] The Rome Treaty did not create a formal framework authorising extensive EU institution building and, as a result, early discussions focused on simple trade and tax issues.

---

[5] The Congress resulted in the development of a weak Council of Europe in 1949. Its Court of Human Rights remains active.

[6] Economic and, eventually, monetary and political integration.

[7] Formally created through the Treaties of Paris; signed in 1951 by six states: France, Germany, Italy, Belgium, the Netherlands and Luxembourg. These treaties also "reintegrated" Germany politically with Western Europe.

[8] The ECSC was originally designed to coordinate French and German coal and steel industries, but received wider regional interest from Italy and Benelux countries and the US. The UK initially declined to participate, predicting the plan would fail, but subsequently signed an association agreement with the ECSC in 1954.

[9] The chief operating executive.

[10] The ECSC also had an appointed European Assembly, a Court of Justice and a consultative committee.

[11] A major European concern, coincident with the creation of the ECSC, was regional defence, particularly concerning Germany and the Soviet Union. In 1950, French Premier René Pleven proposed the creation of a European Defence Community ("EDC") and, in 1952; the six ECSC signatories signed a regional defence plan. A principal objective was to tie Germany into the West European defence structure. However, in 1954, the EDC failed to receive French parliamentary ratification and never came into existence, ironically because France was unwilling to give up control of its military forces.

[12] The British also proposed an alternative to Pleven's EDC plan, the intergovernmentalist Western European Union ("WEU"), which contrasted sharply with the supranational EDC proposal. The WEU was created in 1954, expanding the 1948 Brussels Treaty, a defence alliance, and bringing West Germany into NATO. The UK sent an official to the foreign ministers' meeting but withdrew when discussions advanced beyond governmental cooperation. UK Foreign Minister Anthony Eden, an anti-federalist, proposed a free trade area alternative but was rebuffed

[13] Denmark, Ireland and the United Kingdom joined in 1973, Greece in 1981, and Spain and Portugal in 1986. East Germany was effectively made a member through re-unification with West Germany in 1989.

However, in 1979, the creation of the European Monetary System ("EMS") stimulated further regional co-operation and the integration of European financial services.[14]

This abbreviated institutional history highlights early characteristics of policy negotiations among EU member-states:[15]

1. member-states' reluctance to sacrifice sovereignty;
2. where sovereignty was relinquished, it was incremental and functional, not general – decisions were highly political;
3. contrasting with 1 and 2, original members agreed to common objectives: developing a common market and progressively coordinating national economic policies. Newer members had more difficulty reconciling loss of sovereignty with regionalism;
4. member-states' interest in "locking-in" German participation – reflecting fears of German (or Italian) *revanchisme* and resurgent national economic power;
5. the creation of a powerful multi-layered supranational bureaucracy, designed to achieve a balance between national and supranational interests;
6. British reluctance to tie itself to continental Europe, politically or economically, and its preference for intergovernmental, rather than supranational solutions to policy issues, and
7. Britain's view that its future lay in a closer relationship with the US.[16]

Sources of EU Authority

Following rapid progress in building EU institutions in the 1950s and early 1960s, further regional integration was slowed by national disputes over the scope of institutional powers, economic recession and protracted debates over British EU entry. The 1985 White Paper and 1986 SEA,[17] which were dramatic responses to a changed market landscape and to EU political and economic stagnation, reinvigorated the EU's original objective of asserting its interests internationally. The White Paper's goals also

[14] The EMS created a new currency, the "ECU" or European Currency Unit, which had its value determined by reference to a basket of currencies consisting of specific percentages of the currencies from 10 of the 12 member-states.
[15] As noted earlier, throughout this study, for convenience, I have referred to the EU or European Union rather than the EEC, EC or European Economic Community. The EU superseded the EC in 1992. However, where the context demands it I have retained the original language.
[16] Historic British isolation from Europe, as well as relative economic and political strength following WWII, encouraged Britain - initially - to view its European role more as "mentor" than member-state.
[17] See discussion immediately below.

raised the profile of securities regulatory issues and moved securities regulation from an abstract topic to "a political problem."[18]

EU institutions

EU institutional expansion was premised on ECSC and EEC objectives, codified by treaties and reports, which defined the structure of EU authority and member-state cooperation. Institutional development included the execution of core treaties, which formed the basis of EU legislation; the development of principles underlying financial services directives; and, finally, the CAD and ISD.

EU treaties and reports

Among the Treaty of Rome's objectives was the requirement that member-states act to "progressively abolish" national restrictions to the movement of capital, goods, persons or services within the Community.[19] The Treaty did not establish a formal framework authorising the EU to achieve these objectives. Instead, initial member-state discussions focused on the removal of tariff barriers and the encouragement of tax harmonisation. The launch of the EMS in 1979 helped stabilise member-states' exchange rates and promoted further regional co-operation.[20]

A code of "Community laws"[21] unique to the EU was developed to govern regional activities. Two legal principles serve as the basis for the EU's legal system: first, that EU law, where applicable, assumes precedence over national laws and, second, that individuals have the right to utilise EU law in national courts. These principles give EU law its supranational form.[22] More significantly, establishing the precedence of EU law limited member-state sovereignty.[23] By accepting this principle, the original six EEC member-states indicated their commitment to regional integration and to the gradual

---

[18] Peter Koenig, "Into the Maelstrom," *Euromoney*, June 1987., p.76.
[19] Samuel Wolff, "Securities Regulation in the European Community," *Denver Journal of International Law and Policy* 20, no. 1 (1991)., p. 102.
[20] The EMS created a new currency, the "ECU" or European Currency Unit, which had its value determined by reference to a basket of currencies consisting of specific percentages of the currencies from 10 of the 12 member-states.
[21] EU laws, "*droite communitaire*," are neither national nor international.
[22] Van Doorn & Lowe Thieffry, "The Single European Market: A Practitioner's Guide to 1992," *B.C. International and Comparative Law Review* 12 (1989).
[23] Superseded only by "vital national interests," the so-called "Luxembourg Accord."

migration of national authority to a supranational institution.[24] This would be effected by member-states' adoption of EU laws.

EU laws may take the form of directives, regulations, decisions and judgements of the European Court of Justice ("ECJ"). A directive is an act adopted by the EU Council or EU Commission.[25] The majority of EU measures covering securities and financial services were Council directives, emphasising their intergovernmental character. Re-emphasising this point, directives typically do not take immediate effect, but must first be incorporated into national law, usually within a specified time period. Directives are binding but permit member-states to determine the method of domestic implementation. Member-states may not "justify non-application of a directive on the grounds of domestic difficulties or legal rules, even when the rules deal with constitutional issues," but they can delay implementation.[26] Directives are not as powerful legislatively as regulations, which have immediate effect and apply directly to all member-states.[27] Nevertheless, directives are powerful agreements that bind member-states. Failure to implement directives can lead to lengthy and expensive legal challenges in the ECJ.

Member-state political and business leaders recognised both the potential international economic and political value of an integrated Community and the importance of endorsing EU goals. As EU membership grew, however, the number of conflicting interpretations of member-states' commitment to EU principles and objectives increased. As the original six member-states grew to twelve, EU objectives increasingly encountered entrenched national interests and preferences, forming the grist for subsequent Council and interstate/regional negotiations.

---

[24] Of course, as the EU enlarged, the commitment of member-states to integration varied and conflicts arose. This was dramatically evident in the UK's lengthy EU entry debate and, more specifically, in the willingness of member-states to alter domestic regulations to accommodate regional harmonisation.
[25] See Appendix C for a discussion of EU law making.
[26] This was the case with the CAD.
[27] Directives are "the classic method of integrating European Community policy into the national law of the member-states." Thieffry, Van Doorn & Lowe, *The Single European Market: A Practitioner's Guide to 1992*, 12 B.C. Int'l. & Comp. L. Rev. 357, 360 (1989), as quoted in Warren, 1990, p.196.

EU financial services legislation

In 1985, the European Commission released a White Paper[28] prepared by Lord Cockfield of the UK, which specified a plan for the development of a "European financial common market." The White Paper envisioned the removal of "physical, technical and fiscal barriers between EU countries by the end of 1992," an objective known as the "1992 Single Market Plan."[29] This was to be achieved through regulatory harmonisation. The White Paper detailed almost 300 legislative steps to achieve the common internal market. The majority were proposed as directives, which typically provided member-states with a two-year window for national implementation following Council adoption. Consequently, in order to complete the Single Market by the end of 1992, directives would need to be adopted by the Council by the end of 1990. However, the large number of proposed directives and the EU's emphasis on consensus law-making made achievement of the 1992 goal problematic from the outset. Additionally, much of the legislation would require unanimous agreement from the Council of Ministers.

Recognising these potential difficulties, reform of EU legislative procedures was undertaken in 1986 to replace the treaty-based balance of EU institutions. The most significant changes instituted qualified majority voting on internal market matters and a prescriptive "cooperation procedure" for review and adoption of legislation.[30] Member-states entered into a new treaty, the Single European Act,[31] which amended the Treaty of Rome. The SEA represented a significant alteration in the EU's approach to Council votes on internal market legislation,[32] replacing unanimous voting on Council directives with "qualified majority voting."[33]

[28] "Completing the Internal Market: White Paper from the Commission to the European Council" (COM No. 85) 310 (June 14, 1985). Also, the "Cockfield Report."

[29] Also referred to as the Single European Market Plan ("SEM").

[30] Potter, "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward."

[31] Single European Act of 17 February 1986, 30 O.J. European Commission (No. L. 169) 1 (1987). The Single European Act is not a legislative act but rather an amendment to a treaty, as quoted in Wolff, 1991, p.103.

[32] Manning Gilbert Warren III, "Global Harmonisation of Securities Laws: The Achievements of the European Communities," *Harvard International Law Journal* 31, no. 1 (1990)., p.24.

[33] In "qualified majority voting" voting weights are assigned to each member-state based generally on its population and economic power. However, social and tax matters still required unanimous approval under the SEM. See Appendix C.

The EU's early legislative objective was uniform regulatory harmonisation. The SEA changed this objective to the development of common minimum standards subject to mutual recognition by member-states. This change generated identifiable legislative progress and optimism for achievement of the 1992 Plan.[34] The SEA encouraged member-states to follow the more involved and compromise-oriented cooperation procedure in reviewing legislative proposals. This procedure exposed legislative proposals to a variety of influences, both internal and external, and subjected them to strict time limits during their "second reading."[35] More importantly, this development moved EU policy-formation away from uniform harmonisation.

The SEA explicitly recognised that for the EU to achieve its objectives, compromises between member-states would be necessary. More significantly, that these compromises would not represent the migration of state authority to a supranational body, but rather agreements that allowed the continuation of distinctive national regimes.

The SEA had several implications for EU directives. First, it provided a more active legislative review function for Parliament. Second, the amendments increased the level of interaction between the intergovernmental Council and the supranational Commission. More fundamentally, QMV eliminated the ability of a member-state to veto or filibuster legislation. This meant that issues were more closely reviewed and subject to greater interaction between member-states and the EU. As was evident in the resolution of disagreements over the CAD and ISD, QMV acted as a powerful incentive for negotiators to broker compromises in order to resolve controversial issues and finalise legislation. It also acted as a vigorous incentive for the Commission and Council to consider each other's views and develop consensus solutions to issues arising out of national preferences.

While the SEA was designed to facilitate the SEM it was not an unqualified improvement in EU regulatory review procedures. The Treaty overtly politicised legislative review by mandating compromise and coalition formation. Also, certain EU

[34] Warren III, "Global Harmonisation of Securities Laws: The Achievements of the European Communities."
[35] Previously, second reviews by the Commission, Council and Parliament were not subject to time limits See: GAO, "European Community: U.S. Financial Services' Competitiveness under the Single Market Program," p. 12-13, for a useful outline of the EU Cooperation Procedure. See also: Appendix C.

legislative topics[36] remained subject to unanimous vote of the Council.[37] Finally, the SEA did not address the informal 1966 "Luxembourg Accord."[38]

The White Paper and SEA appeared to represent a dramatic shift of authority to EU institutions from member-states. Potentially, the SEA and QMV could force member-states to adopt legislation they opposed. But the SEA also increased the influence of the Council in developing legislation. While only the Commission could propose legislation (an agenda-setting privilege), the Council had final voting approval. This arrangement forced the Commission to be responsive to national Council concerns, particularly member-state domestic interests. This was graphically reflected in the development of compromises facilitating final agreement to the ISD and CAD. In particular, neither of the voting blocs on ISD issues, the Club-Med[39] and Northern European[40] groups, represented qualified majorities. As a result, they were forced to compromise in order to develop a consensus position on the ISD. Instead of crafting language that defined a middle position (or reflected member-state concessions), the Council and Commission permitted member-state derogations and the inclusion of ambiguous language in the final directives. Both concessions were consequences of the political pressure to which the SEA subjected Council debates. Additionally, both the ISD and CAD were subject to intense political pressure associated with the 1992 deadline. Consequently, the SEA represented two important developments: the establishment of the policy-setting authority of EU institutions and, conversely, the politicising effect of EU principles that promoted legislative compromise to preserve momentum toward regional integration. The SEA indicated the EU's acknowledgement that policy-making authority would remain predominantly with member-states.

In the mid-1980s, the EU and member-states took decisive legislative action to facilitate achievement of the SEM. EU membership represented nationally ratified acknowledgement of shared regional goals and values – and of delegated authority. The

[36] Including fiscal matters, the movement of persons and the treatment of employees.
[37] Potter, "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward."
[38] Darrel S. Lew, "The EEC Legislative Process: An Evolving Balance," *Columbia Journal of Transnational Law* 27 (1989)., cited in Potter, "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward." See footnote 7 above.
[39] France, Belgium, Italy, Portugal, Spain and Greece represented 43 votes in the Council.
[40] Germany, the UK, Denmark, the Netherlands, Luxembourg and Ireland represented 33 votes in the Council.

SEA acknowledged the difficulty of balancing integration, sovereignty and authority. Nevertheless, the goals of the Cockfield Report were strongly endorsed by all member-states, including the UK, which would begin to question SEM objectives several years later.[41]

While at one level, member-states' commitment to the SEM was underscored by their sacrifice of sovereignty to achieve regional goals, the spirit of political compromise was also evident in the EU's decision to implement financial services objectives through directives rather than regulations, reserving implementation to national legislatures. The subsequent detailed negotiations over the CAD and ISD reflect member-states' preference for preserving domestic regulatory institutions over the creation of a uniform regional EU regulatory regime. The balancing of supranational and national interests reflects a continuing tension in EU rule-making.

The development of a single market for financial services was a vital EU goal in its own right and a critical step toward longer-term monetary and fiscal harmonisation. In 1989, Commission President Jacques Delors released the "EMU Report," which proposed three stages for achieving economic and monetary union. The EMU Report extended the original SEM program by proposing that exchange rates between member-states' national currencies be fixed. The report also proposed the development of a single EU currency and central bank.[42] At the EU's 1989 Economic Summit, Community members agreed to hold an intergovernmental conference on July 1, 1990 to amend the

---

[41] In 1988, the EU released the Cecchini Report, a complex economic analysis arguing the Single Market would promote regional price convergence. The report suggested that economic gains from the SEM would amount to somewhere between ECU82 and ECU142 billion for the nine member-states, or between 2.8 and 4.8 percent of GDP. Employment and balance of payments benefits were also predicted. The report's strong economic case for the SEM bolstered public and private political support for the goals of the SEA and the White Paper. See: Paolo Cecchini, Michel Catinat, and Alexis Jacquemin, *The European Challenge 1992: The Benefits of the Single Market* (Aldershot: Wildwood House, 1988). Also based on confidential interviews, London, February 2001.
Responding to speculation over the UK's early SEM commitment, a UK participant in the CAD negotiations, noting Cockfield's British nationality and government resume, commented, "Do you think the British government would allow Cockfield to say what he did if they didn't support it?" See generally: Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community," and Sandholtz, "Choosing Union: Monetary Politics and Maastricht." Quotation is from confidential interviews, London, February 2001.
[42] The Delors Committee Report proposed three stages for EMU: 1) Greater EU member-state co-ordination of economic and monetary policy. This required all members to join the EMS. 2) A second phase established an institutional procedure for fixing budget deficit and macroeconomic targets. 3) A final stage that would fix exchange rates and set rules for the co-ordination of economic and budget polices. The final stage also required the creation of a European central bank and a single European currency.

Treaty of Rome further and to start the first phase of EMU. The decision to proceed reflected member-states' continuing endorsement of 1985 White Paper goals.

Financial services directives

Early securities regulatory directives included the "Stock Exchange Directives," which covered admission,[43] listing,[44] and reporting requirements of bourses. Separately adopted directives covered prospectuses, mutual funds, and insider trading.

In 1987 the EU Council amended the Listing Particulars Directive with the Mutual Recognition Directive,[45] which was designed to improve trading efficiency and uniformity between domestic capital markets by requiring listing particulars approved in one member-state to be recognised in all member-states.[46]

The Mutual Recognition Directive established two conditions for recognition of non-member-state regulatory standards. First, there must be equivalent investor protection under EU and non-EU regulations and, second, non-EU states must provide reciprocity to EU member-states.[47] Reciprocity came up again in debates over banking directives.[48]

The Second Banking Directive

The most significant early EU financial services directive was the 1989 SBD.[49] The SBD amended the First Banking Directive ("FBD")[50] and authorised a single license, valid throughout the EU, for the provision of banking and related financial

---

[43] Directive 79/279, "Council Directive Co-ordinating the Conditions for Admission of Securities in Official Stock Exchange Listing", 22 O.J. European Commission (No. L 66) 21 (1979). This Directive was amended in 1982 by Directive 82/148, 25 O.J. European Commission (No. L 62) 22.
[44] Directive 80/390, "Council Directive Co-ordinating the Requirements for the Drawing Up, Scrutiny and Distribution of Listing Particulars to be Published for the Admission of Securities to Official Stock Exchange Listing", 23 O.J. European Commission (No. L 100) 1 (1980).
[45] Directive 87/345, "First Amendment to the Listing Particulars Directive", 30 O.J. European Commission (No. L 185) 81 (1987).
[46] Even where a member-state mandated more stringent domestic regulations than required by the EU, it was required to accept listing disclosure meeting the lower standard. This diminution in member-state authority provided ample room for regulatory arbitrage and prompted remedial language.
[47] Manning Gilbert Warren III, "Regulatory Harmony in the European Communities: The Common Market Prospectus," *Brooklyn Journal of International Law* 16 (1990)..
[48] See below for discussion of the reciprocity debate.
[49] Other directives addressed bank capital, deposits and related issues. These included the Solvency Ratio Directive, the Own Funds Directive, the Second Consolidated Supervision Directive, the Large Exposures Directive and the Deposit Guarantee Directive. Respectively; 89/646/EEU, 89/647/EEU, 89/229/EEU, 92/30/EEU, 92/121/EEU, and 94/19/EU.
[50] Directive 77/780, "First Banking Co-ordination Directive," 12 December 1977.

services. The directive specifically disallowed host states from requiring additional authorisation or capitalisation beyond that required by a financial institution's home state. With a single "passport" a bank could transact business anywhere in the EU.

The SBD relied on mutual recognition and "home country control." A "credit institution"[51] was not permitted to pursue operations in a host state that were not permitted by its home state. Conversely, under the SBD, if a home state permitted a bank to pursue a "listed" business or activity,[52] the bank was permitted to pursue that activity anywhere in the EU, irrespective of rules pertaining in the host country. In particular, universal banks would be permitted to underwrite securities throughout the EU. It was expected that regulatory competition between member-states would result in the gradual adoption of a "universal banking" institutional model throughout the EU.[53]

"Home country control" reinforced mutual recognition and the single passport. Under this provision, a financial firm was subject to home country supervisory and regulatory constraints, irrespective of where its services were provided. The primary responsibility for supervision resided with an institution's home country. As a result, host countries had very limited supervisory responsibility for foreign institutions.

The EU planned to implement the SBD by the SEM deadline of January 1, 1993, and simultaneously to harmonise bank capital standards, closely following the framework developed in the 1988 Basle Accord.

---

[51] Defined as "an institution that receives deposits or other payable funds from the public and grants credits for its own account." See: Sydney J. Key, "Mutual Recognition: Integration of the Financial Sector in the European Community," *Federal Reserve Bulletin*, September 9, 1989 (1989).

[52] Listed activities included: 1. Accepting deposits or other funds from the public, 2. Lending and factoring, 3. Financial leasing, 4. Money transmission services, 5. Issuing means of payment such as credit cards or travellers cheques, 6. Trading for own or client accounts in money market instruments, foreign exchange, futures and options, exchange and interest rate agreements and securities, 7. Issuing guarantees, 8. Participating in share issues, 9. Providing consulting services and advice, 10. Money brokering, 11. Providing portfolio advice or management, 12. Safekeeping and administration, 13. Credit reference services and, 14. Custody services.

[53] See "1992 Spurs Call for U.S. Banking Reforms", Europe-1992: The Report on the Single European Market 592 (April 1990) and "1992 and Banking Institutions: Markets, Mergers and Margins", Europe-1992: The Report on the Single European Market 316, 317 (Aug. 30, 1989) which indicated the following: "Ultimately, therefore, countries whose regulatory systems are more restrictive than that envisioned by the Commission would come under pressure to liberalise their markets to prevent domestic institutions from being placed at a competitive disadvantage against foreign institutions within their own national boundaries." Cited in Warren, "Regulatory Harmony in the European Communities: The Common Market Prospectus," p. 122.

By 1990, the EU had adopted approximately 30 financial services directives. These related to company law, banking, investment services and securities.[54] They underscored member-states' commitment to creation of a cooperative regional regulatory regime and their sensitivity to the location of authority. These directives also underscored EU regulatory tensions; they developed standards that preserved national regulatory distinctiveness while they simultaneously promoted regional regulatory harmonisation.

EU regulatory concepts

The regulatory concepts underlying EU directives show how EU regulatory evolution attempted to balance the allocation of authority between member-states and EU institutions. EU regulatory concepts acknowledged that nationally distinct regulatory and legal systems would persist. The White Paper and SEA developed regulatory principles based on this conclusion. The core concept was "competition among rules" facilitated by "mutual recognition." Woolcock[55] traces the evolution of these principles to an early 1980s Franco/German trade dispute over manufacturing standards[56] whose resolution established both the principle of mutual recognition and a precedent for compromise political solutions to member-state preference conflicts.

Mutual recognition meant that member-states acknowledged each other's standards, laws and regulations. This encouraged the free flow of capital, labour and services without extensive regulatory harmonisation.[57] A closely related, counter-balancing principle was "harmonisation of minimum standards." This operated as a restraint on regulatory competition by requiring member-states to conform to base-level standards. These principles reflected the EU's desire to avoid a competitive regulatory race to the bottom (or other negative externality) and the difficulty of achieving full regional regulatory harmonisation.[58] The *Cassis* decision also established the ECJ as a

[54] See Glossary. The terms "investment banking" and "securities business" are used interchangeably.
[55] Stephen Woolcock, "Competition among Rules in the Single European Market," in *International Regulatory Competition and Coordination*, ed. William Bratton, et al. (Oxford: Clarendon Press, 1996).
[56] German DIN (Deutsche Industrie Normen) standards and French AFNOR standards
[57] The European Court of Justice ("ECJ") established the principle of mutual recognition in the famous 1979 *Cassis de Dijon* decision, mandating that products suitable for sale in one member-state must be admitted for sale in all member-states. See: Eur. Ct. Reports 649, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein, Cassis de Dijon*, Case 120/78, 1979 Common Mkt. Law Reports 494.
[58] Steil, Competition, Integration and Regulation in EC Capital Markets., p. 18.

potential participant in the evolution of EU regulation, creating a significant incentive for the Council to negotiate minimum standards, or risk having the ECJ do it for them.[59]

The EU's regulatory approach combined compromise with the threat of unilateral political or legal action. This was a practical solution to the difficulties entailed in harmonising regional standards in an area of evolving authority. Tension between harmonisation and competition demonstrated a "constructive ambiguity" in the design of the EU regulatory process.[60] This ambiguity arose from a desire to preserve national regulatory distinctions and authority, while enabling regional regulatory responses to external developments. The underlying assumption of mutual recognition was that it would both foster and restrain competition between member-state regulatory regimes.

The extension of EU regulatory principles to financial services is seen in the adoption of the single passport, home country control, and "reciprocity"[61] provisions. These principles reassured EU financial institutions that regulations protecting domestic markets would not be used to competitively disadvantage foreign firms. However, these provisions also implied that firms from countries with liberal regulatory regimes would have an operational advantage relative to firms from more conservative jurisdictions; they would be able to offer a wider range of services in conservative jurisdictions than local firms could offer. This construction was designed to encourage convergence of regulatory norms around a market-based model[62] reflecting minimum standards and broad permitted powers.[63]

The evolution of EU legislation confirms the importance placed on balancing regional integration with member-state preferences in order to preserve the Union and the harmonisation process. EU legislation mandated cooperation and compromise through EU institutions by establishing fixed public deadlines, by solidifying agreements through treaty and by imposing a cooperation procedure and QMV. These supranational agreements effectively kept policy-making authority in member-states. Member-states,

[59] Woolcock, "Competition among Rules in the Single European Market," p. 294.
[60] Ibid.
[61] Discussed immediately below.
[62] See: Majone, "Cross-National Sources of Regulatory Policymaking in Europe and the United States,"., p. 101-102, R. Dehousse, "Integration v. Regulation? On the Dynamics of Regulation in the European Community," *Journal of Common Market Studies* 30, no. 4 (1992)., p. 392-393 and Woolcock, ibid.
[63] GAO, "European Community: U.S. Financial Services' Competitiveness under the Single Market Program," p. 14.

through the Council, retained authority over final legislative implementation. EU regulatory principles were well developed by the time negotiations on the CAD and ISD began in earnest in 1989. Discussions with negotiators revealed common agreement on the powerful commitment of member-states to achieving the objectives of the Cockfield Report – and to the offsetting objective of protecting national regulatory preferences, markets and institutions.

The reciprocity debate

The reciprocity debate shows how EU regulatory concepts operated in resolving contentious issues. It also demonstrated how private actors and policy networks influenced the development of regulatory norms, inserting their expertise and market knowledge into the deliberative process.

The SBD initially sought "mirror-image" reciprocity between EU and non-EU jurisdictions. "Reciprocity" aimed to create equivalent permitted capabilities between jurisdictions. It meant, for example, that a US financial firm would be permitted the same range of capabilities in the EU as were permitted to EU-headquartered financial institutions in the US. One implication of this was that restrictions would be imposed on US firms operating in Europe. Under Federal Reserve Regulation K, US commercial banks had been permitted limited underwriting capabilities in European capital markets. Because of the separation of lending and underwriting mandated by the Glass-Steagall Act, these activities were prohibited to US commercial banks (and most non-US banks) in US domestic markets. Reacting to complaints from financial institutions, the Council approved amended SBD reciprocity language in December 1989. The amended language specified that the EU would combine reciprocal *national treatment* with open-market access. This meant that the operational scope available to home country institutions would be made available to foreign institutions' operations in that country. Rather than limit foreign financial institutional capabilities in liberal regulatory environments, this compromise accommodated differing regulatory approaches by not extending EU jurisdictional authority beyond its regional market.[64] The EU's actions indicated a legislative approach of tailored compromise, responsiveness to national and market sentiment and constructive ambiguity. How the EU arrived at its compromise reveals

[64] The US/SEC's approach to extraterritorial jurisdiction was the opposite of the EU's. US courts, in particular, and the SEC did not restrain themselves from extending US regulation offshore. See Chapter 10.

how the interaction of EU institutions with state and private interests shaped EU regulation.

A 1988 draft of the SBD stipulated that non-EU banks wanting SBD benefits must first allow the EU to "examine whether all credit institutions of the Community enjoy reciprocal treatment regarding the treatment of subsidiaries...in the third country."[65] This language encouraged the EU to review banking practices of non-EU countries to determine whether they paralleled EU legislation. The provision was controversial because US and Japanese banking laws separated investment and commercial banking. US banks' concern with reciprocity was increased by draft language that argued against "grandfathering"[66] and by proposals for automatic reciprocity review. If adopted, the language could bar US and Japanese firms from operating in certain EU markets. An ISD draft approved by the Commission in December 1988 contained the same language.[67]

The draft also stipulated that any change in the scope of a foreign bank's EU business, enacted after adoption of the SBD, could prompt a reciprocity review. Reacting to criticism, EU Commissioner Leon Brittan indicated that the objective of reciprocity provisions was to strengthen the EU's negotiating position in discussions with third countries over market access.[68]

The draft reciprocity language also reflected a more basic EU objective: ensuring that differentiated national markets were encouraged to migrate to a universal banking model.[69] Within the EU, universal banking was the prevalent bank operating style, but it appeared in different forms.[70] The Commission had earlier acknowledged, through the

---

[65] ISRR, "Reciprocity Should Extend to Bank Branches, MPs Say," 29 March 1989.
[66] See Glossary.
[67] Additional concerns were raised by a private 1989 UK legal study examining the potential consequences of SBD reciprocity provisions. The study identified conflicts between the SBD and FSA 1986 and questioned the ability of the UK, under the SBD, to enforce FSA 1986 against credit institutions from other member-states. The report also confirmed that, following SBD adoption, banks established in certain non-EU jurisdictions would be unable to establish EU subsidiaries, or acquire significant equity positions in EU banks. The report, "Banking in the European Community – 1992", Norton Rose, London, is cited in ISRR, "U.K. Financial Services Legislation May Conflict with EC Banking Directive."
[68] ISRR, "Reciprocity Should Extend to Bank Branches, MPs Say."
[69] Differentiated refers to the separation of investment and commercial banking services. These states included EU member-states, the US and Japan.
[70] In Germany, universal banking predominated. In the Netherlands and UK, universal banks operated alongside domestic and multinational securities firms – but market segmentation predominated. A similar situation existed in France and Italy.

inclusion of securities underwriting in the draft SBD, that it favoured a universal banking model. In the US, concurrent developments indicated a possible weakening in US legislative opposition to universal banking.[71] Commission actions indicated that it wanted to encourage these trends through SBD and ISD reciprocity provisions.

The controversial proposal sparked public debate in the UK and the US. Reciprocity was seen as a threat to the City's pre-eminent market position because it would constrain the Euromarket operations of foreign banks in London. Peter Lilley, Economic Secretary to the Treasury, indicated that the Thatcher government would contest reciprocity provisions. Lilley described the provision as "potentially very damaging." "The threat to London's position as a major financial centre is incalculable."[72] EU officials admitted the language was "obscure."[73]

Meanwhile, The Securities Association ("TSA"), the largest of the UK financial services SROs, issued a report opposing draft ISD reciprocity provisions.[74] The TSA's report made three points: first, that London had become an international financial centre owing to its openness to international firms; second, that the draft ISD language was unclear; and, third, that the proposed language could discourage foreign firms from operating in the EU. The report cited the potential consequences arising from German universal banks operating in the US. Glass-Steagall prohibited them from underwriting securities in US domestic markets; this prohibition could be used to restrict currently permitted EU underwriting activities of US commercial banks.[75] The TSA urged that reciprocity be more flexible.

In April 1989, reports indicated that the EU was backing off its strict reciprocity position. Private sector financial executives, testifying before a US House of Representatives Foreign Affairs subcommittee examining the 1992 plan, indicated that the US government, working together with US businesses, would ensure that the EU did

[71] The development of so-called "Section 20" subsidiaries of commercial banks permitted to underwrite securities and the Federal Reserve approved restructuring of CS First Boston that increased ownership of a domestic US securities firm by a (foreign) commercial bank – Credit Suisse.
[72] Tom Lynch, "EC Bank Plans Threaten City's Role, Says Minister," *Financial Times*, 10 February 1989.
[73] ISRR, "Commission Approves Single License for Providers of Investment Services," 4 January 1989.
[74] The Securities Association, "Investment Services Directive - a Commentary and Analysis," (London: The Securities Association, 1989).
[75] Clive Wolman, "TSA Opposes the Reciprocity Provisions of EC Directive," *Financial Times*, 5 April 1989.

not "discriminate against outsiders."[76] Coincident with the House hearings, a Commission spokesman, responding to a letter sent by the private US Bankers Association for Foreign Trade ("BAFT"), indicated that strict reciprocity would not be required. He emphasised the Commission's global – not regional – approach to regulation, and that the Commission only wanted EU banks operating in the US to be treated like domestic US banks.[77]

Shortly thereafter, Leon Brittan travelled to the US for a series of public and private meetings to quell US bankers' fears that their EU operations would be restricted. Speaking at BAFT's annual meeting, Brittan indicated that the Commission wanted to prevent market access discrimination against EU banks, not to exclude third-country banks from the EU. US bankers were apparently mollified. The EU's mirror-image reciprocity proposal was quietly dropped and "national treatment" became the regulatory standard.[78] In Europe after his US meetings, Brittan addressed London's International Stock Exchange, assuring them that the SBD and ISD would not threaten the City's status. He reiterated that national treatment would be the legal standard established.[79]

The reciprocity debate demonstrated the interaction and influence of private, national and supranational actors in shaping EU financial services regulation. It also highlighted the role of national economic structure in shaping the evolution of directives. First, the debate showed that a preference for compromise influenced EU directive development. Second, it confirmed the Commission's sensitivity to public and private sector reaction to draft directives, particularly to reaction from London and US markets and actors. At the same time, it acknowledged the Commission's authoritative role in the evolution of EU regulatory standards. Third, it revealed the EU's sensitivity to existing domestic economic structures and its - modest – encouragement of future institutional evolution. Finally, by amending the directives in response to criticism, in particular to

[76] The executives also used the hearings to note that European banking was evolving to a universal banking model and that US banks, prohibited from universal banking and interstate branching, would increasingly be at a competitive disadvantage to their international peers. ISRR, "EC Appears to Have Backed Off from "Mirror Image' Proposal," 12 April 1989.

[77] ISRR, "Commission Spokesman Tries to Calm Reciprocity Concerns," 12 April 1989.

[78] ISRR, "EC Commissioner Upbeat on Talks with US Officials," 10 May 1989.

[79] ISRR, "London to Remain Competitive, Brittan Tells Stock Exchange," 7 June 1989. While advocating reciprocal flexibility, Brittan stressed three core objectives for the SBD and ISD: first, the Commission must be capable of assessing whether EU banks enjoyed effective access to third country markets, second, where access was not permitted, the Commission wanted the ability to propose bilateral negotiations, and, finally, if negotiations were unsuccessful, to have the right to restrict new bank branches from offending countries. See: ISRR, "Reciprocity Should Extend to Bank Branches, MPs Say."

commercially damaging aspects of early drafts, the EU indicated its awareness of the competitive aspects of its directives. It also revealed its goal of promoting and protecting the international competitiveness of EU markets, even as it circumscribed the extraterritorial reach of EU regulation.

The iterative review and amendment of draft directives was promoted by EU cooperation procedures. Balancing Commission, member-state, third country, private sector and trade association preferences necessitated that the Commission back away from explicit regulatory harmonisation. In its place, national treatment and mutual recognition advanced the EU's larger objectives.[80]

Was the Commission independent?

Despite the Commission's efforts to remain neutral in directive negotiations, German and French negotiators periodically complained about their lack of allies in DG XV and on the Commission. In particular, DG XV's staff included several British Treasury secondees and was headed by Geoffrey Fitchew, himself seconded from the UK Treasury.[81] Fitchew reported to Commissioner Leon Brittan, another Briton.[82] The number of British secondees in EU financial services positions was explained by the greater experience of British regulators in managing large, diversified markets. EU practice was to appoint experienced personnel to Directorates General. This practice resulted in DG XV and Leon Brittan's financial services cabinet being dominated by British nationals, and DG VI, responsible for agricultural issues, by French nationals, reflecting that country's agricultural prominence within the EU. DG XV staffers vigorously defended their neutrality, arguing that their credibility with the EU's bureaucracy and with member-states depended on it.[83]

[80] Also – possibly – facilitating adoption of these principles (empirical evidence is anecdotal) was the EU's contemporaneous adoption of the principle of national treatment in the Uruguay Round of negotiations of the GATT, reflected in the settlement of trade differences between the EU and US in the 1992 Blair House Accord and in the 1994 Uruguay Round Final Acts. See: "Rules of Origin" - http://www.wto.org/english/docs_e/legal_e/22-roo.pdf.

[81] A British Treasury secondee, John Carr, did much of the drafting for the CAD. Leon Brittan's cabinet member responsible for the CAD and ISD was also British.

[82] Martin du Bois, "EC Considers Plan to Revamp Securities Rules," *The Wall Street Journal*, 16 March 1990.

[83] Despite protestations of neutrality, confidential interviews indicate that, EU staffers favoured British regulatory perspectives, particularly as they learned more about the operations of sophisticated financial markets, primarily from London-based US and UK market participants. London-based regulators and market practitioners had greater experience with large, institutionally-driven markets. The EU was interested in developing a regulatory template that would survive market evolution and regulatory competition (at least in the short-term) and replace one that reflected outmoded trading technologies. As a

Regulatory Principles and the ISD and CAD

This section considers whether principles developed by the White Paper, SEA and QMV were apparent in the evolution of the CAD and ISD. These characteristics include: commitment to the achievement of the Single Market, home country control, single passport, mutual recognition, competition among rules, and harmonisation of minimum standards. Home country control and the single passport are baseline characteristics of the ISD and CAD – and all EU financial services directives – consequently, analytical focus is directed to the remaining characteristics.

Regulatory principles

Interviews with CAD and ISD negotiators reveal three factors considered critical to the directives' successful adoption: member-state commitment to Single Market harmonisation objectives, the adoption of QMV, and time pressure to meet the Single Market deadline. All three factors are based on state preferences or commitments. CAD and ISD negotiations also reveal the influence of EU regulatory principles, notably, the Commission and member-states' persistence in pursuing acceptable compromises that would be approved by a qualified majority. However, empirical evidence tying regulatory principles to unambiguous progress on the CAD and ISD is anecdotal rather than explicit.

At a May 1989 meeting of the International Bar Association, Commission official Christopher Cruikshank affirmed that EU regulatory principles and member-state preferences would be reflected in developmental work on the CAD. He noted that discussions were being held to develop a CAD proposal because early ISD drafts had been criticised for not being as comprehensive as EU banking directives.[84] Cruikshank indicated that the EU would consider the regulation of institutional market risk – an issue not addressed by the ISD – and would provide broad operational guidelines that endeavoured to avoid "trying to put each of the member-states into a mold " by instead defining "broad rules," which, at a "minimum," states would "respect." This meant that directives had to be flexible enough to encompass a range of national banking styles

result, the Commission's "independence" must be viewed in light of its regulatory objectives and bias toward contemporary regulatory technology.

[84] Among other things, it did not define "sufficiently capitalised."

while being sufficiently specific to achieve market opening and prudential objectives.[85] The directives sought to achieve both member-state and Commission objectives.

Timing pressure and commitments

Timing pressures were also evident early in the CAD and ISD discussions. Negotiators were aware that unless talks were resolved by the agreed 1992 deadline two problems would occur: first, the SBD would become active before the ISD and CAD, providing an advantage to universal banks relative to securities firms, and second, negotiators would fail to complete Cockfield's blueprint on time, a goal to which all member-states had publicly committed themselves. Thus, deadlines were a consistent concern in EU debates. For example, in the UK, the House of Commons Trade and Industry Select Committee noted that British negotiators in the EU Council should insist that the ISD be implemented simultaneously with the SBD. The Committee's report, entitled "Financial Services and the Single Market," noted, "If satisfactory progress on the directive is not made by the end of June 1990, that will be a clear signal of a risk that it will not come into effect simultaneously with the Second Banking Directive."[86]

Qualified majority voting

As has been previously noted, the SEA increased the Council's influence in legislative development. This, in turn, required the Commission to be responsive to member-state interests in proposing legislation.[87] This was evident in the negotiation of compromises that facilitated Council agreement to the ISD and CAD. Neither of the ISD voting blocs[88] represented a qualified majority, and they had to resolve stalemates in order to approve the ISD. Rather than develop compromise language, however, the Council and Commission simply permitted exceptions to the directives, in the form of member-state derogations and by including ambiguous language. They were responding to domestic political pressure, particularly deadline pressure, created by SEA commitments. As a result, the SEA and QMV both had a material impact on the final form of the CAD and ISD.

---

[85] ISRR, "New Directive Underway on Capital, Market Risk," 7 June 1989.
[86] ISRR, "MPs Urge Speedier Adoption of Investment Services Rules," 16 August 1989.
[87] While only the Commission could propose legislation, the Council carried final voting approval.
[88] The "Club Med" group - France, Belgium, Italy, Portugal, Spain and Greece - represented 43 votes in the Council. The "Northern Europe" group - Germany, the UK, Denmark, the Netherlands, Luxembourg and Ireland - represented 33 votes in the Council.

Pressure to Fix Regulatory Precedents

As mentioned in the last chapter, pressure to establish international regulatory precedents shaped the course of directive negotiations and demonstrated the desire of the EU and its member-states to define their international regulatory authority. The first international standard established for determining capital adequacy would provide a benchmark against which other standards would be measured.

Several factors indicate that the EU wanted to finalise its deliberations. SEC Chairman Breeden revealed himself to be a vigorous opponent of EU building block capital proposals, surprising European negotiators. With EU and SEC negotiators unlikely to agree on a capital standard in IOSCO, attention turned to the Basle Committee.[89] Basle Committee Chairman Corrigan had endorsed building block capital proposals, but the timing for the Basle Committee's review did not coincide with the EU's 1992 deadline – and Corrigan's support was, at best, tepid.[90] The path for creating an EU regulatory precedent was clear.

Pressure was also evident in rumours of "horse-trading" among EU negotiators over directives. As noted earlier, bankers suspected that German support for British ISD preferences were a *quid pro quo* for British and Commission efforts to develop a CAD acceptable to Germany.[91] Britain's goals in satisfying German regulatory objectives were two-fold. First, the development of a CAD acceptable to Germany *and* the UK meant that the US could not count on German support in IOSCO for US capital adequacy preferences. This relieved British anxiety that it might be compelled to accept a stringent IOSCO capital standard endorsed by the US and Germany.[92] Second, it circumvented the possibility that Germany might vote against the UK and France on the CAD, creating difficulty in establishing a qualified voting majority or resulting in higher capital charges for Paris and London-based firms.[93] These conjectures clarify French COB Chairman

---

[89] In addition to the governance concerns associated with IOSCO, there was an additional disincentive to pursue intense public negotiations in IOSCO – if EU members and the SEC disagreed on a regulatory standard, their disagreement could undermine broad acceptance of any subsequent EU standard. This incentivised EU negotiators but, as predicted, resulted in the broad acceptance of EU capital directives.
[90] Confidential interviews.
[91] This was not, however, explicitly confirmed in research interviews. Lee, "Securities Houses Face Capital Clampdown."
[92] This seemed possible in light of Germany's domestic capital preferences.
[93] Nicholas Bray, "Capital Norms Have a Way to Go," *The Wall Street Journal*, 3 February 1992.

Saint-Geours' comment at the conclusion of the January 1992 Geneva meetings that the EU could not wait for IOSCO or the Basle Committee before establishing its own capital precedent.

Finally, in parallel with the EU's CAD discussions, IOSCO and the Basle Committee were working to develop international capital adequacy standards. Richard Breeden, IOSCO's Technical Committee Chairman, preferred a capital standard significantly higher (and more costly) than the EU's emerging model. Awareness of US preferences – and of the parallel work of IOSCO and the Basle Committee – intensified French and British concern with delays in finalising EU CAD discussions.

In December 1989, a meeting between representatives of IOSCO, the EU and the OECD was held.[94] The meeting highlighted the important role the 1992 Plan played in focusing regulators on developing internationally consistent regulations – and on the EU's interest in setting precedents. EU representatives stressed their leadership in laying the groundwork for international standards and indicated that the EU's evolving financial services directives could serve as a model for IOSCO's efforts to develop a broader set of guidelines for financial services regulation.[95] If the EU did not establish a precedent before IOSCO or the Basle Committee, it might be compelled to follow imposed, rather than negotiated, guidelines. This had been the EU's unhappy experience with the 1988 Basle Accord.[96]

The Basle Accord "surprise"

The Cooke Committee that drafted the Basle Accord had included EU member-states. Thus, it was surprising that both the EU Commission and DG XV felt they had not been sufficiently consulted when the Basle Accord was initially circulated in 1987.[97]

---

[94] ISRR, "IOSCO and EC Officials Meet to Map out Harmonization Effort," 6 December 1989.

[95] ISRR, "Re-Regulation Trend Emerging in the Financial Markets," 31 January 1990.

[96] IOSCO'S regulatory work was stimulated, in part, by Breeden's desire to position IOSCO as the securities equivalent of the Basle Committee and as a competitor of the EU Commission and Council in setting securities regulatory precedents. IOSCO'S work was encouraged by early ISD and CAD debates. IOSCO'S proposals could also influence ongoing EU discussions. Also, IOSCO's research was a response to calls from senior national regulators for the development of a supranational securities regulatory body similar to the Cooke Committee. See: David Lascelles, "Securities Rules Closer to Global Harmonisation," *Financial Times*, 14 August 1989., and Chapters 9 and 10.

[97] Confidential interviews, London, May 2000. The Commission was not, of course, a Basle Committee member. However, there was considerable overlap between EU member-states and the Basel Committee's G-10 members – (although not necessarily between actual negotiators – See Chapter 12). As a result, the EU Commission, a major multilateral actor, was surprised when the Accord was released without its direct

They were surprised by the content and timing of the Accord, and they were concerned the Accord had been drafted by a small group of central bankers without referencing the EU's Single Market regulatory efforts. The EU was working on the Minimum Solvency Ratio directive at the same time that the Cooke Committee was finalising and releasing the Accord in 1988. The release of the Accord effectively pre-empted Commission discussions. Once the Basle Committee had endorsed the Cooke Committee's recommendations, it was a foregone conclusion that the EU and member-states would endorse them as well.[98] For the Commission, most galling was not that they had to adopt Basle Accord standards, but that they had not participated in their development. What also disturbed Commission officials was that core provisions of the SBD, as well as the Solvency and Own Funds directives, were effectively dictated by the Cooke Committee.

The Commission's predicament also highlighted domestic institutional competition *within* member-states; in the UK between the Treasury, DTI and Bank of England, in France between the *Tresor* and *Banque de France*, and in Germany between the Finance Ministry, *Länder* and *Bundesbank.*[99] With only minor exceptions, the language of EU directives paralleled the language of the Basle Accord. International regulatory authority, at least for commercial bank capitalisation, rested firmly within the Basle Committee.

Adding complexity to international policy-making, representatives of different regulatory agencies represented a given country at the different capital adequacy meetings. In EU and IOSCO meetings, the SIB, which reported to the Treasury, was the UK's official representative. At the Basle Committee, the Bank of England officially represented the UK although the SIB attended as an observer. The SEC represented the US at IOSCO while the Federal Reserve attended Basle Committee meetings. Despite efforts to keep parties informed, coherently organising differing perspectives, jurisdictions and prescriptions proved difficult. It was also apparent that domestic bureaucratic rivalries carried over to international discussions. As noted earlier, John

participation or prior notification – especially as it was widely known they were developing Single Market standards. It is doubly surprising if we accept French and German accusations that the Commission reflected a UK bias. Peter Cooke, chairman of the Cooke Committee, was, of course, British, and a Bank of England secondee.

[98] If a state opted for a different or, particularly, weaker, capital standard than stipulated by the Basle Committee's guidelines, that state's banks risked being penalised by their international peers.

[99] See paragraph immediately below.

Redwood, Anthony Nelson and David Walker disagreed over the vigour with which British regulatory preferences should be promoted. This problem also became apparent at the January 1992 Geneva meeting to discuss capital adequacy, where disagreements between Richard Breeden,[100] Gerald Corrigan[101] and IOSCO representatives[102] over capital adequacy caused discussions to break down.[103] Basle Committee and IOSCO attendees' had different interpretations of understandings reached prior to that meeting. Their disagreements spurred Leon Brittan to pre-emptively release the Commission's own regulatory standard on capital adequacy, derailing any possible IOSCO agreement.[104] While the "regional" work of the Commission would not have the same global impact as that of the Basle or Barnes Committees,[105] establishing an EU precedent would potentially influence recommendations made by these Committees.

Following its Basle Accord experience, the Commission determined to remain more closely involved in international discussions over capital adequacy and related regulatory matters. Subsequent to the release of the Accord, Commission officials were invited to attend Basle Committee meetings as observers. As a result, they were able to incorporate in their own negotiations relevant work on capital adequacy and investment services carried out by the Basle Committee. From this experience, EU officials became more sensitive to the importance of regulatory precedents, and subsequently, decided not to delay the release of their regulatory capital standards.

EU member-states' desire to participate in establishing a regulatory precedent was coupled with their decision to set a precedent through the EU rather than IOSCO. Bank of England Director Penn Kent acknowledged the difficulty of developing a broadly acceptable capital adequacy standard. He also remarked on the absence of a supranational forum comparable to the Basle Committee[106] for examining regulatory issues relating to securities firms.[107] In this he echoed the Bank Governor's earlier comments volunteering the Bank for that role. This observation was presented as an

[100] SEC Chairman and IOSCO Technical Committee Chairman but representing IOSCO at the meeting.
[101] Chairman of the FRBNY and the Basle Committee, but representing the Basle Committee.
[102] David Walker of the SIB and Jean Saint-Geours of the COB.
[103] See Chapters 8 and 9.
[104] See below, "The Geneva meeting."
[105] See next section for description of the Barnes Committee.
[106] His comment, surprisingly, ignored IOSCO.
[107] ISRR, "Bank of England Chief Urges Liberal Regulatory Regime." 5 November 1991.

opportunity for the EU to demonstrate its international authority and to develop a capital benchmark that would serve as an international precedent. As negotiations in both the EU and IOSCO progressed, it became clear to EU member-states that IOSCO was unlikely to develop an internationally acceptable standard and that the EU now had an opportunity to take the lead.[108]

International Regulatory Competition

In addition to precedent competition between the EU, IOSCO and the Basle Committee, international focus on capital standards spawned a multitude of groups examining the topic. Despite their declared intent of improving international understanding, cooperation and convergence, the many meetings and reports increased regulatory competition, encouraging the EU's precedent-setting ambitions but also blurring regulatory authority. These developments underline the dispersion of international institutional authority with respect to the evolution of securities regulation and the potential for aggressive institutions to establish regulatory precedents.

Outside the EU, capital adequacy held a prominent place on the agendas of international and national regulators. State and/or supranational regulatory precedents could be established before the EU finalised the CAD or ISD.

In Japan, the Ministry of Finance began to require, from the beginning of August 1989, that Japanese securities firms increase their capital bases in order to decrease their potential vulnerability to risks associated with funds management. New guidelines[109] were scheduled for implementation in 1990.[110]

Also in August 1989, IOSCO released three reports for a one-year public review and comment period that addressed the harmonisation of international securities regulation. The reports covered uniform capital requirements for multinational securities

[108] Confidential interviews, London, February 2001 and May 2000.
[109] Supplementing existing rules covering minimum paid-in capital and leverage. See Glossary.
[110] ISRR, "New Rules Will Tighten Capital Adequacy Requirements," 2 August 1989.

firms as well as recommendations for standardisation of multinational securities offerings and harmonisation of accounting and auditing standards.[111]

In addition to the EU and IOSCO, other groups actively studied capitalisation with the goal of developing regulatory responses to market developments. Frequently incorporating state participants from the IOSCO and EU discussions, these groups included: first, a series of regular meetings referred to as the "Hexagonals," attended by bank and securities regulators from Japan, the US and the UK. Securities regulators from these three countries also met separately on a regular basis. Second, the Basle Committee established a sub-committee, the "Barnes Committee," modelled after the Cooke Committee, to examine regulation of equity position risk in commercial banks. Because of its relevant experience, the UK's SIB was invited to participate in the Barnes Committee's work. Eventually, other EU representatives were invited as well.[112] Barnes Committee recommendations eventually superseded those of the EU and IOSCO. Third, Leon Brittan established an informal, private sector "think-tank," comprised of members of Brittan's Commission "cabinet" and external experts from London's private sector, to independently examine financial regulation. Fourth, a "convention" of European securities regulators (including the UK, France, Italy, Spain, the Netherlands and Belgium) had met twice to discuss regulatory co-ordination and cooperation. Fifth, overlying these specialised multilateral meetings were active, as well as newly established, bilateral agreements[113] that addressed specific regulatory issues.

These meetings, ostensibly arranged to examine regulatory issues and to promote harmonisation, had national competitive objectives as well. No domestic regulator wanted to be surprised by precedents set in other markets or between other states, particularly precedents with which they disagreed. Consequently, these meetings had both cooperative and competitive purposes.

---

[111] ISRR, "Three Harmonization Reports Are to Be Released in Venice," 16 August 1989. The EU and the IASC also addressed these latter two topics.

[112] In the SIB's 1989 annual report, Chairman David Walker noted Barnes Committee discussions were critical to achieving "broadly consistent approaches to capital requirements applied to securities firms and to banks undertaking similar securities business on their balance sheets." While endorsing this initiative, Walker went on to note that the SIB would continue to work actively on other international initiatives, "in particular involving U.S. and Japanese regulators." ISRR, "SIB Joining BIS Group on Equity-Position Risk Study," 2 July 1990.

[113] Some formalised through Memoranda of Understanding ("MOU"). See Appendix E for discussion of MOUs.

In September 1990, securities regulators from the US, UK, and Japan met to discuss regulatory harmonisation. On the agenda were mutual recognition, regulatory harmonisation and capital adequacy.[114] Following the meeting, SEC Chairman Breeden indicated that the SEC expected to release a multi-jurisdictional disclosure proposal ("MJDS") before year-end. MJDS would make it easier for Canadian and US companies to issue securities in each other's domestic markets. MJDS was intended to function similarly to the EU's mutual recognition principle but had additional objectives:[115] making US markets more attractive to foreign borrowers and investors; setting an international regulatory precedent; and promoting US regulatory standards.[116]

The SIB's David Walker announced that a proposal similar to MJDS, but designed to facilitate securities offerings in UK and US markets, was making progress. The DTI's John Redwood commented that British mutual recognition and harmonisation proposals were "willingly accepted" by representatives from Japan and the US at the September meeting.[117] Participants indicated that considerable progress had been made and a consensus reached on closer cooperation.[118]

Like the MJDS, memoranda of understanding ("MOUs") formalised bilateral regulatory procedures affecting issues such as information exchange, investigations and dispute resolution.[119] However, because states that aggressively pursued MOU development, such as the US and UK, had sophisticated regulatory regimes, their MOU agreements often served as precedents for regulatory reform in less sophisticated states. These MOUs served to promote domestic US and UK regulatory norms internationally.

Competing policy-making organisations resented the EU with a choice. If the EU cooperated with other international organisations, agreements would have to accommodate different perspectives, potentially diluting EU authority and complicating EU regional negotiations. Conversely, establishing an EU regulatory precedent would fix

114 Richard Waters, "International Capital Markets: Regulators to Discuss Co-Operation Moves," *Financial Times*, 14 September 1990.
115 Cathy Jordan, "Regulation of Canadian Capital Markets in the 1990s: The United States in the Driver's Seat," *Pacific Rim Law and Policy Journal* 4, no. 3 (1995).
116 See Chapter 11 for a fuller explanation of this proposal.
117 ISRR, "Trilateral Meeting of Securities Regulators Focuses on Multi-Jurisdictional Disclosure Issues," 24 September 1990.
118 Nevertheless, no MJDS-type agreements were ever concluded by the US, UK and Japan.
119 See generally: Tobin, "Global Money Rules: The Political Economy of International Regulatory Cooperation".

an international benchmark.[120] In addition, the 1992 deadline acted as a stimulus to EU negotiations. Public commitment to 1992 objectives was reinforced by broad agreement among European politicians, business leaders and voters that Single Market objectives benefited national and regional economies.[121]

The EU was represented indirectly at the Basle Committee and IOSCO. This intensified the EU's interest in developing its own capital standard. The EU's deliberations were initially influenced by its desire to develop a standard that would conform to both IOSCO'S and the Basle Committee's. It made little sense for the EU to adopt a regional capital adequacy standard that could conflict with succeeding international standards. However, the path negotiated by EU representatives between regional interests and those of IOSCO and the Basle Committee, as one EU official put it, "sometimes seems non-existent."[122]

The EU's early cooperative attitude toward IOSCO changed to a decision to develop their own standard, after it became clear that the Commission's approach was adamantly opposed by the SEC. Additionally, it appeared to EU observers at Basle Committee meetings that the Committee would not develop a consensus on capital adequacy for securities positions until 1993 or 1994 at the earliest, after the 1992 deadline.[123] Adding to the EU's sense of urgency, discussions in IOSCO and the Basle Committee were becoming increasingly public by 1990/1991, and the potential for conflict or redundancy was increasing. Finally, EU administrators were being told by EU bankers and national regulators that legal and political commitment to the Single Market would ring hollow if the CAD and ISD were not simultaneously available with the SBD.

IOSCO asserts itself

IOSCO attempted to set a regulatory precedent before the EU at its September 1991 annual conference. IOSCO's Technical Committee approved a memorandum to the Basle Committee outlining IOSCO's views on minimum capital requirements for

[120] Richard Waters, "Survey of International Capital Markets: Drexel's Fall May Spur Talking-Shop - Regulation," *Financial Times*, 2 July 1990.
[121] Margaret Thatcher's concern with the potential loss of UK political or monetary sovereignty did not dissuade her – or her political and business colleagues – of the economic/commercial benefits of the Single Market, which they strongly endorsed.
[122] Andrew Hill, "Capital Adequacy Rules Delayed," *Financial Times*, 19 December 1991.
[123] The Basle Committee released guidelines for discussion in 1993, and again in 1995.

institutions active in securities businesses. The memorandum achieved several objectives. It positioned IOSCO as an authoritative international forum for the development of capital standards, enhancing IOSCO's credibility and strengthening its working relationship with the Basle Committee. Additionally, the memo established, at least temporarily, an international consensus on minimum capitalisation for debt securities.

The memorandum, which bypassed the EU, offered "principles" rather than hard rules, reflecting IOSCO's continuing internal disagreement over standards.[124] The memo defined where the SEC and EU disagreed over capital. Technical Committee Chairman Breeden reaffirmed that the SEC would continue its "comprehensive" approach to capital calculation, which mandated higher capital levels than required by proposed EU or Basle Committee building block regulations.[125] UK and French regulators in IOSCO argued in support of the EU's approach but were rebuffed by the SEC, despite EU standards being offered as minimum levels, subject to discretionary (and potentially higher) national implementation.[126] Breeden's persistence stymied IOSCO's progress and encouraged the EU to adopt its own standard.

The Technical Committee memorandum focused international capital adequacy discussions on the US-dominated IOSCO and the EU-absent Basle Committee. The EU, in an effort to bolster its international regulatory authority, signed a "Joint Statement on the Establishment of Improved Cooperation" with the SEC in September 1991. The Statement noted that the signatories "will begin a regular dialogue to review developments in securities markets and to discuss the principles underlying securities regulation in the United States and in the European Community."[127] The Statement acknowledged limited prior communication between the parties and recommended that negotiation of future international standards should accommodate US and EU practices, traditions and principles. The Statement was, if nothing else, an admission of the EU's

[124] ISRR, "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved," 7 October 1991.
[125] The comprehensive approach required that capital be set against long and short positions and limited netting. It also required higher capital levels for specific and general risks.
[126] Despite capital standards being presented as minimum levels - subject to discretionary higher national implementation - Breeden never altered his opposition to capital levels that permitted a lower (than US) starting base level.
[127] ISRR, "SEC, EC in Co-operation Agreement," 23 September 1991.

difficulty in asserting its international regulatory authority unless, as was subsequently demonstrated, it teamed up with the Basle Committee.

Limits to Authority

This denouement helps to define the boundaries of the SEC's, the EU's and the Basle Committee's international regulatory authority. The SEC, a national regulator, "won" its initial capital adequacy debate in IOSCO but subsequently lost out to the supranational Basle Committee's proposals. A similar pattern was true for the EU – it adopted a weak compromise regional standard after failing to sway IOSCO, but subsequently, the Basle Committee issued guidelines that superseded EU directives.

The boundaries of authority were defined by predominantly by state actors and institutions. The SEC's and Breeden's authority came predominantly from a national base; the combined influence of domestic capital markets, regulatory history, and political support.[128] The EU's regulatory authority was both national and supranational.[129] Member-states, interacting with EU institutions and private actors, promoted EU regulatory preferences. Additionally, the magnitude of the Euromarkets bolstered EU regulatory decisions and advocacy, helping the EU offset US/SEC interests. The Basle Committee's authority[130] was supranational; derived from its elite, powerful membership and its policy development procedures.

The Geneva meeting

The January 1992 Geneva meeting between IOSCO[131] and the Basle Committee[132] addressed minimum capital guidelines for firms engaged in securities trading. The meeting further convinced the EU that its independent ability to influence international regulatory evolution was increasingly circumscribed by the Basle Committee and IOSCO.[133]

---

[128] As discussed in Chapters 10 and 11.
[129] Leon Brittan was a widely respected figure who represented international regulatory authority.
[130] Discussed further in Chapter 9.
[131] Represented by Richard Breeden and David Walker.
[132] Represented by Gerald Corrigan.
[133] The meeting took place on January 28 and 29. The EU was an observer. Geoffrey Fitchew, head of DG XV, attended on behalf of the EU.

The meetings took place one day after the EU's release of a new CAD draft that adopted a building block approach for both debt and equity position risk. The draft conflicted with Breeden's preferred comprehensive approach, particularly on equity risk. The EU argued that the building block approach "allows for a more accurate measure of the risk reduction associated with hedging."[134] The timing of the draft's release reflected the EU's desire to shape international capital negotiations.

The EU received lukewarm support from the Basle Committee on the building block approach. But the EU and the Basle Committee were actually addressing different issues. The Basle Committee was addressing market risk for bank portfolios,[135] while the EU was addressing market risk for securities firms. Nevertheless, despite the fact that they were contemplating a building block methodology, the Basle Committee did not endorse the CAD draft or its timing. In fact, the Committee did not release market risk guidelines[136] until 1993.[137]

After the Geneva meeting, the EU understood the impediments to its goal of setting a collective international regulatory standard. The SEC would oppose its capital preferences in IOSCO. The Basle Committee had been assured by EU representatives that the CAD and ISD were not "carved in stone" and were "still subject to modification."[138] It contemplated a more leisurely timetable, with different objectives, and constituents, than that of the EU. The EU, facing an unfriendly IOSCO and muted Basle Committee support, decided to set its own capital adequacy precedent.

The COB's Saint-Geours urged the EU to move rapidly: "the United States would like to influence what is happening in Europe. I would like us to complete our [directives] before starting negotiations aimed at coordination with the United States." If

[134] ISRR, "Revised Draft Capital Rules Reflect Technical Changes," February 25, 1992.
[135] A subject not covered in the 1988 Capital Accord.
[136] And then, only for consultation.
[137] The Basle Committee's 1993 proposed guidelines were never officially adopted. They were superseded in 1995 by the Basle Committee's endorsement of bank's internal "Value at Risk" models. See Appendix B for a complete history.
[138] Confidential interviews, New York, January 2001.

discussions in Europe on the CAD remained stalemated, Saint-Geours said, "Perhaps we will accept that the rules are not the same in the United States and Europe."[139]

Additional Incentives to Finalise the Directives

In addition to the Geneva meetings, several developments encouraged completion of the CAD and ISD. First, successful adoption of SEM directives was positively linked to political support for greater European integration and adoption of the Maastricht Treaty.[140] Second, simmering competition between Germany and the UK over the location of the European central bank dominated the finance ministers' agendas, hindering them from focusing on resolution of the CAD and ISD negotiations. Third, negotiations continued to be pressured by the 1992 deadline. Finally, the Geneva meeting convinced EU negotiators that they needed to respond to the SEC's regulatory aggressiveness. These events highlighted constraints to the EU's international regulatory authority and encouraged EU negotiators to finalise the directives.

Conclusions

The contours of the EU's authority were demonstrated in a number of ways. EU legislative principles and treaties established a supranational basis for EU authority, distinct from national authority, and created principles for the development of EU regulations and directives. But, while these principles facilitated working relationships with member-states and with multilateral and non-state actors, they also demonstrated the inability of the EU to achieve its early legislative objectives. In response, the SEA and QMV were adopted; they were designed to moderate national autonomy, but ironically they reinforced it by politicising decision-making and promoting regulatory compromises that retained national preferences. Politicisation of decision-making

[139] ISRR, "Differences on Equity, Technical Details Suggest Long Wait for Global Capital Rules," 11 February 1992.

[140] The Maastricht Treaty (the "Treaty on European Union"), signed in February 1992, dominated European newspaper headlines and ministers' in-boxes during 1991/92. It was an extension of the SEA and SEM as well as the original Treaty of Rome; setting out a comprehensive approach to stronger European integration and laying the foundation for economic and monetary union. Opposition to the Treaty was surprisingly strong, resulting in domestic referenda in Denmark (June 1992, rejected, May 1993, accepted), France (September 1992, accepted) and Ireland (September 1992, accepted). The UK opted out of the Treaty's Social Charter and monetary union provisions.

diminished the EU's ability to assert its regulatory authority and influence in opposition to member-states.

In the case studies, EU regulatory principles did not promote the effective regulatory convergence they were designed to achieve. The reciprocity debate highlighted the interaction of supranational, national and subnational levels of influence. It also demonstrated the influence of national economic structure on policy formation. The energy and persistence of EU negotiators helped drive the negotiations forward. Policy outcomes were, however, determined by state preferences. The limitations of the EU's authority were also apparent in its efforts to avoid regulatory marginalisation by establishing international precedents, and in its interaction with IOSCO and the Basle Committee. The legislative principles of the EU, the agenda-setting and negotiating roles of the Commission, and the balancing of EU supranational objectives with those of other supranational and national agencies, all shaped the structure of the CAD and ISD. However, EU authority was dependant on the authority, preferences, and concurrence of member-states, particularly as expressed through the Council and Parliament. This was evident in the EU bureaucracy's bias toward UK/Euromarket regulatory preferences, in the EU's thwarted precedent-setting ambitions, in the emphasis on compromise in EU regulatory principles and negotiations, and in the EU's inability to promote its regulatory preferences internationally without Basle Committee support.

The next chapter addresses private actor authority in the CAD and ISD negotiations.

Chapter 7

Private Sector Influence in the EU Negotiations

Introduction

Chapters 4, 5 and 6 identified sources of state and supranational authority and efforts to promote those regulatory preferences in the EU negotiations. This chapter assesses the role of sub-state actors and institutions in the negotiation of the CAD and ISD.

The role of sub-national networks and actors in lobbying and educational efforts associated with the CAD and ISD was significant, lending support to non-state centric hypotheses. As discussed previously, private sector networks actively educated policy-makers, assisted in conflict resolution and enhanced the dissemination of relevant policy-making information. These actors and institutions also promoted their own interests across levels of authority. Empirical evidence is anecdotal. While not unambiguous, it indicates influential connections between private lobbying, information dissemination and policy determination.

Examples of Private Sector Influence

The debate over reciprocity, discussed in Chapter 6, involved the EU Commission in an extended dialogue with US and EU private and public sector actors and institutions. The debate's resolution demonstrated that private sector institutions wielded considerable influence. By exploiting their ties to the national and supranational public sector, private sector institutions and actors helped persuade the Commission to alter its original regulatory objectives.

Additional examples of private sector influence are available. Private sector Euromarket actors actively promoted British/Euromarket regulatory preferences. In particular, US securities firms, in an effort to maintain the flexible capital rules operative in London-based markets, aggressively lobbied EU and member-state officials.[1] These efforts demonstrated several characteristics: first that US firms were successful; second, that lobbying efforts were initiated predominantly by large multinational US and UK banks and securities firms; third, that these firms proactively asserted their interests and regulatory preferences directly to supranational as well as state institutions; and finally, that these characteristics confirm the influence of a globalising securities industry, as described in Chapter 2.

During 1990 and 1991, US banks and securities firms began to focus on the implications of the ISD and CAD for their European operations. Over 80 US-headquartered banks and securities firms were active in the EU. Their anxiety over the coordination and timing of banking and investment directives was similar to that expressed by a UK Commons Committee in 1989.[2] In late February 1990, 18 US securities and banking firms issued a statement through the American Chamber of Commerce in London, expressing concern with delays in the ISD, particularly as the SBD had already been finalised.[3] This statement was directed at both the EU Commission and member-state regulators. It urged that financial services directives be adopted simultaneously and that capital adequacy requirements for banks and securities firms be harmonised.[4] The Chamber's statement followed a private letter to Leon Brittan written by four leading US securities firms operating in London.[5] That letter reiterated concerns previously expressed by British private sector officials that adoption of the CAD, as proposed in the most recent, fourth, draft, "could lead to a relocation of substantial [securities] activities to non-EC centres, with resulting loss of market

---

[1] Confidential interviews, London, May 2000 and February 2001.
[2] See Chapter 6.
[3] David Lascelles, "US Groups Seek Air Treatment from EC," *Financial Times*, 21 February 1990.
[4] More specifically, that regulations for the securities operations of commercial banks be harmonised with securities firms. US banks operating outside the US were permitted to establish securities subsidiaries, pursuant to Reg. K, and operated in virtually all respects like stand-alone securities firms. Consequently, US commercial banks in Europe operated similarly to German universal banks although banking and investment activities were legally separated. US securities firms such as Merrill Lynch or Goldman Sachs operated outside the US as they did in the US market – as securities firms. They did not extend their activities materially into banking with the exception being certain limited bridge financings.
[5] The firms were Merrill Lynch & Co., Morgan Stanley & Co., Salomon Brothers Inc., and Shearson Lehman Brothers, Inc.

liquidity, returns and employment."[6] The potential migration of a substantial element of London's Euromarket infrastructure and staff to a continental non-EU city represented an enormous economic and political threat to Britain and the EU.

Lobbying was not restricted to US firms. The City, traditionally short-sighted, had paid little attention to the SEM when it was announced, concluding that its impact was in the distant future. However, public debate over directives, combined with impending UK general elections and Single Market deadlines, galvanised private sector interest. In discussions with EU officials, it became evident to City executives that EU representatives were unaware of the potential regulatory implications of recent market developments. Hedging and capital management technologies had advanced dramatically during the 1980s, coincident with the growth of futures, options and related derivatives markets. These developments facilitated more sophisticated capital management modalities, particularly for the larger US and UK securities firms active in these markets. British SROs had responded to these developments in their regulatory regimes, but "financial engineering,"[7] beyond basic hedging techniques, was not yet widely addressed by other member-states' domestic regulatory regimes. As a result, UK and US private sector financial institutions active in London's markets began to take on the role of educator and advocate, a role they considered critical to the successful development of the CAD and ISD.

As the 1992 Single Market deadline approached and negotiations intensified, the Euromarket private sector focused more closely on the ISD and CAD's potential impact on their institutions. Mutual interests prompted these discussions. Private sector actors were concerned that flexible UK/Euromarket capital rules be preserved, and public sector actors were concerned that the directives accurately reflect market practices and regulators' objectives. During 1991, the UK Treasury, DG XV and the Commission's Financial Services cabinet each consulted with private sector representatives from London's markets. To enhance their lobbying, several US and UK firms began pro-actively to advise the EU Commission and DG XV. Consultation took place primarily via an informal private "think-tank,"[8] with whom Leon Brittan's cabinet consulted

[6] Richard Waters, "US Houses Condemn EC Directive," *Financial Times*, 6 March 1990.
[7] "Financial engineering" refers generally to techniques, using predominantly the derivatives, futures and options markets, to manage financial risk.
[8] Assembled by the Commission and composed of prominent private sector London bankers and attorneys.

frequently on the implications, potential structure and proposed language of the CAD and ISD. These discussions began as seminars, conducted by Morgan Stanley and Goldman Sachs, among others, to educate UK and EU officials on recent market and product developments, particularly the implications of derivative and related hedging products for regulatory capital.[9] As these relationships deepened, EU negotiators consulted with these same bankers on specific language associated with CAD and ISD drafts.[10]

Lobbying by the City

In the run-up to the 1992 UK General Election, Labour's plans for financial services reform and promotion of London's markets attracted the attention and support of senior private sector financial figures. Marjorie Mowlam, a member of Labour's shadow cabinet, lobbied hard to convince bankers that her party's traditional social reformist agenda did not extend to City institutions. Senior bankers responded positively, counselling Labour MPs on market and regulatory developments.[11] In contrast, the Tories missed an opportunity to develop City support, by only passively addressing City bankers' regulatory concerns. Several interviewees commented on the Conservative party's incomplete understanding of recent capital market developments and their connection to the City's continued viability. This situation stimulated further private sector efforts[12] to educate Labour MPs, who were more supportive of the City and its capitalisation preferences. They were also considered strong candidates to replace Tory MPs in the 1992 General Election.

The European Round Table

Confidential interviews indicate that in 1991 and 1992 non-state, non-SRO actors began to participate actively in shaping the CAD and ISD. This was done through private seminars, publicly released reports and direct lobbying. The impetus for their involvement came from two sources: the solicitation by EU and domestic officials of their views on technical issues, and heightened focus by the private sector on the

[9]Other firms undoubtedly lobbied EU Commission and UK regulatory officials, however, these two firms were specifically mentioned in confidential interviews.
[10] Confidential interviews, London, April/May, 2000.
[11] Confidential interviews, London, April/May, 2000
[12] These efforts were mainly in the form of private seminars and individual presentations made to politicians by investment and commercial bankers.

directives' potential impact on their business interests. This was not the first instance, however, of private sector participation.

The European Round Table ("ERT") demonstrates the involvement of the private sector in EU policy formation. The ERT's genesis has been traced to discussions in 1982 between EU Industry Commissioner Etienne Davignon and Volvo[13] CEO Pehr Gyllenhammar. These conversations came about in response to private/public concern with stagnant EU growth and persistent European economic "malaise."[14] Gyllenhammar assembled a diverse group of European industrialists,[15] representing progressive commercial views and domestic political influence, with the objective of providing EU representatives with independent advice on European regional initiatives and industrial development.[16]

The group's membership included a range of EU corporate executives, but French representation was stronger than that of other European states. Gyllenhammar's project enjoyed the active participation of Davignon and Francois Xavier Ortoli, a prominent French political figure and former President of the European Commission. French ERT members also represented the largest national grouping within the organisation.[17] The ERT met initially in Paris in 1983 and established its secretariat there. The group enjoyed special access to French officials, thanks to Gyllenhammar's close professional relationship with Mitterrand and Jacques Ättali. Further contributing to this close relationship were: French interest in Sweden's socialist development model; the close correspondence of social and educational backgrounds between French ERT members and government ministers; and the physical location of ERT's headquarters in Paris. French ERT members were aggressive younger representatives of French industry, schooled in competitive global business practices. They were also members of the French *Patronat*.[18] French ERT representatives were distinguished from their British counterparts by a French emphasis on the execution of concrete projects rather than the

[13] The Sweden headquartered auto and aircraft manufacturer.
[14] "Alas, Poor Europe," *Economist* 1982.
[15] Initially called the "Gyllenhammar Group."
[16] This section adapted from: Maria Green Cowles, "Setting the Agenda for a New Europe: The ERT and EC 1992," *Journal of Common Market Studies* 33, no. 4 (1995).
[17] Roger Fauroux of Saint Gobain, Olivier Lecerf of Lafarge Coppée and Antoine Riboud of BSN.
[18] The *Patronat*, an informal group of Presidents and Chief Executive Officers of major French companies, reflected industry views to government on a range of topics. H. Weber, *Le Parti Des Patrons: Le CNPF, 1946-1990* (Paris: Seuil, 1986).

simple lobbying of EU politicians. As a result, the ERT enjoyed unique access to the highest echelons of French industry and government, and it was in turn influenced by French emphasis on the concrete execution of projects.

The importance of the ERT's close relationship with EU and national government officials in encouraging the adoption of the 1992 objectives is described by Green Cowles.[19] She identifies ERT influence in the shift in Mitterrand's policy preferences away from nationalisation and toward greater regional cooperation. She argues that this shift came about largely as a result of Mitterrand's 1983 economic decision to remain in the ERM.[20] ERT members were also responsible for persuading Mitterrand that nationalised French industries could not compete on a global basis unless they established stronger regional research, development and capital relationships.[21] The ERT's successful promotion of several regional commercial enterprises, including Airbus[22] and Ariane,[23] further encouraged the shift in Mitterrand's own thinking. This was seen in September 1983 in domestic industrial initiatives that encouraged greater regional cooperation.[24] Despite its strong start, however, Mitterrand's project stalled because it was seen as a French, not an EU, initiative.[25]

The ERT rescued Mitterrand's initiative with the publication of the "Dekker Plan" in January 1985. This plan was authored by Wisse Decker, who was CEO of Philips[26] and a member of the ERT. Dekker's proposal, presented to an audience of private sector and EU officials, outlined "a simple plan for a unified market." His proposal transformed Mitterrand's initiative into a European initiative. Just three days later, Jacques Delors spoke before the EU Parliament and completed the transformation by outlining SEM objectives that contained virtually the same proposal. Delors, formerly

[19] Green Cowles, "Setting the Agenda for a New Europe: The ERT and EC 1992."
[20] Moravcsik also argues persuasively that Mitterrand's 'turn toward Europe' began with his 1983-84 rejection of the "Riboud Plan," which urged removing France from the ERM. Mitterrand was persuaded by then Minister of Finance Jacques Delors to remain in the ERM and avoid devaluation of the French franc and the widespread unemployment that would ensue. See: Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community."
[21] Green Cowles, "Setting the Agenda for a New Europe: The ERT and EC 1992."
[22] For joint European aircraft development.
[23] For joint European spacecraft development.
[24] When France assumed the Presidency of the European Council in January 1984, Mitterrand launched a complementary regional initiative. Outstanding issues included the Common Agricultural Policy, proposed changes in the Structural Funds, enlargement issues and the EU budget.
[25] It was also accused of lacking an overall strategy.
[26] The multinational Dutch electronics and household goods company.

the head of the French Treasury, was the new president of the EU Commission and became the spokesman for EU, as opposed to French, regionalisation. The ERT remained active in the promotion of EU initiatives, pressing for the adoption of the SEA in 1985 and the implementation of the1992 Single Market directives.

These events confirm several important observations regarding the relationship of the private sector with EU regional initiatives: first, that the private sector supported regionalisation; second, that they participated in regional development; and finally, that private sector endorsement of regional harmonisation facilitated EU regionalisation initiatives.

The Patronat

The involvement of French industry in the evolution of the CAD and ISD was evident in the resolution of British and French disagreements over concentration. The close relationship of French industry and government officials facilitated the inclusion of commercial interests in regulatory negotiations. The government's primary focus was, however, to protect and promote existing domestic market and institutional regulatory procedures, and, at least anecdotally, it was insensitive to contrary private sector preferences. In explaining the rationale behind the limited French concessions on the ISD, a private sector participant made reference to a confidential meeting between the *Patronat*, the French *Tresor* and the COB in 1992.[27] Speaking at a meeting called by the *Tresor* to solicit industry support for the government's ISD concentration position, the Chairman of ELF, the French multinational oil company, bluntly stated that he would only endorse the *Tresor's* position when French domestic markets could demonstrate the same level of liquidity, depth and pricing as existed on London-based exchanges such as SEAQ-I. Absent that demonstration, he urged the government to change its position. A compromise on the ISD was reached soon afterwards.

Barclays and the Tresor

Barclays Bank, a private UK clearing bank, exploited EU directives in order to promote a new product in France that conflicted with traditional French banking practices. France was unable to block Barclays from doing this, although it was

[27] Confidential interview, London, February 2001.

ultimately the use of a domestic French regulation, not EU directives, that compelled a change in French banking practices, .

The French *Tresor* had historically supported a business understanding, which was maintained by the Association of French Banks, that covered the pricing of French domestic retail banking services. The arrangement stipulated that Association members would not charge for basic banking services.[28] In exchange, the *Tresor* discouraged the introduction of domestic interest-bearing current accounts.[29] In 1992 Barclays, citing the SBD's single passport provision, introduced interest-bearing checking accounts in France, which provoked French Finance Minister Michel Sapin to intercede. When Barclays protested Sapin's intercession to the EU, the *Tresor* defended itself by invoking another provision of the SBD known as the "monetary policy escape clause."[30] Barclays ultimately prevailed by exploiting a loophole in French domestic banking regulation.[31]

The episode demonstrated three aspects of authority and influence in EU policy-formation: first, member-states' willingness to ignore EU regulatory objectives (e.g., mutual recognition or home country control) if they conflicted with domestic or commercial priorities; second, the ability of sub-national actors to exploit supranational EU directives and institutions to their commercial advantage and, as a result, to change domestic practices; and, third, the prevalence of Commission-initiated directive "escape clauses" designed to placate national interests and to promote closure on disputes.[32]

---

[28] Such as cheque processing.

[29] The *Tresor* endorsed the arrangement to facilitate banks' subsidy of services for small account-holders.

[30] Art. 14.2 of the SBD, which says, in part, "Without prejudice to the measures necessary for the reinforcement of the European Monetary System, host Member States shall retain complete responsibility for the measures resulting from the implementation of their monetary policies. Such measures may not provide for discriminatory or restrictive treatment based on the fact that a credit institution is authorised in another Member State." The *Tresor* argued that interest-bearing accounts would interfere with domestic liquidity flows and monetary policy. Their argument was weak, since the clause could be used to hinder virtually any financial innovation.

[31] See: Benn Steil, *Illusions of Liberalisation: Securities Regulation in Japan and the EC* (London: Royal Institute of International Affairs, 1995).

[32] "Art. 15.5 of the ISD, the 'new market' exception to the single passport for trading systems, is perhaps the most obvious and significant escape clause in the Directive." See: Benn Steil, "Equity Trading IV: The ISD and the Regulation of European Market Structure," in *The European Equity Markets*, ed. Benn Steil, et. al. (London: European Capital Markets Institute, 1996).

The SIMs law

Another example of private sector influence in EU regulatory debates came in the form of complaints about non-compliance with provisions of the Treaty of Rome and the evolving ISD.

Italian securities deregulation in 1989 and 1990 eliminated several categories of financial intermediaries, replacing them with *Società de Intermediazione Mobiliare* ("SIM"). Only SIMs were authorised to transact securities business in Italy. To qualify as a SIM a company had to be incorporated in Italy. This requirement appeared to contravene the Treaty of Rome and ISD single passport provisions.[33] In response to the SIMs law, and in anticipation of the Single Market, several international securities firms went to the expense of setting up locally incorporated securities subsidiaries in Milan.[34] Other international firms, principally US and UK firms, complained directly to DG XV and the UK Treasury about the Italian law.[35] In response, the UK filed a formal complaint with the Commission in September 1991. Following further lobbying by securities firms after Italy ignored the initial complaint, the Commission filed an "Article 169 letter" with the ECJ in October 1992,[36] threatening legal action against Italy.[37]

Private sector participation in the SIMs dispute was comprehensive. DG XV consulted actively with private firm representatives on specific aspects of their negotiations with Italian regulators and even solicited comments on drafts of their Article 169 letter.[38] The fact that private sector protests were made to both DG XV and the UK Treasury confirms the close association of US and UK London-based private institutions with these public institutions in the evolution of regional regulation – and the leveraging effect this association had on both parties' influence.

The AIBD

---

[33] Brian Scott-Quinn, "EC Securities Markets Regulations," in *International Financial Market Regulation*, ed. Benn Steil (Chichester: John Wiley and Sons, 1994).

[34] Including the US firms Salomon Brothers and Goldman Sachs.

[35] Richard Bacon, "EC Finance Rules Face Fresh Obstacles," *Euromoney*, May 1993. and confidential interviews, London, February 2001.

[36] Article 169 of the Treaty of Rome provides for the EU's Internal Market Financial Services Commission to deliver a "reasoned opinion" warning a member-state of potential legal action if it fails to comply with an explicit Commission request.

[37] In June 1996, the ECJ declared the SIMs law illegal, five years after it was originally adopted.

[38] Confidential interviews, London, February 2001.

In mid-1991, the Association of International Bond Dealers ("AIBD"), a private London-based Eurobond SRO, attacked French concentration and transparency amendment proposals. The AIBD, in a letter to its members, noted that French proposals were "contrary to the interests of the international securities markets" and "conflict directly with the international self-regulatory nature of the market."[39] The letter noted that supranational Eurobond markets would not qualify as "regulated markets" because they did not specify formal listing requirements. The AIBD also noted their concern that the EU had not adequately analysed the potential market impact of their directives nor had they consulted adequately with affected groups like the AIBD. The AIBD letter carried the "general support" of the EU Commission and unspecified member-states. The AIBD urged its members to lobby their national representatives on behalf of the EU, confirming an observation of MLG theorists. Driving its point home, the AIBD cautioned its membership: "in the current political climate, there can be no guarantee of success in [our] arguments. The proposing countries apparently remain unchanged in their view."[40]

AIBD views reflected the opinions of sub-national Euromarket actors. Financial firms active in the Euromarkets, including most EU financial firms, benefited from Euromarket trading and from regulatory norms established and monitored by the AIBD. The AIBD letter highlighted regulatory tension between market participants and national regulatory institutions. Member-state officials negotiated to protect domestic institutional norms while, simultaneously, domestic private sector institutions benefited from Euromarket developments and regulatory regimes that conflicted with domestic norms. The AIBD acted similarly to UK SROs (see below) and multinational investment banks, educating national and supranational regulators on market preferences and developments. As national negotiators became more aware of market developments and private sector regulatory preferences, through letters like the AIBD's, information dissemination was enhanced, shaping the form of policy ultimately adopted.

Lobbying by UK SROs

UK SROs were also active in promoting the views of their private sector members on regulatory matters. Their lobbying focused principally on domestic

[39] ISRR, "EC Sets up High Level Working Group to Boost Investment Services Directive," 11 March 1991.
[40] Ibid.

institutions and technical issues but extended to supranational institutions and broader questions. In 1990, draft CAD language on position risk[41] raised private sector UK concerns. In the UK, regulations developed by SROs allowed investment firms to net portfolio positions in calculating capital. UK market complaints arose over the draft's different methodology for determining required capital. Both the TSA and FIMBRA began aggressive lobbying to amend the draft. Discussions also took place between private sector representatives and EU Commission officials, including representatives of DG XV, the Economic Secretary's office of the Treasury, and the SIB.[42]

The TSA's concerns focused on the Commission's inexperience with sophisticated, risk-based capital adequacy systems, such as those used by UK institutions. The majority of their experience had been with credit-based systems prevalent among continental Europe's universal banks. In particular, TSA rules on capital adequacy permitted UK institutions to net long and short securities inventory positions, potentially reducing required capital significantly. A large position in securities might not require a capital allocation if it could be demonstrated that the position was hedged by an offsetting position. The draft capital adequacy directive did not permit netting for equity securities.

The TSA was also concerned with the draft's language on portfolio diversification. TSA rules reflected their view that diversified securities portfolios were less risky than concentrated portfolios. The EU's CAD draft did not consider diversification in determining required capital.

FIMBRA's concerns centred on the draft's required minimum capital level for financial intermediaries of ECU50,000. The UK financial services market included many small financial advisory firms. In continental Europe fewer, and significantly larger, firms dominated domestic markets. The high initial capital requirements of the CAD draft threatened to force small UK intermediaries into liquidation or into merger with larger firms.

[41] The risk of holding securities in inventory.
[42] Confidential interviews, London, February 2001.

TSA and FIMBRA argued that the draft CAD language threatened UK domestic market business practices and, potentially, the long-term attractiveness of London as a wholesale financial centre. Estimates ranged broadly, but the overall effect of the proposed language was to dramatically increase the capital required to maintain securities inventories and, as a result, operating costs, particularly in the London market.

The SROs' lobbying was apparently effective, as the sixth and final draft of the CAD responded to TSA concerns. The final draft introduced the securities trading book concept as a compromise between universal banks' and securities firms' capital methodologies. But British SROs remained concerned that the directive would change again when it reached the Council[43] and they continued to follow negotiations closely, also pressing FIMBRA's as-yet-unaddressed objections.[44] Underlining Commission sensitivity to domestic reception of its proposals, Leon Brittan commented about the draft, "the objective is to allow banks and non-banks to carry on with their activities," rather than to force changes to domestic securities practices.[45]

The Coopers & Lybrand Report[46]

The promotion of sub-national preferences was further facilitated by a report commissioned by IPMA,[47] another Euromarket SRO. In May 1992, IPMA asked Coopers & Lybrand Deloitte,[48] to investigate what the impact of draft CAD and ISD proposals would have been on the capitalisation requirements of seven major Eurobond firms, based on their underwriting positions over the 12 months preceding March 1992. The report concluded that implementation of the directives, as then proposed, would probably have resulted in "a substantial part of the Euro capital market leaving Europe."[49]

---

[43] See Appendix B for discussion of EU regulatory review and approval procedures.
[44] ISRR, "EC-Adopted Capital Adequacy Rule Gets Low-Key UK Approval."
[45] Ibid.
[46] See also discussion of remarks by David Barnard and Norton Rose regarding early ISD drafts in Chapter 5 for further examples of private sector influence.
[47] International Primary Markets Association. See: Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics.*, p. 130ff.
[48] A major international accounting and consulting firm.
[49] "If the Euromarket is in effect priced out of the European Community by excessive capital requirements, the overall interests of the Community will have been changed." See: International Financial Review, "International Capital Markets," (London: IFR, 1992).

The report's blunt language intensified private lobbying efforts by London bankers against draft language in the CAD and ISD. The report's release was timed to coincide with an ECOFIN meeting in May to discuss the CAD.

The report pointedly noted that the EU had poorly researched the CAD.[50] As an example, the report indicated that neither the UK nor Germany's domestic capital regulations required capital allocations against "no risk" underwriting positions. The CAD did not endorse this view. Further, the UK SFA's[51] endorsement of sophisticated hedging techniques in calculating capital contrasted with the CAD's simple, sliding time scale methodology.[52] These observations indicate a limited role for policy network and sub-national actor influence in the early evolution of the CAD and ISD.

Simultaneous with the release of the Coopers & Lybrand report, Geoffrey Fitchew, Director General of DG XV, announced a significant breakthrough on the CAD. Member-states that had insisted on tough restrictions on underwriting positions were now prepared to accept more relaxed guidelines. This change represented movement on one of the CAD's most contentious issues and one of the major concerns of financial institutions engaged in securities underwriting.[53] The new draft amended controversial language that prohibited firms from taking single underwriting positions in excess of 25 percent of their capital and replaced it with graduated capital requirements. This permitted continuation of a risky though profitable industry practice of "bought deals" whereby firms individually underwrote entire securities offerings rather than utilising a group of firms in a joint underwriting.[54] The practice was dramatic and popular with large, well-capitalised, particularly US, securities firms, the same group that was aggressively courting negotiators.

The report demonstrated the effectiveness of private sector lobbying in specific areas, particularly where the private sector had specialised expertise. The early absence of sophisticated capital management techniques in CAD drafts reflected both the EU's failure to consult with the private sector and its poor understanding of contemporary

---

[50] The AIBD made a similar observation in its report.
[51] See Glossary. The SFA succeeded the SIB, the UK's securities regulator.
[52] The CAD's capital formulation was based on time elapsed since an underwriting commitment was made, and it ignored hedging.
[53] Simon London, "IPMA Urges EC to Revise Proposals for New Rules," *Financial Times*, 13 May 1992.
[54] David Owen and Richard Waters, "EC Poised to Rule on Capital," *Financial Times*, 18 May 1992.

capital management. During confidential interviews, representatives from DG XV and the EU Commission indicated that they favoured British regulatory standards.[55] Nevertheless, early drafts of the CAD and ISD did not reflect a British regulatory bias. The slow evolution of the CAD to a more "Euromarket/British" structure reflects the impact of British and US seminars and lobbying devices such as the Coopers & Lybrand report. Once representatives from international securities firms and consultancies educated supranational negotiators on current techniques and the consequences of proposed directive language on current business practices, their efforts resulted in subsequent drafts incorporating more sophisticated Euromarket practices endorsed by British regulators and City bankers.[56] Private sector lobbying was critical in shaping the final form of the directives.

US and UK Firms Dominate Lobbying

Although private sector lobbying came predominantly from British and American firms, lobbying from France and Germany indicated that private sector regulatory preferences were not uniformly held. The Coopers & Lybrand report, as well as the earlier AIBD report and the SIMs controversy, were reflective of the preferences of a cross-section of financial services firms operating in London markets. Nevertheless, the larger EU financial services private sector did not uniformly back London's preferences. Domestic negotiators from France and Germany, arguing for regulation at odds with London's regulatory regime, reflected their national and domestic private sector preferences, which sought to insulate domestic regulatory or institutional/economic structures. This diversity of national preferences reflected differences in the structure, capabilities and histories of financial institutions operating in the Euromarkets.[57]

Experiential and cultural advantages contributed to the predominance of British and American firms in lobbying.[58] British firms had a long-standing tradition of consultation with the Bank and other regulatory authorities, which facilitated their promotion of domestic regulatory preferences. American firms also had a well-

[55] Specifically, they "gave greater weight" to British opinions.
[56] Confidential interviews, London, February 2001.
[57] As described in Chapter 4.
[58] US and UK firms more aggressively sought to develop new products and markets than firms from other countries largely because they came from home markets that stressed market competition.

established domestic tradition of lobbying government and state regulators on matters of interest to their industry or firms. In addition, big American securities firms dedicated more of their human and capital resources to lobbying than other firms did. Significantly, US securities firms, together with a handful of British, Swiss, and Japanese firms, operated as true multinationals, dominating global markets. They stood to benefit the most from regulatory liberalisation. Finally, the American houses, in addition to being the largest firms, were also the most comfortable with the financial engineering involved in sophisticated capital management.

French and German firms, while dominant in home markets, could not match US or British securities firms in market expertise or leadership. French banks[59] were involved in international investment banking, but on a smaller scale than US and UK firms. They were also strategically statist and uncomfortable with certain risks associated with regulatory liberalisation. German banks, which were traditionally lenders and government partners, had little experience in multinational securities markets, expertise they only gained through the acquisition of UK merchant banks.[60] Swiss banks UBS[61] and Credit Suisse followed the German model, developing securities expertise through the acquisition of UK merchant bank E.M. Warburg and the US securities firms White Weld and First Boston, respectively.[62]

Based on earlier discussion of the influential roles of the ERT and *Patronat*, it is surprising that French private institutions were not more successful in lobbying. In addition to the constraining influence of *dirigisme* and nationalisation, French financial firms were smaller, less sophisticated and less significant in international markets than their US and UK peers.[63] Additionally, early lobbying by French banks was directed predominantly at French government actors rather than at the EU. The US and UK

[59] Particularly Banque Nationale de Paris, Credit Commercial de France, Indo-Suez and Société Generale.
[60] Deutsche Bank acquired Morgan Grenfell in 1989. Dresdner Bank acquired Kleinwort Benson shortly afterward.
[61] Union Bank of Switzerland.
[62] Both Swiss firms (the "third" big Swiss bank, Swiss Banking Corporation, was eventually merged with UBS) rapidly developed securities expertise, faster than their French and German counterparts, and promoted Euromarket regulatory norms. Credit Suisse became a peer of major US firms when it acquired the well-established "bulge bracket" US firm First Boston, with whom it shared ownership of Euromarket pacesetter Credit Suisse First Boston during the 1980s and 1990s.
[63] "Smaller" refers to their capital markets expertise. Certain French banks were among the largest in the world.

established inroads earlier into DG XV and the Commission.[64] Finally, French domestic securities regulation was not internationally endorsed, as was UK regulation. It is highly likely, based on the *Patronat's* comments to the *Tresor*, that nationalised French banks did not press their government's regulatory arguments aggressively with the EU or their private sector peers.

Private Sector Lobbying Increases

The British position on capitalisation reflected aggressive lobbying over the language of the CAD by the UK Treasury and London representatives of private sector Euromarket institutions. Both were concerned with continued attempts by German negotiators to promote tough capital rules for securities firms based on those applicable to universal banks.[65]Early in June 1992 British negotiators, fearing that the Portuguese Council President might push for an unsatisfactory political resolution as his term ended, tried to slow a quick resolution of the outstanding disagreements on the directives.[66] The negotiators' position was supported by British lobbyists, who shared their desire that any final resolution of the CAD and ISD debates should come during the UK's EU Presidency, which would follow Portugal's.[67] EU officials tried to reassure British negotiators that they would not do anything to drive markets offshore or to jeopardise London's market position.

The influence of UK and private sector lobbying was confirmed in resolutions to several outstanding technical CAD issues reflected in the final draft. Tier Three (subordinated debt) capital was permitted up to 250 percent of core equity capital. No fixed upper limit on underwriting positions over 25 percent of a firm's capital was established. Instead, a 10-day underwriting window was allowed during which normal capital limits would not apply. In a further "win" for British negotiators, "repo" and share borrowing arrangements were made subject to flexible CAD guidelines rather than to tougher bank guidelines. London bankers had opposed the proposed guidelines because they would have constrained liquidity, raised costs and damaged profitability.[68]

[64] This was facilitated by the Commission and DG XV's preference for British regulatory norms.
[65] "Status of City Preserved," *The Daily Telegraph*, 8 June 1992.
[66] Owen, "UK Plays Down Capital Adequacy Hopes."
[67] Confidential interviews, London, April 28, 2000 and May 8, 2000.
[68] Repo and other share borrowing arrangements were critical to funding the operations of financial institutions.

Commissioner Brittan noted of the final draft, "I have been well aware of the concern expressed by some in the City of London and also in other financial centres in the Community about the potential pitfalls in this area. I'm glad that agreement has now been reached on a set of proposals which in no way prevent the continuation of present trading activity in the Community or anywhere else."[69]

The London private sector's success in influencing the final language of the CAD was not, however, unequivocal. A recommendation from the British Bankers Association that CAD discussions be tied to the Basle/IOSCO negotiations was ignored by EU and British negotiators. EU Ministers negotiating the CAD wanted to move ahead rapidly given the impending Single Market deadline, and any attempt to coordinate with Basle or IOSCO would delay development of a harmonised capital standard. As well, over the summer of 1992, ministers' attention shifted to debates over the Maastricht Treaty.

Despite agreements, private, technical concerns with the CAD persisted. Securities firms had successfully lobbied to end limits on underwriting positions but, on closer scrutiny, they were dismayed by the compromise resolution.[70] It frequently took underwriters longer than 10 days to distribute securities positions. More critically, a change in market conditions could affect liquidity and profitability, especially if a firm was forced to unwind its position simply to meet a 10-day limitation.

Multinational, principally American, securities firms also protested the necessity of increasing their capital bases to accommodate large underwriting positions. They argued that the compromise language advantaged institutions with immediate access to large capital resources such as universal banks and securities firms affiliated with banks. The chief financial officer of a leading US securities firm, commenting on the latest CAD revisions, noted, "It smells of a European universal bank conspiracy."[71] But despite complaints, the position of securities firms had improved dramatically from the situation reviewed by Coopers & Lybrand several weeks earlier.

[69] London, Rawsthorn, and Hill, "Muted Cheers for the Single Market: Attempts to Unify European Securities."
[70] Review, "International Capital Markets."
[71] Ibid.

Private Interests and Harmonisation

As mentioned, information provided by private market participants may have hindered international harmonisation. In the instances cited, information provided by private actors or institutions, even institutions with a national focus, generally supported London's regulatory objectives. However, policy communities had national as well as regional perspectives. Domestic French and German policy communities and regulators such as the COB, the *Conseil des Bourses de Valeurs*,[72] *La Société des Bourses Françaises*[73] or the *Arbeitsgemeinschaft der Deutschen Wertpapierbörsen*[74] may have supplied information to negotiators that supported parochial national regulatory objectives. Arguments made by Rüdiger von Rosen of the German Federation in IOSCO negotiations endorse this view. It would be reasonable to conclude that these institutions provided information that promoted national distinctiveness rather than regional harmonisation. This conclusion is, however, contradicted by the advice provided by the French *Patronat* to national negotiators and by the support provided to the UK by Germany on the CAD.

Conclusions

Aggressive US and UK private sector promotion of UK/Euromarket regulatory values to state and EU officials demonstrates the contextual authority and influence of private actors and policy communities in information dissemination and advocacy. The roles of UK SROs, the ERT, the *Patronat*, the AIBD and the Coopers & Lybrand reports, and the reciprocity debate resolution support this view.

State and supranational officials' awareness of the significance of market globalisation, while varied, was initially limited. As a result, they were receptive, especially in the UK and the EU, to private sector tutorials. Leon Brittan even created a private/public think-tank to address technical issues. As knowledge limitations were addressed, state and supranational officials became more cognisant of the Euromarket's operating advantages. Non-UK state negotiators' receptivity to compromises on the CAD and ISD was, in part, an indication of this development.

[72] See Glossary, "CBV".
[73] See Glossary, "SBF".
[74] See Glossary.

UK private and public sector objectives generally overlapped, which encouraged public/private consultation (this was also the case in Germany and, to a lesser extent, in France). These overlaps were not solely a function of private educational or lobbying efforts and they do not indicate whether state and private sector policy agreement preceded or succeeded private lobbying efforts. There is little evidence of private sector preferences being translated directly into policy. The reciprocity debate resolution is an exception. Capture is not demonstrated by public/private preference overlap. Consequently, state autonomy was preserved.

In the UK, the objective of preserving Euromarket regulatory standards confirmed the government's reliance on City revenues as much as it reflected private lobbying. In Germany, both the private and the public sector prioritised the preservation of domestic operating relationships over regulatory evolution. In France, the *Patronat's* influence was limited by statist interest in protecting nationalised industries. These observations qualify arguments for the migration of authority from the state to private or supranational actors and institutions. Private actors used their context-based authority to advise policy-makers. However, regulatory debates and language compromises were executed by member-states influenced by state and non-state factors.

Evidence has been presented that French and German private sector institutions promoted UK-style market preferences domestically, sometimes in opposition to positions argued in EU negotiations by their own governments.[75] However, private actors did not always agree on regulatory preferences. While instances of private sector influence in France and Germany are noted, the evidence suggests that French and German negotiators were more concerned with encouraging the growth (and protection) of domestic markets than they were with opposition to a London-based regulatory regime. Private influence was present but had a specific, limited influence on negotiators.

These observations do not unequivocally demonstrate migration of authority away from the state. State policy preferences and negotiating positions were influenced by private actor lobbying and educational efforts. But, states retained the predominant

[75] This is evident in the French *Patronat's* comments and the German *Finanzplatz Deutschland* program. See Chapter 4.

role in shaping the CAD and ISD. National governments' fundamental regulatory preferences remained intact, despite lobbying, and states were able to preserve their decision-making autonomy. Early member-state and EU consultation with the private sector was limited. As negotiations intensified, the negotiators sought out private sector expertise in order to better understand the technical ramifications of policy options. These discussions clarified, but did not necessarily resolve, disagreements. The intensification of the discussions also demonstrated the desire of private sector actors to be involved in the negotiations, as they became more aware of the 1992 deadline and the potential impact of the directives. Their influence was based on their expertise and credibility in defining the consequences of proposed regulatory constructions and on their access to public authority. However, their advice did not resolve issues, the final language of the directives indicates that many disagreements were left unresolved.

Chapter 8

The IOSCO Negotiations

Introduction

This chapter outlines the evolution and issues that defined capital adequacy negotiations under IOSCO's auspices. Identifying the range of supranational, national and subnational factors shaping these negotiations is important for comparing and contrasting the different outcomes of the EU and IOSCO negotiations. It also permits identification of the sources of authority and influence in the negotiations. The overview in this chapter will focus primarily on intergovernmental relationships. Other relationships will be addressed in succeeding chapters.

Two distinctions between the EU and IOSCO negotiations are important to note. First, the historic factors that encouraged the EU's 1992 initiative were not shared by all members of IOSCO, most importantly by the US. EU member-states had been incentivised, for political and economic reasons, to create the EEC. But IOSCO's most significant member, the US, did not share important harmonisation motivations and objectives with IOSCO's EU member-states.

A second important distinction is that US capital markets were "balanced"[1] by the Euromarkets. Using a structural perspective, this predicts difficulty in identifying predominant or hegemonic states or actors. Nevertheless, the SEC and its Chairman, Richard Breeden, dominated the IOSCO negotiations.[2] The reasons behind this dominance are located in IOSCO's structural weakness, in EU members' prioritising 1992 objectives, in Breeden's intransigent regulatory views, and in the support his views received domestically. These observations preliminarily locate regulatory authority with

[1] "Balanced" refers to being matched in terms of market size, depth and diversity.
[2] Breeden's tenure as SEC chairman began in 1989.

the SEC. However, as we are aware from examination of the CAD and ISD negotiations, authority may be organised on a multi-level basis or expressed through private actors or networks. Chapters 8, 9 and 10 explore these levels of analysis in the IOSCO negotiations.

This analysis will argue that IOSCO's US and European members approached harmonisation negotiations from strikingly different, and largely incompatible, perspectives. EU member-states focused on expanding their regional harmonisation initiatives, while the US was focused on unilaterally exporting domestic regulatory norms. Additionally, both groups faced powerful domestic or regional incentives to protect regulatory precedents. Private actors and policy networks were surprisingly passive in the IOSCO negotiations.[3] As a result, IOSCO's capital adequacy negotiations evolved into a confrontation between EU and US regulatory preferences and finally resulted in stalemate – but for more complex reasons than predicted by conventional state-centric paradigms.

Early IOSCO Negotiations

In 1987 and 1988 IOSCO began, through its Technical Committee's working group apparatus, to develop policy recommendations for an international capital adequacy regulatory regime. Financial services globalisation and contemporary market crises stimulated early research. In addition, competition between the EU, Basle Committee and IOSCO to develop regulatory standards encouraged the creation of new regulatory institutions. These factors fit conventional institutional definitions of market failure recognition and responsive regime creation. However, IOSCO's failure to foster international cooperation indicates that other factors may have influenced IOSCO's regulatory development capacity, deliberations and international authority.

Initial Report on Capital Adequacy

In August 1989 IOSCO announced that, after two years of discussion, the Technical Committee would release a common approach for determining securities firms' capital adequacy and an administrative mechanism for national regulators to exchange market information. The report, "Capital Adequacy Standards for Securities

[3] Particularly in comparison with their assertiveness in the EU negotiations.

Firms,"[4] was accompanied by two further reports, one on standardization of multinational securities offerings and one on accounting and auditing harmonisation. The major report was developed by a working party, headed by LSE Chairman Jeffrey Knight, which included representatives from the twelve IOSCO members with the largest securities markets.[5] IOSCO officials noted that the report's objective was the establishment a common regulatory approach and that US and UK capital adequacy models had served as starting points. The report indicated agreement on the "need for a common conceptual framework" but little on specific details.[6] Nevertheless, IOSCO's membership viewed the announcement as significant, timed in part to ensure that IOSCO established its place in an increasingly crowded field, including the EU and the Basle Committee, devoted to developing international capital adequacy standards.[7]

However, difficulty in balancing disparate member interests was already apparent. At IOSCO's September 1989 annual meeting, disagreement between British and German representatives over the Report was only resolved shortly before the meeting concluded. The Report's framework for assessing capital adequacy was less than a formal policy statement. It urged that capital requirements be premised on a risk-based assessment of a firm's asset portfolio rather than simply on the maintenance of high capital levels. German disagreement with the Report reflected differences between domestic German and British capital calculation methods. The Federation of German Stock Exchanges argued that IOSCO's proposed risk-based capital standard would potentially permit smaller institutions, including non-banks, to operate on German exchanges using more lenient capital standards than applicable to universal banks. The same "level playing field" concern had surfaced at a BIS capital adequacy meeting the previous week,[8] where Germany abstained from supporting the BIS proposal, as well as in earlier EU CAD discussions.

At the annual meeting, a compromise was engineered that allowed the report to be published with a comment that negotiations with the German Federation were

[4] The report was released at the September 1989 annual meeting. IOSCO, "Capital Adequacy Standards for Securities Firms."
[5] This included Canada, France, Australia, West Germany, Hong Kong, Italy, Japan, The Netherlands, Sweden, Switzerland, the US and the UK.
[6] IOSCO, "Capital Adequacy Standards for Securities Firms."
[7] Lascelles, "Securities Rules Closer to Global Harmonisation."
[8] ISRR, ""Convergence," More Than Harmonisation, Is Key Word in Cautious Working Group Sessions," September 27, 1989.

continuing. Knight commented, "It is our intention to arrive at convergent views. It is important for us to ensure multinational securities firms don't migrate to areas with low capital adequacy requirements. In this, the needs of regulators and operators come together."[9] A British Working Group member noted that progress had been "very satisfactory" and that differences were not insurmountable.[10] Follow-up discussions were scheduled for January 1990 and the following summer.[11]

Debates in IOSCO echoed debates in Brussels. First, regulatory perspectives of statutory regulators such as Britain's SIB and the French COB would need to mesh with the perspectives of SROs such as the German Federation. IOSCO members expressed concern that SROs were biased against newer capital approaches.[12]

A second concern was that differing domestic financial services standards would be difficult to reconcile. Capital adequacy regulations for securities firms in the UK were based on risk analysis for stand-alone firms. Hedging was permitted. But in Germany, universal bank regulators focused on credit and interest rate risks, rather than market risks, and required high minimum levels of capital. In the US, securities regulation focused on investor protection and, like the Germans, the maintenance of high capital levels. The SEC might endorse risk-based capital standards, but not if they reduced minimum capital levels.

A final concern was that members' domestic regulatory regimes reflected differing market, economic and political histories and, significantly, different levels of market development and operating experience. In continental Europe and Japan, and even in the UK, institutional regulatory experience with securities firms and markets was modest. Nevertheless, newer regimes might more readily accept newer regulatory technology. In contrast, the US regulatory regime was robust and well-established. The SEC, founded in 1933, operated from a regulatory foundation thoroughly tested by markets and courts, and it benefited from the support of the US Congress and the private

[9] Ibid.
[10] ISRR, "Progress on West German-IOSCO Accord to Resolve Capital Adequacy Row," October 25, 1989.
[11] German private and public sector concern with a "level playing field" was later resolved by development of the trading book. This resolution brought private sector interests into alignment for "Euromarket" capitalisation methodologies.
[12] This was an ironic concern considering the proactive role of British SROs in the CAD and ISD discussions.

sector. However, there was a danger that the SEC's bureaucratic, lawyerly traditions might hinder its potential ability to embrace new regulatory approaches. These contrasts highlight a critical distinguishing issue for the IOSCO discussions – US participation. The regulatory issues addressed by IOSCO were closely related to those raised in EU discussions; however, US participation changed the deliberative landscape significantly.

By the end of IOSCO's annual meeting, members' expectations had already moved from regulatory harmonisation, a goal still espoused by the EU, to regulatory "convergence," a less ambitious but more "balanced" objective. Rüdiger von Rosen of the German Federation stressed that "value should be attached to the possibility of giving issuers and investors a choice between quite different rules and regulations."[13] The Technical Committee's report on capital adequacy concluded differently. It indicated that a more specific harmonised conceptual framework was needed, which would encompass liquidity and solvency issues, mark-to-market provisions, and risk-based requirements covering risk assets. A one-year industry comment period was proposed.

At the meeting, outgoing SEC chairman David Ruder promoted the SEC's own distinctive approach to international regulatory convergence. He urged IOSCO members to examine the SEC's MJDS proposal, then under discussion with Canada, as a potential regulatory harmonisation model,[14] and he encouraged members to discuss similar bilateral arrangements with the SEC. Ruder's comments appeared to contradict IOSCO's goal of developing an inclusive conceptual framework.

Ruder also verbally endorsed UK-style risk-based capital adequacy standards. His endorsement did not correspond with then current SEC regulations, however, which mandated a "comprehensive" capital adequacy standard premised on high minimum capital levels.[15]

[13] ISRR, ""Convergence," More Than Harmonisation, Is Key Word in Cautious Working Group Sessions."
[14] See Chapter 9 for a discussion of MJDS.
[15] The SEC calculated capital on both long and short positions and limited the extent to which matching or hedging reduced required capital. The EU's evolving CAD standard contemplated greater consideration of hedging. "Risk-based" standards may have referred to the EU's nascent building block approach, which considered both general and specific position risks. Scott-Quinn describes three capital approaches: the SEC's comprehensive, the EU's building block and the UK's portfolio approach. The UK approach permitted the greatest amount of hedging to reduce required capital. See: Scott-Quinn, "EC Securities Markets Regulations."

The purpose behind Ruder's contradictory statements is unclear, but there is no evidence to indicate that he was urging a fundamental change in US capital adequacy standards. Rather, his comments appear to have been encouraged by the general tone of IOSCO's recommendation, "a capital adequacy test that reflects liquidity, solvency, and the risks faced by securities firms,"[16] and his deeper conviction that bilateral agreements would better promote US interests. Ruder's lame-duck status as SEC Chairman may also have encouraged him to endorse UK standards.[17]

Given that Ruder was prepared to think unconventionally about developing capital standards, it is also unclear why he did not more aggressively support German capital preferences, which more closely matched SEC practice. By the time Ruder's successor, Richard Breeden, became actively involved in the IOSCO discussions almost a year later, the EU had proposed resolving German concerns by segregating securities and loan assets in calculating capital. This made it more difficult for the SEC to influence the EU negotiations and subsequent IOSCO discussions. The SEC's failure made it easier for the EU to endorse both universal banking and the use of hedging technology in capital calculation, practices that were anathema to Breeden.

Should the EU and IOSCO cooperate?

The IOSCO report's emphasis on regulatory convergence prompted IOSCO's EU members to suggest that the EU's work on the ISD and CAD be incorporated into IOSCO's research. They felt there was no need to duplicate work already well-advanced in the EU. Non-EU IOSCO members were less vocal, acknowledging the potential benefits of collaboration but also the difficulty of success unless convergence was widely accepted as an explicit objective.[18] Federal Reserve Chairman Alan Greenspan, in testimony before the US Senate, acknowledged this difficulty. Cautiously endorsing harmonisation efforts, Greenspan noted, "the nature and regulation of securities markets have been sufficiently diverse that a multilateral regulatory approach along the lines of

[16] IOSCO, "Capital Adequacy Standards for Securities Firms."
[17] However, had Ruder remained SEC Chairman after 1989, and pursued risk-based capital standards legislatively, he would likely have been rebuffed by a US Congress concerned with financial services standards challenged by market events and scandals and a public concerned with the solvency of securities firms. Ironically, the US representative to the Basle Committee, and its current Chairman, Gerald Corrigan, who had recently endorsed risk-based capital standards, would have supported Ruder.
[18] Lascelles, "Calls to Bring Watchdogs into Line: Moves to Harmonise Securities Rules Worldwide."

the Basle agreement on capital guidelines for commercial banks may be difficult."[19] An unnamed EU official cited by the *Financial Times* was more candid: "there is a desperate need to ensure that rules in Europe are not developed which are wholly incompatible with those in the UK and the US."[20]

Potential regulatory convergence also raised competitive concerns for US regulators, markets and participants. The EU's detailed Single Market objectives led US regulatory officials to consider whether their complicated domestic regulatory infrastructure might need to be streamlined in order to compete with the EU. "The US deals with two regulators and the rest of the world may be able to speak with one voice," commented Brandon Becker, an SEC director, referring to the long domestic history of conflicts and overlaps between SEC and CFTC jurisdictions.[21] CFTC Commissioner William Albrecht, concurred, "What we're going to need to see in the future is an international super-regulator."[22]

These developments mark the starting point for a regulatory harmonisation discourse between IOSCO (and the SEC), the EU and eventually, the Basle Committee. The challenges facing IOSCO negotiators appeared initially to be the same as those faced by the EU. As has already been noted, differing domestic regulatory histories had created entrenched bureaucracies and national preferences. To avoid regulatory arbitrage and to preserve competitive fairness, it was considered essential that the securities activities of universal banks and securities firms be treated similarly. A complicating factor was that the SEC and EU member-states did not share harmonisation perspectives or objectives. Further, IOSCO's capital adequacy working party had not consulted with market participants before developing its recommendations. IOSCO acknowledged this failure in the Report, noting "there's a great deal of consensus on some of the issues…[but] we still need some feedback from industry."[23]

Two additional early factors distinguished the EU and IOSCO deliberations: timing and scale. The EU faced a 1992 Single Market deadline. IOSCO, like the Basle

---

[19] Ibid.
[20] Ibid.
[21] Of course, US financial institutions dealt with more than two regulators (The Fed, the SEC, the CFTC, The Comptroller of the Currency, state agencies, and the Treasury, in addition to various SROs).
[22] ISRR, "1992 Spurs US Agencies to Regulatory Cooperation," October 25, 1989.
[23] ISRR, "Three Harmonisation Reports Are to Be Released in Venice," August 16, 1989.

Committee, had no immediate deadline. In addition, the EU, with 12 participants, operated on a smaller stage than did IOSCO, with approximately 100 members.

The SEC promotes US regulatory norms

The SEC's international response to the 1987 stock market crash was twofold: to provide leadership in developing international regulatory reform proposals and to use its market position to promote US regulatory standards. Its response differed from the response of EU member-states, which stressed regulatory harmonisation through multilateral forums, coupled with modest domestic reforms. The differing approaches also exposed contrasting views of IOSCO's international role.

David Ruder, SEC Chairman from 1986 to 1989, outlined the SEC's principles for international cooperation in a speech at IOSCO's 1988 annual meeting.[24] Attendees interpreted his speech as a statement of the SEC's view that it should assume a leadership role in the development of international securities regulation. Ruder commented: "As regulators seek to minimise differences between systems, the goal of investor protection should be balanced with the need to be responsive to the realities of each marketplace."[25] Ruder's remarks highlighted the historic SEC regulatory emphasis, investor protection, over market promotion or institutional efficiency, which were primary regulatory objectives in European domestic markets. His comments also underlined the SEC's conviction that international regulatory harmonisation was driven by individual "marketplace realities," state preferences rather than harmonisation. He indicated that regulatory change sponsored by supranational institutions could be acceptable, but only if sensitive to national, i.e., American, preferences. Underlying Ruder's comments was a firmly held belief that American domestic securities regulation should be the model for international regulatory cooperation.

Ruder's beliefs were based on several factors. First, US capital markets were the largest and most sophisticated in the world. Only the Euromarkets could be compared to US markets in terms of size or sophistication. However, aside from the modest authority of standardised market practices and private SROs, the Euromarkets were largely unregulated, and had limited experience with institutionalised public regulatory

[24] John Durie, "Regulation Easy as SEC," *Australian Financial Review*, 11/16/88.
[25] Chris Sherwell, "SEC Chief Draws up Global Blueprint," *Financial Times*, 11/16/88.

mechanisms. Domestic capital markets in Europe were significantly smaller than US markets. Japan's domestic Yen markets were enormous in US dollar terms but a poor alternative regulatory model to the US. In Japan, domestic market access by foreign firms was restricted, regulation was based largely on US models, and Japanese regulators were reluctant to lead internationally. In addition, the SEC had over 50 years of applied and codified regulatory experience, significantly more than any other national or supranational securities regulatory agency. Finally, US court cases and years of practical application had thoroughly tested the SEC's regulatory apparatus. This combination encouraged US regulators to conclude that their securities regime was the best model available, nor was there domestic political support for changing US regulatory standards.[26] Considering these factors, it was not surprising that the US asserted its leadership position in regulatory harmonisation initiatives.

Ruder's efforts to export domestic regulatory norms included precedent-setting domestic market liberalisation designed to attract foreign firms. It also included bilateral and multilateral efforts.[27] Recent European domestic securities regulatory reform had resulted in the creation of new regulatory bureaucracies and regulatory juridification, making domestic European regulatory regimes appear more like the US.[28] However, the US distinguished itself by passing domestic legislation to facilitate international information sharing, cross-border investigations, and foreign access to US domestic capital markets. The US also increased the number and scope of its bilateral securities regulatory agreements, which typically adopted a US regulatory model. As the intransigence of the SEC's approach to international regulatory harmonisation became clearer, EU member-states refocused their international regulatory harmonisation energies on EU-sponsored initiatives, where they had powerful political commitments and the incentive of regional market share competition. The US, without regional capital market competitors, focused its efforts on promoting US regulatory standards through IOSCO and bilaterally. This entailed both domestic and multilateral initiatives.

Steps to improve international coordination

To better coordinate regulatory discussions, representatives of IOSCO, the EU and the Organisation for Economic Cooperation and Development ("OECD") met in

[26] See Chapter 10.
[27] See Chapter 11.
[28] This was, of course, not the case for domestic capital adequacy standards.

December 1989 to discuss IOSCO's capital adequacy work. Their objective was to ensure that regulatory developments in the world's major capital markets "converged." Jean-Pierre Cristel of IOSCO's General Secretariat was optimistic, indicating that the EU "is ...quite willing to look at what we are doing and try to cooperate."[29]

Yet despite optimistic pronouncements, the difficulty of harmonising international regulatory standards was already evident in parallel, though further advanced, efforts to harmonise international accounting standards. Paul Cherry, Chairman of IOSCO's working party on accounting and auditing standards harmonisation,[30] pessimistically commented that regional "standards blocs" would defeat international harmonisation. Speaking in 1990, Cherry indicated that IOSCO and the IASC were working to develop harmonised international accounting principles. But the US national accounting standards body, the FASB,[31] resisted adopting IASC and IOSCO approved standards.[32] Cherry presciently foreshadowed a further potential problem in harmonising regulatory norms: the possibility that the EU might develop its own regional accounting standards that would not conform to IASC, IOSCO or FASB models.[33]

In July 1990, Paul Guy, IOSCO's Secretary General, provided a status report on the work of the capital adequacy working party. The group had "been working on the banking side, and we have integrated some members that have universal banking systems," a reference to the difficult reconciliation of securities firm and universal bank capitalisation. IOSCO's debates paralleled those in the EU. The working party had begun to coordinate its work with the Basle Committee by inviting Committee members to attend its meetings and had stepped up the pace of its work, increasing Technical Committee meetings from two to three a year.[34]

In September 1990, securities regulators from the US, UK and Japan met to discuss enhancing international securities market cooperation. Topics included IOSCO's efficacy, information sharing and capital adequacy. The meeting also addressed mutual recognition and harmonisation, particularly in the context of the pending US-Canadian

---

[29] ISRR, "IOSCO and EC Officials Meet to Map out Harmonization Effort."
[30] Cherry was also Canada's representative to the International Accounting Standards Committee.
[31] The Financial Accounting Standards Board ("FASB").
[32] FASB concluded IASC proposals often codified reductions in accounting disclosure.
[33] ISRR, "IOSCO: EC Moves Could Doom Global Accounting Harmony,", January 17, 1990.
[34] ISRR, "IOSCO Sees Major Effort on Futures and Ethics in Chile," July 16, 1990. However, contrast this with the Basle Committee's monthly meetings and the EU's almost daily work on the CAD and ISD.

MJDS agreement, which referred to "parallel development of minimum regulatory standards" and enhanced information exchange. No changes to existing bilateral information sharing, enforcement, or mutual recognition agreements were announced.[35] The meeting produced a communiqué on cooperation, marked by a delicate balancing of divergent market preferences, very similar to the conditions defining the EU negotiations. The UK's DTI indicated that both the SEC and Japanese MoF agreed to British proposals for a degree of mutual recognition and harmonisation.[36] The meeting was significant in signalling states' desire to preserve domestic regulatory authority by limiting the scope of international regulatory harmonisation.

Commercial bank regulators met in Frankfurt in October 1990 to discuss supervision of financial conglomerates. Supervisors were aware that bright line legal distinctions between banks, securities firms and insurance companies were becoming increasingly anachronistic. While the US continued to legally separate securities underwriting and bank lending, most other countries had given up the legal distinction.[37] The *Bundesbank* proposed a functional model that matched the businesses pursued by operating groups within a financial services conglomerate with specific regulatory standards.[38] This proposal contributed to the "trading book" language eventually adopted in the CAD. It did not, however, surface in IOSCO's working party discussions even though level playing field considerations did. Unlike EU CAD and ISD deliberations, where multiple financial services operating models influenced regulatory development, IOSCO's emphasis on securities capitalisation focused discussions on capital adequacy definitions rather than broader issues.

Discussions at the bankers' meeting underlined potential disagreements between the EU, IOSCO, and the Basle Committee. The meeting had been called to discuss Basle Committee work on extending the 1988 Capital Accord to encompass market risk. Market risk included equity portfolio risks incurred by universal banks. Anglo-Saxon banks with minimal equity operations were little affected by the Basle Committee's

[35] Richard Waters, "Regulators to Discuss Cooperation Moves," *Financial Times*, 14 September 1990. See Chapter 11 for a detailed discussion of bilateral MJDS (multilateral jurisdictional disclosure system) agreements.
[36] ISRR, "Trilateral Meeting of Securities Regulators Focuses on Multi-Jurisdictional Disclosure Issues."
[37] The distinction in the US was weakening, however, beginning with the 1989 development of "Section 20" commercial bank subsidiaries being allowed limited underwriting privileges.
[38] Underhill, "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy."

discussions, but new guidelines addressing equity-related risks were very important to universal banks. German objections to the application of commercial bank capital standards to equity portfolio risks had been expressed in earlier IOSCO and EU negotiations. And, in an effort to keep affected parties advised of its deliberations, the Basle Committee had included IOSCO in its meetings. But, while the meeting carried important implications for universal banks – and potentially for securities firms, – no recommendation was made that securities-related regulatory developments be formally coordinated.[39]

IOSCO's 1990 annual meeting

At IOSCO's 1990 annual meeting the Technical Committee adopted five working party reports, including one on capital adequacy.[40] Richard Breeden, Ruder's successor at the SEC and Chairman of IOSCO's Executive Committee, indicated that he considered an international capital adequacy standard a top priority. He noted that IOSCO was under pressure to agree on a standard in order to ensure that its views were incorporated in EU and Basle Committee deliberations. He also confirmed that the capital adequacy report had identified specific capital standards and that the working party was endeavouring to bring standards for bank and non-bank securities activities into conformity.

The Technical Committee invited Huib J. Mueller, chairman of the Basle Committee, to its annual meeting. At the meeting, Mueller called for "one-world" solutions to regulatory problems, which reflected the impact of globalisation and the blurred distinction between banks and non-banks. Mueller defined a framework for developing minimum capital adequacy standards for securities firms and financial conglomerates, suggesting presentation of proposals, initially to the Basle and Technical Committees, and subsequently to the G-10. Jeffrey Knight, presenting IOSCO's capital adequacy report, noted that among working party members there was sufficient consensus to warrant further work. But consensus had been achieved only after intense negotiating. The German delegation had objected to the report's "direction," once again citing fears that universal banks would be made subject to tougher capital rules than those applicable to securities firms; the report was adopted over German protests.

[39] Katherine Campbell, "Regulators Discuss Financial Giants," *Financial Times*, 10 October 1990.
[40] IOSCO, "Capital Requirements for Multinational Securities Firms."

Additional progress was predicted, particularly given the Technical Committee's newly streamlined organisational structure based on recommendations of the SEC-drafted Strategic Assessment.[41]

Meeting delegates were optimistic that IOSCO could begin to act as an equal partner with the Basle Committee. A member of the Technical Committee commented, "IOSCO is now at a watershed. At this meeting, it has essentially made up its mind as to what it wants to be...that is, the securities regulatory equivalent of the Basle Committee. I think that's what is behind the push of the SEC,[42] the result is that IOSCO is a much more powerful organisation than it has been. There are people within IOSCO that don't agree with the SEC asserting its role, but as far as I'm concerned, the SEC is the most powerful securities regulator in the world."[43]

Stewart Douglas-Mann, executive director of the LSE, also commented on the consolidation of authority in IOSCO.[44] He noted that IOSCO's research was actually executed by a small group of senior regulators and, describing members' "investments" in IOSCO policy deliberations, Douglas-Mann offered, "I think that most would agree... the US and the UK are tackling the major tasks. They have the largest work burdens, closely followed by Canada and France."[45] Douglas-Mann's comment confirms that the disproportionate "investment" of the US and the UK made their agreement critical to the resolution of the IOSCO debates. It also underscores the continuing significance of state authority in developing regulation.

1991 Deliberations

International capital adequacy harmonisation appeared to be stalemated in early 1991. EU negotiations were deadlocked. Concrete progress was needed by June 1991 if directives were to be adopted by the 1992 SEM deadline.[46] Political commitment and

[41] See Chapter 9 for a discussion of the Strategic Assessment Report.
[42] Referring specifically to the Strategic Assessment Report.
[43] ISRR, "U.S. SEC Forges New Global Role within IOSCO; Breeden Chairs Strengthened Technical Committee," November 19, 1990.
[44] During the 1990 Annual Meeting, Breeden was made Chairman of the newly empowered Technical Committee, after retiring by rotation as Executive Committee Chairman. The SIB representative replaced him as Executive Committee Chair.
[45] ISRR, "ISE's Douglas-Mann Gives IOSCO's Strategic Report a Cautious Welcome," December 3, 1990.
[46] Lucy Kellaway and Tim Dickson, "Painful Birth of Single Market: The Deregulation of Financial Services in the European Community," *Financial Times*, 19 December 1990.

national interests clashed in EU debates,[47] but despite disagreements, the EU was clear on its objective.

IOSCO did not share the EU's sense of urgency or purpose. The Strategic Assessment improved IOSCO's operating procedures but had not clarified the objective of capital adequacy discussions. Was an international standard being established, or was a set of principles being developed? The priority of IOSCO's EU member-states was to establish harmonised rules, definitely through the EU and, ideally, in tandem with IOSCO. The SEC's objectives were made clear at a Technical Committee meeting in Hong Kong in March 1991.

The Hong Kong meeting was intended to iron out details of working party reports scheduled for delivery in July. The capital adequacy working party[48] was reportedly unsuccessful in developing a capital formula that would satisfy the conflicting demands of universal banks and US and Japanese brokerage firms. Reports indicated that it was Richard Breeden's questioning of a proposed building block approach to capital calculation, adapted from Basle Committee deliberations and EU CAD discussions, that had prevented the Technical Committee from making further progress.[49]

Differences are clarified

The Hong Kong discussions highlighted the issues dividing the EU, IOSCO and the Basle Committee. The EU had resolved disagreement over the CAD by allowing banks to segregate securities trading for capital calculation. Their solution applied to both universal banks and more highly differentiated banking and securities operations, and it facilitated the eventual adoption of a building block approach to capital calculation.

The Hong Kong meeting had been an opportunity for IOSCO to approve a building block calculation method that had been advanced by the Basle Committee for banks involved in securities business. IOSCO had reportedly agreed in principle with the Basle Committee's recommendations prior to their last annual meeting. However, the

[47] Richard Waters, "The European Market: Securities Firms Look across Borders - How Bankers and Brokers Are Preparing for Battle," *Financial Times*, 7 January 1991.
[48] Capital adequacy was considered by the working group on the regulation of market intermediaries chaired by Roy Croft of the UK Securities and Investment Board.
[49] ISRR, "Technical Committee Meeting Sets Stage for Standards Reports," March 25, 1991.

Technical Committee delayed an endorsement and sought more time for review. Breeden questioned the Committee's earlier agreement and won the support of the Japanese delegation.[50] Breeden's concern was that the building block approach[51] was different from US standards, particularly in its use of hedging to reduce required capital. His reluctance to consider an early compromise between US and EU/Basle Committee approaches arose from both international and domestic considerations.

Internationally, Breeden wanted to prioritise SEC regulatory perspectives in multilateral debates. Breeden believed that the proposed building block approach was an untested, risky methodology and a "Basle problem" in the making.[52] SEC (or IOSCO) endorsement of the building block approach did not present any obvious international conflicts. The EU had already adopted the policy and the Basle Committee had generally endorsed it. In hindering IOSCO's consideration of the approach, Breeden used his bully pulpit on the Technical Committee to ensure that the SEC's domestic political and bureaucratic interests, which were opposed to any weakening of US regulatory standards, were supported. The failure of the Technical Committee to agree to a common approach for capital adequacy caused a six-month postponement of a planned April 1991 meeting of the Basle Committee with IOSCO.[53]

Breeden's intransigence brought the nascent three-way international discussion over capital adequacy to a shuddering halt. This was not a matter of great concern to the Basle Committee or to IOSCO, which did not face policy deadlines, but the implications were more dire for the EU.

The EU was concerned that its CAD proposal not conflict with formulations under consideration by the Basle Committee and IOSCO. But, having achieved regional

---

[50] Japan had adopted new capital adequacy guidelines a year earlier and was unhappy at the prospect of revising them so shortly after adoption.

[51] The 'building block" capital adequacy approach favoured by the EU and Basle Committee involved assessing the various risks of holding securities. Risks were broken down into credit and market components, each of which was used in calculating required capital. The approach also allowed hedging or matching to offset required capital. The approach encompassed provisions for minimum capital levels, but at lower percentages than stipulated by comprehensive approaches.

[52] Some observers accused the 1988 Basle Accords of unwittingly contributing to the 1990/91 economic recession by encouraging restrictions on lending. See Peter Cooke, "Bank Capital Adequacy and Capital Convergence," (London: Price Waterhouse, 1991). Breeden saw potentially lower capital requirements as increasing bank vulnerability to economic or business setbacks, what he referred to as a "Basle problem," i.e., a problem of unforeseen consequences. See also discussion on page 306 and in footnote number 80 in Chapter 10.

[53] David Lascelles, "Reforms Fail to Keep Pace with Changes in the Markets," *Financial Times*, 24 May 1991.

agreement on the building block approach through difficult negotiations, the EU was loath to re-open the issue and set back its 1992 objective.[54] More fundamentally, the EU did not want its standards superseded by IOSCO or Basle recommendations, particularly if they differed materially from its own. Uncertain how to proceed, the EU initially determined to wait for the outcome of discussions in IOSCO and the Basle Committee before formally adopting its own proposal. In any event, the ISD remained bogged down in disputes over trading,[55] although EU negotiators were optimistic that the CAD could be agreed to by the end of 1991.[56]

In yet another effort to enhance regulatory coordination, representatives from IOSCO, including Breeden, and the Basle Committee met in Paris in July 1991 to discuss regulatory harmonisation. The meeting produced a memorandum on ten principles to govern bilateral agreements but failed to achieve consensus on capital adequacy. Breeden used the opportunity to dampen expectations further: "The development of the Basle capital formulas took 14 years, reflecting the fact that global banking supervisors had many of the same difficulties that confront securities supervisors – differences of markets, differences of regulatory traditions, differences of principle." Breeden added that his regulatory objective was not harmonisation but the development of "common principles."[57]

These comments marked Breeden's first public acknowledgement of difficulties encountered in developing an international capital adequacy standard and of his limited objectives for IOSCO. His comments also help in resolving whether his thinking on capital adequacy changed during the IOSCO negotiations. IOSCO members accused Breeden of changing his position on capital adequacy in 1992; this was cited as the primary reason for the collapse of IOSCO's discussions. However, Breeden voiced his objections to EU and Basle Committee capital adequacy formulations as early as March 1991. Where the EU had vacillated over member-state preferences, Breeden had consistently opposed building block standards proposed by the EU and the Basle Committee. Breeden's inflexibility ultimately encouraged EU member-states to focus on finalising EU directives rather than on broader harmonisation initiatives. After the Paris

[54] Waters, "The Quest for a Capital Adequacy Directive."
[55] ISRR, "Investment Service Directive Remains Stalled among Ministers," July 15, 1991.
[56] London, "Fresh Try on Securities Directive."
[57] George Graham, "Regulators Lay Basis for Fraud Fight," *Financial Times*, 18 July 1991.

meeting, Breeden publicly rejected suggestions of any internal IOSCO feud stemming from the failure of the March Hong Kong meeting of the Technical Committee.[58]

IOSCO's 1991 annual meeting

At IOSCO's September 1991 annual meeting, a majority of the Technical Committee approved a memorandum outlining IOSCO's views on minimum capital adequacy requirements for securities firms and for banks involved in securities businesses. The 12-page memorandum, addressed to the Basle Committee, was, according to Breeden, intended to "form the basis for discussions."[59] The memorandum did not recommend hard rules; it offered instead principles for developing standards for market risk and capital. The absence of unanimity over the memorandum's recommendations reflected the divide between supporters of the SEC's "comprehensive" approach and supporters of the building block approach favoured by the Basle Committee and the EU.[60] The Technical Committee indicated its willingness to accept the building block approach for debt securities, but with alterations to the Basle Committee's formulation. In particular, the Technical Committee endorsed tougher SEC-sponsored standards for allowable reductions in required capital for matched positions.

On required capital for equity positions, Technical Committee members continued to disagree on an overall approach while agreeing on some issues. A majority of Committee members agreed that for diversified, highly liquid portfolios, an international minimum standard utilising the building block approach should be 4 percent on gross position risk[61] and 8 percent on net position risk.[62] An 8 and 8 position was recommended for other securities. Breeden commented that "there has been a major disagreement among some countries who felt the 4+8 standard is too high – the United Kingdom and France, in particular."[63] The disagreements were not surprising since domestic regulations in the dissenting countries permitted both lower capital levels and greater flexibility in the determination of required capital. The SEC's tougher approach

---

[58] Ibid.
[59] ISRR, "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved."
[60] The comprehensive approach, the traditional approach used by the SEC, Canada and Japan, set a fixed percentage of a firm's asset portfolio as its capital requirement. A minimum capital level, higher than permitted under the building block approach, was required.
[61] This is a charge of 4 percent on long positions and 4 percent on short positions.
[62] After deducting offsetting long and short positions, a net position is the remainder.
[63] Breeden also added, "In some areas, the Japanese have expressed concern." ISRR, "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved."

would penalise these countries. The UK had initially proposed a 2+8 approach but finally allowed the 4+8 standard to be published.[64]

The memorandum also recommended that regulators using the building block approach fix minimum capital levels or that they at least maintain minimum capital consistent with the building block method. The approach was designed to prevent regulatory arbitrage. The memorandum, while reflecting majority endorsement of a building block approach for equities, still did not resolve basic disagreements between the SEC and European regulators. Breeden explicitly noted that the SEC would not abandon its domestic approach to capital. "We have no intention of changing the comprehensive approach. We believe it works very well here in the United States. We have a lot of experience with it. It has gone through major market downturns. It ain't broke and we're not going to fix it." In allocating blame for continuing disagreements, Breeden asserted that the SEC's approach, "is not the problem...because our rule is much higher than the rules in other major markets."[65] Breeden was unconcerned that the SEC's approach might disadvantage US securities firms internationally. "Yes, there can be a competitive effect if the competitors of American firms were more highly leveraged than American firms were. The focus of the discussion has been that when you have sharp market downturns that [they] did not trigger failures of firms in the marketplace. So it's the issue of stability."[66]

Any concern Breeden had with potential damage to US securities firms' competitiveness was allayed by three principal factors: statistics indicating US firms' international market dominance; US firms' reluctance to press for capital reductions; and the SEC's focus on protecting investors.[67] A further consideration was the SEC/Breeden's stature (personal, bureaucratic and professional) in Washington and in the securities industry. This combination of factors helped insulate the SEC from

[64] As indicated on page 243, the UK proposal permitted UK (and US) firms to exploit their expertise in developing proprietary risk management models (so-called "VaR" models). This development was adamantly opposed by Breeden.
[65] ISRR, "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved,".
[66] Ibid.
[67] See Chapter 11 for a discussion of competitive statistics and firms' reluctance to lobby and Chapter 10 for the SEC's institutional regulatory focus.

commercial and political pressures on capitalisation, dramatically distinguishing the agency from its peers in Europe.[68]

Breeden had also concluded that EU member-states' advocacy of the building block approach reflected regional political considerations and the relative uncompetitiveness of European firms, not their belief in the superiority of their approach to risk mitigation. Additionally, he surmised that the EU's advocacy reflected Single Market deadline pressure, rather than market experience or research.[69] Most non-US securities firms were capitalised at significantly lower levels than US firms. This stemmed from the fact that many non-US firms were privately owned and US firms increasingly were publicly listed.[70] Breeden had concluded that US firms' market dominance, particularly in the Euromarkets, came in large part from their strong capital positions.[71] Additionally, universal banks' competitive securities expertise had been retarded by their focus on lending. Market disintermediation had also pressured bank profitability encouraging their search for additional sources of revenue and lower costs.

Domestic political considerations made it difficult for private sector Wall Street firms to contest Breeden's conclusions, even if they disagreed.[72] Hobbled by recession and embarrassed by scandals, investment banks were reluctant to press the politically powerful Breeden for liberalisation of domestic capital regulations. Additionally, long-term disintermediation and securitisation trends discouraged US securities firms from further attracting the ire of commercial banks by provoking a regulatory battle with the SEC over capital adequacy. Commercial banks' efforts to reform Glass-Steagall would only intensify if they could argue that these securities firms' regulatory regime provided advantages not available to commercial banks, such as hedging to reduce capital.

IOSCO's failure to negotiate unanimous agreement to a capital standard encouraged speculation that another group's proposal, either the EU's or Basle

[68] This is discussed in succeeding chapters. The SEC was not, however, immune from political or economic pressure on other regulatory issues that affected the securities industry.
[69] A contemporaneous research project by the London Business School argued that the portfolio capital approach adopted in the UK, which took into account portfolio diversification, and the EU's building block approach, were both superior to the SEC's comprehensive approach in managing securities firms' risk exposure. See Dimson and Marsh, "City Research Project: The Debate on International Capital Requirements - Evidence on Equity Position Risk for UK Securities Firms, Subject Report VIII."
[70] Of the major US firms, 6 (Merrill Lynch, Salomon Brothers, Morgan Stanley, First Boston, Kidder Peabody, Lehman Brothers) were public (or subsidiaries of public companies) and only 1 (Goldman Sachs) was private.
[71] Confidential interviews, New York, April 2001. See discussion in Chapter 9.
[72] See discussion, Chapter 9.

Committee's, would be adopted internationally. Breeden denied this was the case, asserting that the Basle Committee and IOSCO were not "negotiating" multilateral capital standards, which were, in any case, only applied by national regulatory authorities.[73]

Breeden's comment is revealing; as it confirms his perception that IOSCO's discussions were over regulatory principles, not rules, and, more importantly, that the SEC would not implement IOSCO guidelines with which it disagreed. As the nearly universal adoption of the Basle Capital Accords had demonstrated, if US and UK regulators endorsed a capital standard, that standard had a high likelihood of being widely adopted. The Basle Accord's success also indicated that both US and UK assent were necessary for successful adoption of international standards. Each represented a vast market and broadly accepted regulatory regimes. Disagreement between US and UK securities regulators would delay development of a harmonised international regulatory regime, irrespective of multilateral institutional involvement.

This gave each domestic regulator effective veto power over regulatory standards. Moreover, it would be awkward if IOSCO, the EU, and the Basle Committee, endorsed differing standards. If the SEC refused to conform its domestic standards to EU or Basle-endorsed standards, it would make general adoption of those standards highly problematic.[74] This was particularly likely since, as Breeden was later to claim, Japanese and Canadian regulators agreed with him, and together their three markets represented 75 percent of global equity trading. There was no real alternative to universal agreement on the one hand or the perpetuation of national/regional standards on the other. Other options, such as the declaration of an irreconcilable stalemate or the adoption of incompatible standards, were unattractive. Breeden reiterated his position at the end of IOSCO's annual meeting. His statement confirmed the centrality of state authority in regulatory harmonisation and his view that the objective of capital adequacy discussions should be the development of a common view on principles, not the development of

[73] ISRR, "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved."
[74] Disagreement between the SEC and Basle Committee would likely imply disagreement between the SEC Chairman and the President of the FRBNY, the US' Basle Committee representative. This would reflect a more profound domestic disagreement over international regulatory standards, making international agreement that much more difficult. This was, of course, the case with capital adequacy until Breeden left the SEC in 1993. Ironically, despite Breeden's (and Corrigan's) departure, agreement over international capital standards for securities firms continued to prove elusive.

rules. When that was achieved, regulators would "go back to their home statutes and make whatever changes would be necessary to conform [to] those principles."[75] This approach to regulatory evolution differed significantly from the harmonisation approach advocated by the EU and the Basle Committee.

Following its September meeting, the Technical Committee announced that it would meet again with the Basle Committee in November. However, the failure to produce unanimous guidelines raised speculation that the Basle Committee might assume IOSCO's role. Pressure increased on the EU to finalise its standard and fix a precedent before IOSCO fixed theirs. Rather than meet in November, the Basle Committee and the Technical Committee announced that they would meet in Geneva in January 1992. The Technical Committee's capital memorandum would serve as the basis for discussion.

Privately, the SEC reiterated to IOSCO members its inflexibility and its expectation that further meetings would not produce different results from either the July or September meetings.[76] The Basle Committee continued research into equity portfolio risks for banks but elected not to pressure the SEC to alter its views. Gerald Corrigan, the US representative on the Basle Committee, endorsed the Committee's regulatory recommendations but chose not to use the Committee's stature to pressure the SEC to accept Committee or EU regulatory preferences. Such lobbying would have been unusual, as the Committee operated consensually. It could also have created domestic political problems for Corrigan who, as President of the FRBNY, was scrupulously apolitical. Participants also speculate that Corrigan, either for political or risk management reasons, decided not to pressure Breeden because he was unconvinced by EU arguments supporting the building block approach.[77]

The Geneva meeting

Representatives from the Technical and Basle Committees met in Geneva on January 28th and 29th, 1992.[78] Before the meeting, Breeden reiterated his limited vision of the Technical Committee's objectives and his opposition to altering US regulations. EU

[75] ISRR, "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved," October 7, 1991.
[76] Confidential interviews, New York, April 2001.
[77] Confidential interviews. See discussion in Chapter 9.
[78] Richard Waters, "Securities Regulators Close to Capital Rules,'" *Financial Times*, 27 January 1992.

member-states, under 1992 political and business pressure, pressed ahead with the building block approach and released new CAD guidelines the day before the Geneva meetings began. The new CAD language appeared to complement the general position reached by IOSCO and the Basle Committee at the Geneva meeting. However, it actually underlined the gulf between SEC and EU positions on capital adequacy. Breeden agreed only to "consider" a building block approach for equity risk while EU regulators had already committed themselves to it. The ensuing French and British complaints over SEC obstinacy are unsurprising, considering that they had committed themselves to a capital calculation approach that the SEC opposed. Further EU negotiations in March, finalising CAD language, were "heavily influenced" by the unproductive Geneva meeting.[79]

The Geneva meeting failed to produce agreement. The SEC, pursuing a unilateral harmonisation strategy dictated largely by domestic political considerations, was unable to sway European regulators. For their part, European regulators were compelled to focus on domestic and regional, rather than international, concerns. Their inability to get the SEC to adopt their harmonisation objectives defines the limit of their authority and their interest in the IOSCO process.

The official report on the Geneva meeting stated that substantial progress on capital adequacy had been made. It soon became obvious, however, that major disagreements persisted. The interplay between IOSCO, the Basle Committee, and the EU discussions became clearer. The Geneva meeting promised that a public consultative document on capital adequacy would be released over the summer, but remaining differences appeared substantial. One of the participants gave a more realistic assessment: "There is no way these guidelines will be issued this summer without another meeting."[80] But no additional meetings were planned.

Disagreements

The remaining disagreements centred on specific capital levels. For debt securities, a building block approach was reaffirmed. Breeden and Corrigan indicated that either comprehensive or building block approaches to calculating capital for equity

[79] ISRR, "Compromises Sought to Move Capital Adequacy Rules Ahead."
[80] ISRR, "Differences on Equity, Technical Details Suggest Long Wait for Global Capital Rules."

position risk might be applied. They further indicated that a "general consensus was reached on percentages applied to gross and net portfolio values." Consensus turned out to be strained, however. In subsequent testimony before the SEC's Congressional Market Oversight and Financial Services Advisory Committee, William Heyman, Director of the SEC's Division of Market Regulation, indicated that Corrigan and Breeden had agreed on an 8 percent standard for net position risk and a 4 percent standard for gross positions. The British and the French however, did not share this "agreement." The British delegation indicated that the 4 percent standard would cause financial hardship for UK firms, a position the SEC disputed. Japanese, British and French delegations had again urged a 2 percent ratio on gross equity portfolio risk, with a majority of other countries favouring 4 percent and the US holding out for 8 percent. The issue was complicated by prior agreements in EU negotiations.

The depth of disagreement, not evident in public statements, was well appreciated by EU member-states. The 2 percent capital level advocated by the British and French had been the basis for the EU's own discussions. There was speculation that the majority advocating a 4 percent level had been encouraged by German and Dutch representatives; who used the Geneva meeting to leverage EU discussions. Media speculation of a possible negotiating alliance between SEC, German and Dutch regulators to promote higher capital levels was cancelled by the SEC's insistence on levels that were considered anti-competitive in the EU and by its general antipathy to the building block approach. Treatment of arbitrage portfolios was another point of contention, particularly between the US and UK. William Heyman reiterated the SEC's position, noting the US tried to be flexible but, "we feel [US standards] have served our country well."[81]

The failed Geneva discussions re-energised EU CAD discussions.[82] COB President Saint-Geours noted that the SEC disagreed both with this level and with the concept of specifying different capital levels for differing risks. Saint-Geours urged the EU to agree on its own capital standard in order to counterbalance SEC preferences more effectively. He noted, "The United States would like to influence what is happening in Europe. I would like us to complete our [directives] in Europe before starting negotiations aimed at coordination with the United States."[83] Saint-Geours bluntly

---

[81] Ibid.
[82] Bray, "Capital Norms Have a Way to Go."
[83] ISRR, "Differences on Equity, Technical Details Suggest Long Wait for Global Capital Rules."

indicated his concern that the Geneva talks could create problems for the EU; "Points on which we have reached a difficult agreement in Europe may be put into question by the positions taken at Geneva. I fear that new complications have been introduced."[84]

Speaking to the Institute of International Bankers on May 27th, Breeden indicated he still hoped for agreement on capital adequacy standards, but his comments reinforced the impression of SEC obstinacy.[85] Breeden singled out the Basle Accord as an example of a regulation that was not "market neutral;" he argued that the Accord encouraged investment in government securities (with low capital allocations), rather than loans (with higher capital allocations) and consequently served as a credit allocation system.[86] This comment reflected SEC officials' opinion that the Basle Committee was overly political and insular, driven by consensus rather than best practices and insensitive to securities-related risks.

EU steals a march on IOSCO

Meeting on June 29th, the EU Council agreed to final language on the ISD and CAD, formally closing the door on any immediate agreement with IOSCO. With the Single Market deadline looming and their attention focused on the Maastricht vote, finance ministers in Europe decided that waiting for resolution of the Basle/IOSCO discussions would not guarantee a better, and certainly not a speedier, capital formula. The adoption of compromise language was viewed as a political breakthrough and an example of EU ministers' determination to successfully develop solutions to difficult technical issues.

In July, IOSCO's Technical Committee met to review progress on capital adequacy. The meeting was described as "acrimonious." One participant said, "Breeden talked well over half the time, and many saw it as an abuse of power of the chair. I think the feeling of most of the people at the meeting was that he didn't want an agreement. So he reverted to a hard and fast position which he knew the others wouldn't adopt."[87]

[84] Bray, "Capital Norms Have a Way to Go."
[85] ISRR, "SEC Chairman Urges Capital Rules That Cover All Types of Securities," June 16, 1992.
[86] Underlying these comments was a conviction that market risk had been dropped from the Basle Accord for political reasons - assigning country risk ratings was too sensitive for regulators. As a result, bank portfolio risk had been distorted, banks could zero risk-weight government securities, but securities firms were required to mark-to-market the same securities. This was Breeden's "Basle Problem."
[87] ISRR, "Disagreement Plagues Committee Discussions on Harmonised International Capital Standards,", July 28, 1992.

Breeden was accused of back-pedalling on his earlier "acceptance" of the building block approach in Geneva. The SEC countered that it had never wavered in its stated preference for a comprehensive approach.

Breeden argued that the building block approach was fatally flawed; it was impossible to perfectly match long and short positions. Participants argued over capital for gross position risk, over the percentage of subordinated debt in capital, and whether commercial banks' investment books, as opposed to their trading books, should be exempt from capital standards.[88] Breeden even raised new questions about the treatment of swaps and futures for capital purposes.[89]

By August it was clear that release of draft capital adequacy guidelines by IOSCO would be further "delayed." Roy Croft, the UK's representative, confirmed that members had asked for more time to review the CAD rules in order to determine their impact on IOSCO's deliberations.[90]

IOSCO's 1992 annual meeting

IOSCO's 1992 annual meeting was described as the "last, best hope to head off pressure on Basle to go it alone" on capital adequacy standards.[91] The Basle Committee had made progress developing a capital standard for commercial banks' securities positions, but agreement with IOSCO had proved impossible. Richard Breeden was held responsible.[92]

At the annual meeting the SEC opposed a building block proposal by the SIB, arguing that a minimum capital floor was the only basis on which a calculus could be developed. Breeden also rejected the UK's reiterated 2+8 proposal, saying, "The standard that has been proposed would represent the lowest standard in the world. Setting that as the minimum doesn't accomplish anything. It should be clear by now that

---

[88] "Investment books" referred to portfolios of securities held 'for investment' rather than 'for trading' purposes. Breeden was concerned that banks would switch securities portfolios from trading to investment as a way of minimising their capital costs.
[89] ISRR, "Disagreement Plagues Committee Discussions on Harmonised International Capital Standards,".
[90] Richard Waters, "International Capital Markets: International Draft Rules on Capital Delayed," *Financial Times*, 12 August 1992.
[91] International Reports, "Banking & Finance - the Securities Summit: Consensus with Basle?" (IBC USA Licensing Inc., 1992).
[92] Richard Waters, "Search for Security: Last-Ditch Efforts to Reach an Agreement on Capital Adequacy in the Securities Markets," *Financial Times*, 23 October 1992.

2+8 without a floor is unacceptable to us in any way, shape or form."[93] Andrew Large, newly appointed SIB chairman, replied, "We think it's desirable to encourage people to have balanced, matched books."[94] Large's argument coincided with the compromise adopted on the CAD.

IOSCO would not adopt the CAD formulation over the SEC's objections. SEC abstention from an IOSCO standard would undermine the legitimacy of the standard and the institution. For domestic reasons as well, it was impossible for Breeden to endorse the SIB's proposal.[95]

Breeden's warning was loud and clear: "The levels of capital under the CAD are highly unsafe."[96] Leon Brittan, the CAD's principal architect, responded by calling Breeden's comments "ill-informed." He pointedly accused the SEC of bullying IOSCO members, saying, "In today's global markets no single national regulator...can expect to impose their system on everyone else."[97] Breeden retorted, "If we have many more ill-informed comments like Sir Leon's, the prospects for an agreement are not too good." He added, "We do not seek to ask or suggest anyone around the world should use US standards. It's important that people respect the judgment of professionals. The politicians need to stay out of it."[98]

Breeden reaffirmed his view that IOSCO was a discussion forum, not a rule-making body,[99] and he commented, "There is no earthly reason why it is important to have an agreement at this meeting, or at next year's meeting in Mexico City, or the year after that. I don't get paid to weaken the protection to US investors." Discussing the possibility that CAD adoption would prevent agreement in IOSCO, Breeden commented, "Who cares? We don't think you ever have to bridge the gap."[100] The heated discussions

[93] ISRR, "US, Europe Split on Capital Adequacy Standards; Breeden Firmly Rejects UK Approach as 'Unsafe'," November 3, 1992.
[94] Ibid.
[95] This will be discussed in Chapters 10 and 11.
[96] Robert Peston and Tracy Corrigan, "Breeden Opposes IOSCO Capital Standard: SEC Chairman Condemns Proposal as 'Imprudent' - Chance of Agreement Recedes," *Financial Times*, 28 October 1992.
[97] Robert Peston and Tracy Corrigan, "International Capital Markets: Sir Leon Brittan Joins Row over Capital Standards - IOSCO Conference," *Financial Times*, 29 October 1992.
[98] Dow Jones News Service, "Sec's Breeden Calls Brittan Remarks 'Ill Informed'," *Dow Jones News Service - Ticker*, 10/29/1992 1992.
[99] Robert Peston and Tracy Corrigan, "International Capital Markets: Hopes Dwindle for New Agreement on Capital Requirements," *Financial Times*, 28 October 1992.
[100] ISRR, "US, Europe Split on Capital Adequacy Standards; Breeden Firmly Rejects UK Approach as 'Unsafe'."

carried over to the formal closing dinner, where Breeden and Brittan continued to debate, raising their voices and, according to one observer, nearly coming to blows.

At the end of the meeting, Andrew Large, newly appointed Executive Committee Chairman, stated that IOSCO would continue capital discussions, with the Basle Committee for debt and internally for equity. Saint-Geours was elected to replace Breeden as chair of the Technical Committee.[101] In February 1993, less than four months after the annual meeting, the Technical Committee formally abandoned work on capital adequacy.[102] At a minimum, this meant that in the near term, significant differences in domestic capital regulations would persist. A year earlier, at the Geneva meeting, agreement had still been considered possible.

Conclusions

Breeden considered IOSCO an immature organisation, still developing its potential and its authority. For him, IOSCO was a forum for discussion and modest multilateral initiatives, particularly if they embraced SEC positions. It was not a rule-making peer of the EU or the Basle Committee – or of the SEC. The SEC used its membership on the Executive and Technical Committees to enhance IOSCO's capabilities and to promote US regulatory values, particularly through the Strategic Assessment. The SEC preserved US regulatory sovereignty, in part by imposing its preferences on IOSCO and in part by impeding policy formation. As described in Chapter 11, the SEC also imposed its preferences through bilateral agreements. Sub-national interests are addressed in Chapter 10.

Three factors are significant in locating authority in the IOSCO debates; at IOSCO the US was involved, members' commitment to policy formation was weaker than in the EU, and, as a result, timing issues were less pressing. The SEC was able to dominate IOSCO debates by refusing to compromise. Additional factors are important as well in locating authority. First, IOSCO's working parties initially failed to consult with the private sector, nor is there evidence that they subsequently established effective consultative relationships. Second, the IOSCO negotiations highlighted the importance

[101] Breeden's term had expired.
[102] Richard Breeden, an appointee of the outgoing Bush administration, stepped down from his post as SEC Chairman in July 1993.

of US and UK regulatory agreement. Third, the IOSCO discussions confirm the influence of powerful individuals on the negotiations. Arguably, the negotiations failed because of Richard Breeden's intransigence. The background to Breeden's intransigence is important to defining policy-making authority and the preservation of state autonomy. The same observation can be made with respect to Leon Brittan's role in the EU. These observations prompt investigation into the source of the US/SEC's authority. They also confirm state-centric hypotheses.

For Breeden, IOSCO did not represent supranational authority. The SEC effectively vetoed progress on harmonisation initiatives. This observation does not clarify, however, how or why this occurred. The next three chapters will address the roles of IOSCO, of private authority, and of the SEC and Richard Breeden in defining authority in the IOSCO negotiations.

Chapter 9

IOSCO's Authority and Private Sector Influence

This chapter is divided into two sections. Part A analyses the impact of IOSCO's institutional history and structure on its authority, and Part B assesses the nature of private sector authority in the IOSCO negotiations.[1]

A. IOSCO's Authority

Introduction

IOSCO's authority and influence are assessed through an examination of its organisational and governance procedures and the effect of the SEC-sponsored "Strategic Assessment" on IOSCO's operating structure and procedures. IOSCO is subsequently compared with the Basle Committee to isolate comparable and contrasting characteristics that make up and facilitate institutional authority. IOSCO's governance structure is identified as a significant source of institutional dysfunction, stifling international consensus and communication among members and the private sector.

The International Organization of Securities Commissions

Founding characteristics

IOSCO's predecessor organisation, the InterAmerican Association of Securities Commissions, was founded in 1974, largely at the urging of the US, which wanted to encourage the development of Latin American domestic capital markets. This was intended to help diversify regional funding sources in an area that had historically relied

[1] An analysis of the SEC is presented in Chapter 10.

on bank borrowing, with mixed consequences for borrowers and lenders.[2] It was an informal, regional forum designed to examine securities regulatory developments and to aid in capital-raising in North, South and Central America. Membership was extended to all states in the region.[3]

Starting with its founding, the Association evidenced a powerful US influence. Originally structured as a hemispheric forum, it was not meant to be a rule-making body that could potentially challenge US regulatory norms. Initial meetings were so informal that annual reports were not published.[4] In 1983, the Association was renamed[5] and reorganised as a global organisation headquartered in Montreal.[6] IOSCO's mandate was expanded to encompass international regulatory cooperation and enforcement. However, formal steps to institutionalise either its international legitimacy or its authority did not accompany IOSCO's dramatic expansion in scope. The organisation itself characterised this transformation as evolutionary. But the new IOSCO had no formal operating charter or treaty-based authority. As a consequence, its ability to enforce rules and to promote international cooperation was limited. These gaps in IOSCO's "formal" authority were similar to gaps in the Basle Committee's authority and are examined in detail below.

Objectives

IOSCO's bylaws defined its new objectives: "to cooperate to ensure better regulation of the markets, on domestic as well as on the international level; to exchange information.... to promote the development of domestic markets; to unite their efforts to

[2] Bank lending crises in Mexico, Brazil, Argentina and other Latin American countries had been devastating to US financial institutions as well as to local economic development, infrastructure and populations. Guy, "Regulatory Harmonisation to Achieve Effective International Competition."

[3] In the early 1970s, before capital market globalisation took root, US commercial banks had more extensive and longer standing banking relationships with Latin American businesses and governments than with their counterparts in Asia (ex. Japan), Africa or the Middle East. Latin America was, after Europe (and for some banks after 1972/73, the Middle East), the most important source of international business for many US institutions. However, in sharp contrast with US and Canadian financial institutions, Latin American banks were not active in international securities markets.
In 1975, international bond offerings (including both Eurobonds and foreign bonds) by non-oil LDCs and "Other Countries" (excluding US, Japan, UK, Canada, Germany, Australia, Switzerland, France, Italy, Netherlands, other OECD, Oil Exporters and Eastern Europe) totalled just 5.4 percent (US$1,084 million out of a total of US$19,960 million) of all international bond offerings. The comparable figures were 10.7 percent in 1980 and 5.3 percent in 1985. In 1978, market capitalisation of "All Other" stock markets (after US, UK, Japan, Germany, Canada, France, Switzerland, Italy, Australia and the Netherlands) was US$75 billion, or 4.5 percent of total world stock market capitalisation (US$1,685 billion). See: Chuppe, Haworth, and Watkins, "The Securities Markets in the 1980s: A Global Perspective."

[4] IOSCO's first annual report was published in 1988.

[5] The formal name was changed to: The International Organization of Securities Commissions ("IOSCO").

[6] IOSCO was incorporated by act of the Quebec Parliament under Quebec law as a non-profit, private corporation.

establish standards and effective surveillance of international securities transactions; and to provide mutual assistance to ensure the integrity of the markets by rigorous application of the standards and by effective enforcement against offences."[7] IOSCO's focus on markets and regulatory change meant that its main connection with its membership was through the national regulatory organisations responsible for securities markets.

This, of course, constituted a major distinction between IOSCO and the Basle Committee and the EU. Myriad official connections between member-state and EU authority existed. Basle Committee members were typically senior central bank officials. They frequently were the most important national regulators and had economic and/or political authority. But because many countries did not have official governmental securities regulators, IOSCO's principal connection with member-states often came through informal or quasi-public authorities. National representatives to IOSCO were a disparate group including national securities regulatory institutions, SROs, trade associations and stock exchange managers.

It was unclear how IOSCO would develop or enforce regulatory guidelines without an officially recognised international mandate or a cohesive membership. The organisation had transformed itself from a regional discussion forum into an ambitious international securities regulatory body without taking any steps to lend credibility or legitimacy to its work. In addition, the organisation operated with a very small secretariat and no enforcement staff. It was also based in Montreal, a capital markets backwater. Unlike the Basle Committee or the EU, IOSCO did not have access to significant financial or human resources. Consequently, its ability to develop or enforce regulatory standards relied on the cooperation of domestic authorities, particularly of its largest members, the SEC and SIB.

There are three possible explanations for the genesis of IOSCO's transformation from regional to international entity. As discussed in Chapter 2, the rapid growth in debt and equity markets in the early 1980s, coupled with the impact of market globalisation,

---

[7] International Organization of Securities Commissions (IOSCO), "1995 Annual Report," (Montreal: IOSCO, 1996).

are potential market-based causes.[8] US authorities claim, however, that the initiative came from the SEC. Finally, in the mid-1980s, US and UK central banks concluded that Basle Committee progress in developing capital standards for commercial banks was "too slow." They took collaborative steps to accelerate the development of what became the 1988 Basle Capital Accord.[9] This has encouraged conjecture that IOSCO's expansion was caused by competitive factors, that the US and UK encouraged IOSCO's upgraded international stature to address both international securities concerns and to ensure that the US and UK continued to exert their influence over international regulatory initiatives.

Unlike the Basle Committee or the EU, IOSCO was not directly associated with sovereign entities or with recognised supranational authorities. Its authority was derived from its large membership. Operationally, the 1983 reorganisation did not change IOSCO; it continued to hold extravagant annual meetings and to facilitate member information exchange. Many national regulators considered IOSCO a "talking shop," rather than an international standard-setter. Its regional history, limited track record, and lack of resources further circumscribed its legitimacy and potential authority. This had the consequence of placing disproportionate research and developmental burdens on IOSCO's largest member, the SEC and, after 1986, on the SIB. Despite its democratic organisational structure, this brought into greater prominence the regulatory perspectives of members from larger markets. IOSCO's democratic aspirations contrasted with the structure of the Basle Committee, which made no pretence of democratic operations or membership.

In setting up an inter-American regulatory association, the US had endeavoured to promote both the development of local capital markets and the utilisation of US domestic markets. Another objective was the promotion of US regulatory standards for regional securities markets.[10] The expansion of IOSCO's remit in 1983 was a mixed opportunity for the US. On the one hand, it established an international securities forum and filled a gap in the international financial services regulatory infrastructure that had been highlighted by globalisation. It also created a potential platform for the SEC to

---

[8] Related stimuli included contemporaneous regional financial crises and the success of the Basle Committee in developing the 1975 Basle Concordat. (See: BIS: Basle Committee on Banking Supervision, "Basle Concordat," (Basle: 1975).)

[9] Kapstein, *Governing the Global Economy: International Finance and the State.*

[10] Confidential interview, New York, May 2001.

promote domestic US regulatory norms to a wider audience. But these developments raised risks for US authority. Expanding IOSCO's membership could dilute US regulatory leadership. This tension was reflected in IOSCO's "split personality." Although it expanded national representation and the international visibility of securities regulation, the diversity of IOSCO's membership (and their resources) and its lack of an official mandate constrained the organisation's effectiveness and had the paradoxical consequence of enhancing US authority. IOSCO's governance procedures, combining limited voting opportunities with powerful committees, also ensured that the organisation's authority would be limited.

Membership

IOSCO membership was divided into three categories: regular, associate and affiliate. Regular membership was reserved for government regulators of national securities markets, but it was extended to SROs, such as stock exchanges, if no securities regulator existed.[11] Associate membership applied to public regulatory agencies with supervisory responsibility from countries where a national regulator was already a regular member.[12] Affiliate memberships were created for international organisations whose objectives included the regulation or development of securities markets. As a result, IOSCO's membership represented a large, disparate "policy community" rather than a tightly defined group – such as the 12 central banks represented on the Basle Committee.[13] At year-end 1992, when discussions over capital adequacy ended, IOSCO's combined membership totalled 102, including associate and affiliate members.[14]

IOSCO's multi-layered membership policy contributed to its institutional weakness. Because IOSCO had grades of membership, several national regulators, all from the same country, could be members at the same time.[15] This introduced the prospect of domestic disputes entering IOSCO's deliberations and diluting national

[11] The Federation of German Stock Exchanges is an example.
[12] For example, the SEC was the US 's regular member, the CFTC was an associate member.
[13] Underhill, "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy".
[14] International Organization of Securities Commissions (IOSCO), "1992 Annual Report," (Montreal: 1993).
[15] This was true for the US (the SEC was a full member, the CFTC was an associate member) and the UK (the SIB was the full member, the DTI was an associate member).

representatives' authority, particularly since associate members were also permitted to sit on working parties.

These issues were highlighted during IOSCO's 1989 annual meeting, when Britain's DTI attempted to join IOSCO as a regular member.[16] Britain's SIB was the official UK representative. The DTI argued that it was responsible for regulating certain aspects of the UK securities industry[17] and should therefore be granted full membership. Several President's Committee members,[18] including France and Italy, reportedly objected to DTI's application, citing the Committee's desire to remain independent of political processes and to avoid similar applications and potential conflicts.[19] The President's Committee considered DTI's application privately and elected to maintain its associate membership.

The decision to allow DTI to retain a foothold in IOSCO came at a sensitive time for the organisation, which was trying to burnish its international reputation and establish itself as a peer of the Basle Committee. By this compromise, IOSCO confirmed its discomfort with tough decisions and opened the door for other governmental agencies to seek membership.

A similar dilemma confronted IOSCO at its 1990 annual meeting, where Richard Breeden proposed organisational changes to IOSCO's working parties,[20] which would have had the effect of reducing or eliminating the CFTC's[21] influence.[22] The President's Committee rejected Breeden's proposal. However, by keeping the CFTC as an active member of its working parties, IOSCO ensured that domestic policy and institutional disputes could influence international policy debates.[23]

---

[16] DTI was a "limited" national regulator and a branch of the government.
[17] Including insider trading and investment exchange authorisation.
[18] See page 259 for a discussion of the President's Committee.
[19] Richard Waters, "IOSCO Conference: French and Italians Turn Down DTI Membership," *Financial Times*, September 21, 1989.
[20] Restricting Working Party membership to Regular members only.
[21] The Commodity Futures Trading Commission. See Glossary.
[22] See below under "The Strategic Assessment."
[23] See: Jr. Coffee, John C., "Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation," *The Business Lawyer* 50, no. 2 (1995). for a description of the SEC's longstanding domestic jurisdictional battles with the CFTC.

In summary, IOSCO's organisational structure inhibited the development of mutual member benefits. Additionally, its governance mechanisms limited and constrained policy-making, as did the diversity of its membership. These limitations vested significant responsibility and influence with a small group of members, giving them effective veto power over policy decisions. Lastly, the organisation's thin regulatory track record limited its international authority.

Committees

Committees carried out IOSCO's governance and policy development projects. The President's Committee, composed of representatives of regular and associate members, was the senior IOSCO committee and operated as a general congress. It met once a year (at the annual meeting); it was responsible for approving official policy recommendations; and it operated in secret. In addition, it elected members of the Executive Committee, which operated as IOSCO's principal governing organ. Limiting President's Committee meetings and policy votes to the annual meeting further constrained IOSCO's standard-setting capabilities, and it reposed significant responsibility in the Executive and Technical Committees.

The Executive Committee had twelve members,[24] elected by the President's Committee to two-year terms.[25] The Committee met periodically[26] and approved statements or recommendations made by the Technical Committee. It focused on governance rather than on policy-formation[27] and it took "all decisions necessary to achieve the purpose of the Organization in accordance with the guidelines of the President's Committee."[28]

The Technical Committee was responsible for assessing the status of mature markets and for making policy prescriptions. This committee comprised representatives from the national securities agencies responsible for regulating the world's larger securities markets. The Technical Committee generally determined its own membership

---

[24] It currently carries 19 members.
[25] After the 1990 Strategic Assessment (discussed below) . It included the chairs of the Technical and Emerging Markets Committees and a representative from each regional standing committee. The Executive Committee also nominated members of the Technical and Emerging Markets Committees.
[26] Typically 3 or 4 times annually.
[27] A.A. Sommer, "IOSCO: Its Mission and Achievement," *Northwestern Journal of Law and Business* 17, no. 1 (1996).
[28] *By-Laws of the International Organization of Securities Commissions.*

and agenda, although the Executive Committee approved its nominations. The Committee's work was allocated among seven working groups,[29] each representing a distinct area of international securities activity, including market intermediaries, which considered capitalisation.[30]

The Basle Committee

After its 1983 restructuring, IOSCO emerged as a multilateral organisation devoted to developing international regulatory standards for securities markets.[31] However, IOSCO's presumptive prominence contrasted with the long-standing international regulatory stature of the Basle Committee and of the EU, both of which had been involved in the development of international regulatory standards before the creation of IOSCO.

The Basle Committee was formed in 1974 in response to two major commercial bank failures.[32] It had no constitution, by-laws, staff or facilities; it operated in secret and it did not publish minutes. In many of these respects, it resembled IOSCO. The BIS and Basle Committee members seconded staff from their national organisations for Committee projects and research. Central bank governors of the G-10, Luxembourg, and the Netherlands made up the Committee, whose broad brief encompassed supervisory issues associated with the operations of credit institutions. Because its research encompassed universal banks it was concerned with the operation and regulation of securities markets and institutions. Thus it was inevitable that overlaps and competition between IOSCO and the Basle Committee would occur.

The Basle Committee operated informally, meeting at least monthly, and developed agreements and policy recommendations by consensus. The Committee was (and is) notable for its reliance on personal contacts and an "interactive and decentralized

[29] As of the early 1990s.
[30] The working group on the Regulation of Market Intermediaries considered capital adequacy. See: (IOSCO), "1995 Annual Report."
[31] See: Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics*.
Porter, *States, Markets and Regimes in Global Finance*.
Underhill, "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy."
[32] The failure of the German bank IG Herstatt and of the US bank Franklin National.

method of ensuring compliance" with its policy recommendations.[33] The Committee's notable accomplishment, the 1988 Basle Capital Accord, established minimum international capitalisation standards for credit institutions. Near universal compliance with the Accord reflected the Basle Committee's legitimacy and international regulatory authority.[34] A Basle Committee Chairman explained the Committee's success as based on "shared goals and vision, open-minded perspectives, collegiality and trust." A "non-political" approach to the Committee's work was also cited.[35] Peter Cooke, a former Committee chair, summarised its rule-making approach as follows: the Committee "formulates broad supervisory standards, practices, and guidelines which individual authorities use to implement the detailed arrangements – statutory or otherwise – which are best suited to their own national systems. In this way, the Committee encourages convergence toward common approaches and common standards without attempting detailed harmonisation of member countries' supervisory techniques."[36]

Cooke's comments parallel Richard Breeden's observations about IOSCO's methodology, made during capital adequacy discussions. This, of course, raises the question of why Basle Committee capital guidelines for credit institutions were universally adopted while IOSCO's guidelines for securities firms were never even finalised. A second question will be addressed in Chapter 12; whether multilateral regulatory institutions (or other factors) promote regulatory convergence, as suggested by state/market theorists.

IOSCO and Basle Committee Compared[37]

The Basle Committee and IOSCO were different[38] in several critical respects:

- They differed in size. The Basle Committee comprised 12 members, while IOSCO had 102. Unlike the Basle Committee's small, homogeneous, and

[33] David Zaring, "International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations," *Texas International Law Journal* 33 (1998).
[34] GAO, "International Banking: Strengthening the Framework for Supervising International Banks," (Washington, D.C.: The United States General Accounting Office, 1994).
[35] Confidential interview, New York, January 2001.
[36] Zaring, "International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations," p. 269.
[37] See generally: Tobin, "Global Money Rules: The Political Economy of International Regulatory Cooperation".
[38] And continue to be different.

overwhelmingly western central bank membership, IOSCO's large membership was geographically and represented a wide spectrum of organisations associated with securities markets.

- Central bankers represented traditional, long-standing regulatory authority, a status unmatched by securities regulators.

- The Basle Committee was founded to address specific market failure whereas IOSCO's predecessor organisation was created for informational and commercial purposes.

- The Basle Committee operated by developing policy consensus. IOSCO required a unanimous vote of the President's Committee to promulgate policy recommendations.

- IOSCO's President's Committee voted only once a year to adopt policy recommendations. The Basle Committee, with a smaller cast, met frequently – in informal and private sessions – to discuss proposals.

- The Basle Committee had no stated objectives, rules or governance procedures. IOSCO was more formally structured with committees, discrete objectives and operating procedures.

- The Basle Committee's proposals were discreetly circulated for consideration by members and were revised into guidelines following a review of pubic/private sector feedback. IOSCO was still developing procedures for proposing and reviewing policy guidelines.

- The Basle Committee's smaller, more uniform membership facilitated the development of focused guidelines reflecting the objectives of major economic actors and markets. This practice was followed in the development and revision of the Basle Capital Accord. IOSCO's policy review and approval procedures encouraged the development of general, broadly acceptable principles. This ensured passage by the President's Committee but, as with the EU, also encouraged potentially differing national applications.

This analysis reflects the different objectives of the Basle Committee and IOSCO and, in part, the differing traditions and statutory bases of central banks and securities regulators. The Basle Committee's approach more closely resembled the EU's regulatory process and objectives than it did IOSCO's.

Because, early on, IOSCO members failed to specify precisely the organisation's objectives, expectations for capital adequacy discussions differed, with the SEC emphasising principles and EU states seeking to duplicate regional regulatory harmonisation. Additionally, it is clear that the traditions sustaining the Basle

Committee's work did not characterise relationships on IOSCO's Technical Committee. Technical Committee relationships reflected wide disparities in experience and institutional stature, both internationally and within home markets. These factors contributed to the prominence of the SEC, SIB and COB within IOSCO regulatory debates. Each was a statutory, governmental institution representing well-defined regulatory traditions and markets. Each contributed "more than its fair share" to executing IOSCO's research and developmental workload. But these institutions had no history of working together. During the period in which IOSCO was considering capital adequacy guidelines, the SEC occupied the chairmanship of the Executive Committee and then of the Technical Committee.

Disagreements among this small group arose from differing national regulatory preferences; they paralysed IOSCO's policy-making ability, and they help to explain IOSCO's inability to forge international cooperation or to project international authority. But the EU was able to build agreement on the CAD and ISD, and the Basle Committee was able to build agreement on the Capital Accord, despite differing national regulatory traditions. Why was agreement not possible in IOSCO? Additional factors, beyond differing national preferences are indicated. IOSCO's complicated organisational structure and membership contributed to its failure to foster international cooperation. Its organisational governance required unanimity. Without institutional or political incentives for cooperation or a consensual tradition, it was possible for senior members of the Technical Committee (or the Executive Committee) to assert their preferences and to veto or stalemate regulatory proposals.

The Strategic Assessment

At IOSCO's 1990 annual meeting, the membership unanimously approved a strategic assessment report that had been initiated and prepared by the SEC. It outlined a major overhaul of the Technical Committee's organisational structure and installed SEC Chairman Richard Breeden in a two-year term to the newly created post of Technical Committee Chairman. Before assuming his new post, Breeden completed his one-year term as chairman of the Executive Committee.[39] His move to the newly strengthened

[39] Sir David Walker, then chairman of the UK Securities and Investments Board, succeeded Breeden as IOSCO Executive Committee Chairman.

Technical Committee ensured that he remained in a position to exert influence over IOSCO's research agenda and rule-making processes.[40]

The Strategic Assessment was begun in 1989, closely following the successful 1988 promulgation of the Basle Capital Accords. Its objective was a bold attempt to position the Technical Committee internationally as a regulatory peer of the Basle Committee. However, IOSCO's membership had not yet agreed whether IOSCO should establish harmonised international regulatory standards or should continue to operate as a clearinghouse for the examination of national standards. The US was particularly reluctant to consider adoption of standards that might affect domestic regulation. This brought the US into conflict with EU members, whose perspective on IOSCO's objectives was influenced by their work on harmonising EU standards.

The Strategic Assessment represented a concerted effort to strengthen IOSCO's organisation, in order to make it more effective in developing international regulatory policy. The report was in part a response to IOSCO delegates' concern that disagreements over capital adequacy guidelines had delayed the release of definitive regulatory principles.[41] As a consequence, the EU and the Basle Committee had overtaken IOSCO in developing international standards. The Strategic Assessment was designed to ensure that neither the Basle Committee nor the EU would establish a regulatory regime without first considering IOSCO's views.[42]

The Strategic Assessment addressed factors constraining policy-formation: IOSCO's unwieldy size, lack of effective governance and imprecise agenda-setting. The recommended changes clarified objectives and provided a platform from which a strong Technical Committee chairman could promote a policy agenda. Because many Technical Committee members were also Executive Committee members, adoption of policy recommendations by one committee helped ensure adoption by the other. In assuming the Technical Committee chairmanship, Breeden positioned himself to influence IOSCO's regulatory policy agenda, ideally in line with US interests.

[40] The SEC also remained a member of the Executive Committee.
[41] Which had been recommended in IOSCO's 1989 report on capital adequacy.
[42] Richard Waters, "Regulators Seek to Give IOSCO Greater Influence," *Financial Times*, 12 November 1990.

As Executive Committee Chair, Breeden had proposed the strategic assessment exercise and, when his recommendation was adopted, had appointed Michael Mann, an SEC official, to manage it. Previously, Mann had led vigorous SEC extraterritorial enforcement efforts against violations of US securities laws. These actions indicate Mann's support for the offshore application of US securities regulations. Mann's aggressiveness had led non-US regulators to view him as intolerant of those who did not agree with SEC regulatory perspectives.[43] In 1989, demonstrating his interest in expanding the SEC's international regulatory influence, Breeden had created an SEC Office of International Affairs and named Mann its director.[44] In this position he was responsible for coordinating the Commission's international regulatory activities. In conducting the strategic assessment, he equated IOSCO publicly with the Basle Committee. But privately Mann had concluded that IOSCO needed further maturation before it could be a peer of the Committee or take precedence over the SEC's own international regulatory efforts.[45]

The initial draft of the Strategic Assessment met with complaints when it was circulated to Technical Committee members in June 1990. But, after revision, the final version was approved at the fall annual meeting and praised for its reform of the Technical Committee and its incorporation of British, Japanese and French regulators' perspectives. Breeden gave his view of the Technical Committee's role at the annual conference: the "principal standard-setting focus of IOSCO is in the Technical Committee, and the Committee (the Strategic Assessment policy group) felt it was important as it evolved to have a somewhat more formal leadership structure to review the progress of the working groups and to try to push some of the more substantive work along more quickly."[46]

At the 1990 annual meeting, Breeden noted that work on developing capital standards was proceeding well and that the Technical Committee would take the lead in developing specific harmonisation approaches. Recommendations would be passed to

---

[43] Christina Morton, "Michael Mann: Making a Mission of International Enforcement," *International Financial Law Review*, (1990).
[44] See Chapter 11.
[45] Mann commented that "IOSCO is growing into a much more mature organisation for multilateral discussions." Alluding to the Strategic Assessment he noted that "We're working very hard to develop within IOSCO a context for developing multilateral initiatives."ISRR, "SEC's Michael Mann Sets Active Pace and New Initiatives for the Recently Formed Office of International Affairs," April 23, 1990.
[46] ISRR, "U.S. SEC Forges New Global Role within IOSCO; Breeden Chairs Strengthened Technical Committee."

the Executive Committee, which would decide whether to present them to IOSCO's full membership. Among the Strategic Assessment recommendations adopted were that the number of Technical Committee meetings be increased,[47] that the number of working groups and committee memberships be reduced,[48] and that each representative be a high-ranking official from the member's national regulatory organisation. This had two consequences: a potential reduction in the democratic scope of the committee's operations and a concentration of policy-making authority. But the revamped Technical Committee still lacked the stature of the Basle Committee, though it had been redesigned to emulate it. Since IOSCO's governance procedures resulted in the President's Committee largely rubber-stamping recommendations made by the Technical and Executive Committees, enormous authority was placed in the hands of committee chairs.

One reason for the Strategic Assessment's unanimous adoption was that Breeden had agreed to modify his early attempts to exclude the CFTC, an Associate IOSCO member, from any meaningful IOSCO role. Members of the Technical Committee had challenged Breeden's attempt to bring the SEC's domestic jurisdictional competition with the CFTC into IOSCO's deliberations.[49] By amending his posture, Breeden was able to have his broader objectives approved. Nevertheless, his attempt to exclude the CFTC, viewed together with his promotion of the strategic assessment, helps to define his aggressiveness in promoting SEC views and leadership within IOSCO's immature organisation. One Technical Committee member indicated, "The significance of this annual meeting is that now IOSCO has a clear leadership structure in place, made up of major regulators and led by Breeden. IOSCO is not a group where you can build consensus by bullying people. Under Breeden...a new consensus has emerged, that consensus on tough issues will be built through a process of flexible dialogue and by getting behind a strong leader."[50] Another Technical Committee member was less sanguine, noting that the annual meeting was, "a high stakes poker game, with nobody...calling Breeden's bluff. He's winning because he's calling their bluff, and because they're afraid to call his."[51] A senior European member of the Technical

[47] From 2 to 3 annually.
[48] From 17 to 12 members.
[49] Breeden had been forced to alter draft language that called for limiting Committee memberships to full voting members of IOSCO. See Chapter 10 for a detailed history.
[50] ISRR, "U.S. SEC Forges New Global Role within IOSCO; Breeden Chairs Strengthened Technical Committee."
[51] Ibid.

Committee summarised the meeting, "If you leave the conference with an impression that the SEC and Breeden didn't get all they wanted, I'd be very interested in knowing what they didn't get." The same official noted that policy development "needs to be approached with a degree of flexibility, which the Europeans and others like the Australians and Canadians don't always think the American regulators exhibit."[52]

Breeden's objective in initiating the Strategic Assessment was to improve decision-making at IOSCO and, ideally, to shape IOSCO's policy recommendations. What is unclear, however, is the degree to which Breeden also expected IOSCO's members, particularly other Technical and Executive Committee members, to support SEC regulatory preferences. Comments from the annual meeting indicate that Breeden wanted to steer IOSCO's policy recommendations explicitly and to position the organisation to produce international regulatory guidelines congruent with SEC preferences. The adoption of the Strategic Assessment was an indication of Breeden's authority and influence within IOSCO.

The Strategic Assessment did not specify the content of IOSCO's regulatory output. Considering the SEC's aggressive promotion of the Strategic Assessment, it is reasonable to conclude that the SEC expected IOSCO to produce definitive regulatory prescriptions, ideally in line with SEC preferences. However, as IOSCO's capital adequacy harmonisation discussions bogged down, Breeden's opinion of IOSCO's ability to establish policy changed, and he began to emphasise his preference for producing policy guidelines rather than explicit rules. Whether this represents a shift in preferences is uncertain. However, it does reflect the SEC's inability (despite the Strategic Assessment) to comprehensively assert its authority in IOSCO debates.

The Strategic Assessment exercise suggests several important observations on IOSCO. First, IOSCO was still a maturing organisation, needing guidance and support from senior national regulators in developing its policy prescriptions. Second, the SEC had taken a leadership role in redesigning IOSCO's operating style and policy agenda. Third, IOSCO's other members had not seriously challenged the SEC's authority – at least initially. As noted below, this does not indicate members' agreement with SEC regulatory policies but rather acquiescence with the SEC's IOSCO reorganisation

[52] Ibid.

strategy. Fourth, the SEC had been successful in executing a portion of its strategy, concentrating policy-making authority in a few national securities regulators. Finally, however, the exercise did not facilitate the SEC's promulgation of its regulatory preferences.

The SEC's authority and IOSCO's weak governance regime were confirmed by the SEC's leadership in IOSCO's reorganisation and by its refusal to change its regulatory preferences. These actions stymied IOSCO's policy output and retarded its ability to establish itself as a peer of the Basle Committee. The cost to the SEC of taking these actions was low. Conversely, the cost to EU member-states of adopting the SEC's regulatory preferences was high, especially in light of their Single Market commitments. Finally, however, the strategic assessment also indicated that there were limits to the SEC's authority. If members disagreed with SEC preferences, they could block or veto SEC-sponsored proposals.

The SEC's ability to ignore IOSCO's EU members' international regulatory preferences is explained by two factors: the size and attractiveness of the US markets[53] and a strong domestic preference for preserving regulatory standards. Domestic US support for existing regulatory arrangements is explored in Chapters 10 and 11, but it derived, in large part, from political considerations. If Breeden were compelled to alter domestic regulations, particularly in response to EU pressure, the SEC would be weakened bureaucratically and the Bush Administration's re-election chances might be damaged. Preserving domestic regulatory standards constituted a safer political course of action for Breeden than domestic regulatory change. Additionally, market globalisation had not progressed to a point where arbitrage and regional regulatory differences would have penalised US firms sufficiently to provoke them to lobby for regulatory change. Moreover, in 1991/92, US securities firms, weakened by two market crashes, a recession and damaging publicity concerning operating practices and products, were in no position to challenge the SEC in the courts of public or legislative opinion. There was a third factor in the SEC's successful protection of domestic standards: IOSCO's EU members prioritised their 1992 EU objectives when it became apparent that Breeden's regulatory obstinacy was deeply entrenched.

---

[53] Which provided the US with both negotiating leverage and a funding alternative to the Euromarkets.

Geneva – Redux

The January 1992 Geneva meetings are significant to assessing the IOSCO negotiations in several respects. First, regulatory stalemate indicated that a balanced allocation of authority existed among national regulators and, possibly, that agreement was not the most important objective to negotiators. Second, it was surprising that IOSCO's EU Technical Committee members did not argue their regulatory perspectives more aggressively in Geneva. Third, the Basle Committee, despite its endorsement of a building block approach for equity securities, did not vigorously support regulators who opposed the SEC.

These observations lead to several conclusions. First, policy-making preferences and authority in IOSCO were evenly balanced and were concentrated in states rather than in IOSCO or in private actors. Second, SEC veto power and inflexibility encouraged EU member-states to focus exclusively on establishing a regional EU capital standard rather than an international one. Third, the subdued role of the Basle Committee can be explained by the absence of a fixed deadline and by conjecture (see immediately below) that it had concerns about the efficacy and politics of the building block approach. SEC and EU observations can be explained by reference to domestic support and 1992 commitments, respectively. The SEC's intransigence was also premised on the low cost, domestic and international, of disagreeing with the EU Commission, with IOSCO's European members or even with the Basle Committee. European intransigence, national and supranational, was based on the high domestic cost of agreeing to an inflexible standard rather than to the more flexible CAD.

During the Geneva meetings, the EU (by proxy) and the Basle Committee did, in fact, go head to head with the SEC on capital adequacy. David Walker of the SIB and Gerald Corrigan, both negotiating with Richard Breeden, felt they were very close to a consensus for a building block capital standard for both debt and equity. Negotiations progressed far enough that press releases announcing an agreement were drafted. However, in reviewing draft releases, Breeden and Corrigan realised that they still disagreed significantly. Breeden reiterated that the SEC would not agree to standards that weakened current US regulation. Corrigan and Walker were frustrated because they were attempting to coordinate capitalisation standards for both securities firms and universal banks, and Breeden, who was only concerned with securities firms, was holding up progress across the board. Walker and Corrigan also felt that the SEC's regulatory emphasis on investor protection was too narrow and that Breeden, despite his IOSCO position, reflected only SEC perspectives. Their regulatory concerns, encompassing safety and soundness, systemic risk and related issues, were closer to European capital perspectives than to the SEC's.[54] Left unstated were Breeden's domestic political constraints.[55]

The SEC defended its "spoiler" role by noting that it had previously indicated it never intended to alter US capital standards and that it had only reluctantly agreed to attend the Geneva meeting. Going into the meeting, the SEC was aware it would not compromise with EU member-states or the Basle Committee. As a result, it had a significant negotiating advantage; it never intended to change domestic US regulation.

But how was Breeden able to hinder cooperation and reflect only SEC views? Two explanations suggest themselves: first, that he deliberately used the power of the Technical Committee Chairmanship to advance the SEC's regulatory agenda. This seems unlikely, as it would have provoked a storm of protest from the SIB and COB, who were not in fact intimidated by Breeden. A more plausible explanation is that Breeden vetoed a harmonised regulatory standard that he could not accept philosophically or politically. He was aware that he could do this without negative domestic repercussions.

Participants disagree on whether the Basle Committee strongly supported EU perspectives at the Geneva meetings. The Basle Committee certainly did not share the EU's sense of urgency. Additionally, the SEC and FRBNY[56] were working jointly to "stress-test" the proposed CAD, applying it to the balance sheets of international securities firms, using 1987 market crash data for their test case. Their research revealed that 17 firms would have failed if the CAD had been used to determine capitalisation during the crash. The EU and several prominent scholars disputed the study's methodology and findings.[57] Meeting participants speculate, however, that the Basle Committee, concerned about the results of the stress tests, distanced itself from EU and

[54] Confidential interviews, London and New York, 2000 and 2001.
[55] See Chapters 10 and 11.
[56] Basle Committee Chairman Gerald Corrigan was President of the FRBNY.
[57] Richard Dale and Benn Steil have both disputed the stress test's methodology. See: Dale and Wolfe, "Capital Standards," and Steil, *Competition, Integration and Regulation in EC Capital Markets*.

IOSCO discussions after Geneva, convinced that neither the EU nor IOSCO would develop a widely acceptable international standard.[58]

Prior agreements

IOSCO's weak authority is also traceable to its brief track record. Created in 1983, it had not had a significant opportunity to execute agreements among its members before beginning research into capital adequacy harmonisation in 1986/87. IOSCO's members had entered into separate bilateral and multilateral agreements, but not through IOSCO. These agreements, to the extent they covered financial issues, primarily addressed capital liberalisation[59] and the facilitation of cross-border business. For precedents analogous to the ones IOSCO was endeavouring to develop, negotiators had to look to the Basle Committee and the EU.[60] This circumstance derived from the fact that capital market globalisation was a relatively recent phenomenon and that the need for international regulatory coordination prior to 1985 had been limited. Events such as the 1972/1973 oil crisis, the 1974 Herstatt crisis and the 1982 Mexican debt crisis had not resulted in the creation of international securities regimes. Additionally, as discussed above, the context in which Basle Committee and EU agreements were developed differed significantly from IOSCO.

Conclusions

The success of Basle Committee and EU agreements does influence our interpretation of why the IOSCO deliberations failed. Several factors contributed to the success of the Basle Capital Accord. These include early US/UK collaboration and agenda-setting, subsequent consultation and consensus building in the Basle Committee and, finally, international implementation uniformly supported by the Committee and enforced domestically by Committee members and the marketplace. The success of the EU process is primarily attributable to political and legislative commitments made by EU member-states in the agenda-setting process, which itself was influenced by prior agreements among EU member-states. As discussed above, the IOSCO process

[58] Confidential interviews. New York, April, 2001.

[59] The OECD "Codes of Liberalisation of Capital Movements and of Current Invisible Operations," first promulgated in 1961.

[60] For a general discussion of international agreements in banking and finance see: White, "International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues."

encountered disagreement at the agenda-setting stage, did not build a consensus among its members and, as a result, did not consider implementation. This analysis points to failure in the agenda-setting stage of IOSCO's policy-making process. Failure derived from the inability of IOSCO's governance processes to resolve member disagreements. These were principal reasons why the organisation lacked authority and why individual states pursued their own policy preferences.

IOSCO's failure to develop a regulatory regime was a result of its inability to foster mutual member benefits or to assert its putative international authority. Additionally, because Richard Breeden was able to impede IOSCO's policy-making process, regulatory harmonisation benefits were vague, and the cost of cooperation – to EU members in particular – was high. This combination of factors locates authority – initially – in members' veto power, rather than through support for regulatory evolution from public, private and supranational sources. In the CAD and ISD, diverse sources of authority worked together to facilitate closure on directives. The absence of prior agreements meant that IOSCO's membership did not have a history of cooperation, through IOSCO, on which to build consensus.

National governments imposed their preferences on the IOSCO process, in part to preserve their sovereignty, and, in part, to preserve the EU deliberations. Decision making was not shared across levels of authority.

Additional reasons behind the SEC's negotiating rigidity and its imperviousness to international pressure will be explored in Chapters 10 and 11, which consider the SEC and Richard Breeden.

B. Private Sector Authority

Introduction

This section assesses the role of policy networks, private actors, and multi-level lobbying in the IOSCO negotiations.

Policy networks

Non-state centric hypotheses predict that private interests will mobilise directly in the supranational arena or use it to pressure state executives. This focuses analysis on the role of policy communities in promoting cooperation through lobbying and educational efforts. As with the CAD and ISD analyses, non-state centric perspectives develop significant, though not sufficient, observations for explaining policy-formation and authority. Private sector policy communities educated policy-makers regarding the regulatory preferences of industry participants. Lobbying efforts enhanced the dissemination of policy-making information. In the US, however, policy networks were inhibited from aggressively promoting industry views and from promoting international harmonisation by a combination of factors. These factors affected the domestic US securities industry generally and encouraged divided views on capital adequacy among industry participants. Empirical evidence is anecdotal and sometimes ambiguous. Nevertheless, connections between lobbying, information dissemination, policy decisions and authority can be identified.

According to the SEC, domestic US policy networks, in particular the NASD and the SIA, supported the SEC's position on capital adequacy standards. The SEC also claimed strong support from firms in the US securities industry.[61] European policy networks focused their attention on EU deliberations rather than on IOSCO. To the extent that they commented on IOSCO's deliberations at all it was in the context of delaying EU regulatory decisions to ensure they complemented the slower IOSCO or Basle Committee regulatory deliberations.[62] Private sector opinion on IOSCO's work was very limited with most comments addressed to the EU's work. Conversations with private sector European and American institutions indicate a significantly greater awareness of the EU's work on capital adequacy than with IOSCO's. This reflects IOSCO working parties' limited private sector consultation and the comparatively private nature of their work. It also is indicative of the private sector's judgement that the EU and Basle Committee deliberative processes were more likely to generate definitive policy guidelines than were IOSCO's.

---

[61] Confidential interview, New York, April 2001.
[62] The British Bankers Association took this step.

The limited role of the private sector in IOSCO's discussions may also reflect disagreement within the US securities community over capital adequacy. Large institutions with a sophisticated appreciation of capital management techniques preferred capital provisions that incorporated hedging and related techniques to minimise required capital allocations. This was the case with large US and UK institutions active in the Euromarkets. However, unlike most European states,[63] the US securities industry was comprised hundreds of local, state, regional and national financial institutions, of which only a handful (estimates range from 10 to 25) aggressively promoted sophisticated capital management techniques. Consequently, the SEC's comments regarding industry support for conservative capital preferences likely obscured divisions within the industry, which constrained the industry's ability to lobby aggressively. As described elsewhere, where the industry was united, their lobbying efforts were successful.[64]

US and European policy communities[65] shared an appreciation of IOSCO's limitations as well as of the different commercial implications of the EU's and the SEC's capital adequacy preferences. Consequently, the SEC's claimed "support" from US policy networks for its capital preferences better indicates policy networks' domestic political and economic weakness, their relative ambivalence with the IOSCO process, and their potentially divided views, than it does their affirmative endorsement of SEC preferences. EU policy networks (which also included US institutions) similarly recognised IOSCO's weaknesses, but they also recognised their own greater influence in the EU's deliberative processes, as well as the EU's supranational authority – and the commercial advantages of the EU's capitalisation proposals.

The NASD, SIA and industry disputes

In the US, the two principal securities industry policy networks were (and are) the National Association of Securities Dealers ("NASD") and the Securities Industry Association ("SIA").[66] As securities industry lobbying and research organisations, these groups reflected industry opinions on legislative and regulatory issues to the SEC and

[63] The UK, with 5-8,000 investment advisors, is the obvious exception. However, many of these advisors operated as 1-2 person operations unlike the many state and regional organisations in the US.
[64] The is was the case where the SEC amended accounting regulations in 1993
[65] These policy communities included private sector lobbying groups such as the SIA and NASD in the US and the FSA in the UK as well as private firms.
[66] The Public Securities Association (PSA) is a third domestic industry lobbying group but maintains a narrower public profile.

relevant Congressional institutions through educational and advocacy efforts.[67] Thus, in order to determine whether policy networks influenced policy formation through information dissemination or otherwise, it is useful to identify domestic US industry preferences for international regulatory harmonisation.

Domestic industry opinion regarding international regulatory harmonisation was pragmatic; harmonisation was a useful objective as it would clarify, simplify, and ideally, lower costs for multinational securities firms – while maintaining safety standards. Global securities firms operating in numerous markets and jurisdictions were required to follow a confusing array of national regulatory standards. Mutual recognition and related regulatory principles were not universally endorsed and would not simplify international operations in any event. The swelling ranks of compliance and legal personnel required to operate internationally evidenced the expense of meeting different regulatory standards. Consequently, the SIA and NASD were generally supportive of SEC regulatory initiatives that promoted the more efficient and transparent operation of markets. Interviews indicate that large US securities firms preferred liberalisation of US capital standards in order to approximate more closely the flexibility afforded their European securities operations under the CAD and FSA 1986. However, smaller, regional US securities firms, without the hedging needs or expertise of their larger colleagues, were ambivalent about proposed capital adequacy changes. They could even be potentially hostile to change if harmonisation was construed as a risky means of reducing operating costs at the expense of safety. The explosion in derivatives trading, commencing in the late 1980s, had been popularly portrayed in this way.[68] Consequently, it would not be surprising if smaller firms objected, as the SEC claimed they did, to capital harmonisation proposals.

Multinational US securities firms were world leaders in the exploitation of new techniques to hedge portfolio positions and, under the CAD and FSA 1986, to lower required capitalisation.[69] Richard Breeden's expressed preference for historic US capital

---

[67] See Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics*. for an overview of industry epistemic communities.
[68] See: GAO, "Financial Derivatives: Actions Needed to Protect the Financial System," (Washington D.C.: United States General Accounting Office, 1994).
[69] US securities firms had also supported the SEC's Rule 144A, Reg. S. and MJDS initiatives as they helped US domestic markets compete with Euromarket offering procedures. However, these SEC initiatives did not affect capitalisation. See Chapter 11 for a discussion of Rule 144A and Reg. S.

standards conflicted with the capital preferences of large securities firms. These firms did not persuade Breeden to change his opinion on capitalisation – as the breakdown of the IOSCO negotiations bears out – and as a result, they did not influence the negotiations. As we will see below, the failure of large domestic firms to make their case for liberalised capital standards was predominantly a result of industry conditions, disagreements within the industry, and lack of support from industry lobbying organisations.[70]

The preference of large US securities firms for flexible discretionary capital management – the building block approach – was confirmed in numerous interviews. Despite their preference, however, the US securities industry did not aggressively lobby the SEC to change domestic capital standards. The SEC has indicated that domestic lobbying groups and securities firms actually endorsed arguments it made in IOSCO promoting US capital standards. The SEC's opinion was that higher US capital requirements enhanced the ability of US firms to penetrate new markets and introduce new products.

In the fall of 1989, the SEC proposed significant increases in minimum net capital levels for US securities firms. Despite the potentially anti-competitive nature of a capital increase, the private sector supported the SEC's action. The NASD and the SIA also endorsed the increases, prompted by a review of problems with four securities firms following the 1987 market crash.[71] This action confirms the SEC and Breeden's opinion of industry support for higher capitalisation. However, the US securities industry's apparent "endorsement" of the SEC's capital preferences is problematic, as it was in the economic and commercial interest of securities firms to endorse a capital standard permitting greater use of hedging. This was particularly true for large, multinational US securities firms, as they were generally more adept in the use of hedging instruments than non-US firms.

There are several reasons behind the decision of US securities firms not to vigorously lobby the SEC directly or through the SIA. Large US securities firms

[70] As described in Chapter 10, the NASD and SIA did on occasion openly disagree with the SEC, as was the case on the question of whether the SEC should have the right to halt trading on bourses in emergencies. However, their success in that instance – the SEC did receive the right through the Market Reform Act – did not indicate consistency in their regulatory influence.
[71] ISRR, "SEC Asks Major Capital Hike for US Securities Firms," September 13, 1989.

typically operated internationally through locally incorporated and separately capitalised operating entities. This made their local operations subject to local capital requirements. As a result, they benefited from lower UK capital standards for their London-based operations. The principal benefit of international harmonisation – regulatory uniformity – might mean higher or lower capital levels for these firms.

Additionally, large securities firms were aware that one of Breeden's arguments was correct; their higher relative capitalisation had facilitated their entry into new markets and their introduction of new products by cushioning the risks inherent in new ventures. US securities firms typically maintained high levels of excess capital to accommodate unanticipated funding needs, abrupt market changes, and new product opportunities. They also maintained higher capital to reduce their cost of borrowed funds. Higher capital levels had been a critical variable in their successful penetration of foreign markets through the provision of new products and expertise, particularly in the provision of risky, often capital intensive, M&A, equity and junk bond products. Consequently, for large US firms, an increase in regulatory capital did not necessarily increase their cost of capital nor complicate their allocation of capital.

Lobbying for capital liberalisation would also have confronted substantial opposition. It would have entailed a domestic battle with an SEC convinced of the investor benefits of domestic capital standards and supported by a Congress and executive branch still trying to recover from an S&L crisis caused, in part, by liberalised capital regulations. As the Congress and White House approached 1992 domestic elections, the likelihood they would support liberalising domestic capital standards appeared slim.[72]

Trading scandals, poorly managed product introductions and bloated compensation schemes damaged the industry's reputation and credibility in the late 1980s and discouraged aggressive lobbying. The securities industry itself was also in

[72] As noted elsewhere, US firms, already scarred by market disruption and scandal, and suffering from public scepticism aggravated by poor publicity surrounding high compensation levels and new products, decided not to take a strong stance on "lowering" domestic capital standards. Wall Street's occasionally egregious compensation packages, combined with over-excited press coverage regarding the potentially dire consequences of new financial products, particularly derivatives, served to undercut the credibility of potential Wall Street initiated or endorsed regulatory reforms.

poor competitive shape.[73] The recession of 1989/91 had led to a decline in securities underwriting that weakened industry profitability. The industry was rapidly increasing employee redundancies, a significant one-time expense. Most significantly, Glass-Steagall restrictions separating investment and commercial banking were increasingly under attack by commercial banks. A securities industry request for additional capitalisation flexibility in the context of industry financial weakness would only encourage commercial banks to press for more rapid Glass-Steagall reform. These factors argue that securities industry weaknesses discouraged aggressive lobbying for the liberalisation of domestic capital standards. Additionally, the SEC's well-regarded chairman was a powerful Washington insider with whom securities firms were disinclined to clash in the current environment. Finally, as noted above, the domestic securities industry was not uniformly supportive of amending capital adequacy regulations.

In the early 1990s, large US securities firms had begun to develop proprietary models, based on unique portfolio risk valuation methodologies, for generating capitalisation targets. These models evolved into so-called "Value at Risk" ("VaR") models, which came to dominate capital calculation technologies in the late 1990s.[74] What is most distinctive about these models is that they are based on proprietary valuation technologies developed by individual securities firms rather than regulatory agencies. They represent a new form of self-regulation.[75] Their development was spurred, in part, by the increasing complexity of financial instruments that made up securities firms' portfolios and by the difficulty of applying the SEC's conventional "comprehensive" capitalisation requirements to instruments whose risk valuation could vary dramatically. Self-regulation was, of course, far removed from capital adequacy methodologies favoured by Richard Breeden.[76] Breeden's vehement opposition to EU/Basle Committee regulatory approaches discouraged US firms from promoting or actively endorsing alternative approaches until after Breeden retired as SEC Chairman in 1993.

[73] After hitting a peak of US$5.5 billion in 1986, pre-tax profits for the domestic securities industry declined to a net loss of US$200 million in 1990. Corporate bond underwriting volume was flat between 1986 and 1990 and more profitable equity underwriting declined by 50% over the same period

[74] See Appendices.

[75] Firms' proprietary VaR models differed significantly, further dividing securities firms over capitalisation policy - making opposition to the SEC more difficult.

[76] Nevertheless, less than two years after Breeden stepped down as SEC Chairman, the SEC began to delegate a degree of self-regulatory authority to securities firms.

Despite industry weaknesses, securities industry lobbyists and private firms were powerful and did influence domestic regulatory development – when the largest firms were united, when they felt they could be effective, or when they were compelled to act. This was seen in the SIA's decision to abandon opposition to Glass-Steagall reform. In December 1989, after a hiatus of nearly sixty years, the SIA endorsed a plan permitting commercial banks to underwrite securities, reversing long-standing opposition from securities firms and the SIA.[77]

Glass-Steagall had slowly eroded over the preceding five years, and modification had been debated for at least a decade prior to the SIA's policy change.[78] Nevertheless, the SIA's decision to change its policy came as a surprise to many securities industry participants, including Breeden.[79] While praising the SIA's decision, he noted that they were also acknowledging market evolution to a universal banking model.[80] Nevertheless, the SIA announcement influenced the structure of domestic financial services regulation. While government regulators and Congress had advocated Glass-Steagall reform for many years, the securities trade association, bolstered by the SEC, had delayed it. When the securities industry elected to exert its influence in Congress to shape policy, through the SIA or directly, it could be influential. However, on the issue of capitalisation, for the reasons discussed above, the SIA decided not to lobby for domestic regulatory change.

[77] The SIA's decision was encouraged by a 1989 US Federal court's denial of an SIA lawsuit that sought to enjoin Bankers Trust's commercial paper trading operations. Following the court decision, several larger domestic securities firms dropped their defence of Glass-Steagall and the SIA joined them. For a detailed history of the Glass-Steagall Act's evolution see: Reinicke, *Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980 - 1990.*

[78] In 1987, the Federal Reserve changed its interpretation of Glass-Steagall language prohibiting federally chartered commercial banks from affiliating with firms "engaged principally" in underwriting non-government securities. The change permitted subsidiaries of bank holding companies to underwrite new classes of securities. An SIA court challenge failed. In 1989, the Federal Reserve, through a reinterpretation of Sec. 20 of the Glass-Steagall Act, indicated it would expand the type and volume of debt securities commercial banks could underwrite through specialised "Section 20" subsidiaries. Market participants expected that equity underwriting would be permitted in 1990 or 1991.

[79] The policy change was the work of three of the largest US securities firms: Goldman Sachs, Morgan Stanley and First Boston. These firms met privately to draft the SIA's new policy, had their approach endorsed by the SIA's ten member legislation committee (which included the three firms) and, finally, by the Association's Board.

[80] William Power, "Securities Industry Accepts Bank Role, but on Its Terms," The Wall Street Journal, December 4, 1989. The affirmative role of private US firms in shaping US regulatory policy is evidenced through the initiative of US investment banks in altering SIA policy and the efforts of Bankers Trust and Morgan Guaranty in challenging Glass-Steagall. However, the decision to endorse Glass-Steagall change was as much a grudging reflection of inexorable US domestic market evolution to universal banking, and a desire to proactively manage regulatory change, as it was a positive decision to adopt universal banking.

But private US securities firms were not consistently successful in lobbying the SEC or Congress. The SEC unfailingly rebuffed industry efforts to obtain reductions in disclosure requirements for listing foreign clients on US bourses.[81] Consequently, the role of private actors or policy communities in shaping the course of US regulatory evolution was variable but occasionally significant, depending on the nature of the issue and on policy agreement between the SEC and the private sector. As noted above, their role in determining the evolution of negotiations in IOSCO was very limited.

For their part, US securities firms did not lobby IOSCO, because of IOSCO's thin bureaucratic infrastructure. IOSCO's work was carried out by its working parties, which were staffed by representatives of member-states. Private sector lobbying efforts were directed to national regulatory agents, not to IOSCO. The critical domestic agency accessible to US industry lobbyists was the SEC, which had already indicated its lack in interest in changing US domestic capital regulation. As a result, both US and European private sector lobbyists turned their attention to the EU.

Despite encouraging better coordination with the Basle Committee and IOSCO, European policy networks strongly endorsed the EU's building block approach. This resulted from their negative judgement of IOSCO's capabilities and their own deeper penetration of EU deliberations.

One European policy community's argument[82] that the EU should delay adoption of regulatory standards, in deference to IOSCO and the Basle Committee, indicates the value that European actors placed on multilateral harmonisation.[83] Thus, it is not surprising that the initial positive response of European policy communities to the possibility that a broader multilateral agreement on capital might be developed by IOSCO or the Basle Committee was a recommendation to delay adoption of the CAD. However, domestic and regional political considerations, together with the greater likelihood of the EU producing a preferred capital standard, finally outweighed more

[81] See section entitled "Daimler Benz" in Chapter 11.
[82] The policy community was the British Bankers Association.
[83] The EU's preference for multilateralism can be traced to the Treaty of Rome and SEA.

altruistic inclinations, and the CAD was adopted before IOSCO and Basle Committee recommendations were issued.[84]

Conclusions

IOSCO's governance structure constrained the institution's ability to adopt policy prescriptions, to exert international authority, and to facilitate mutual benefits. Effective veto power allocated to IOSCO's principal members frustrated the development of policy recommendations. The SEC's attempt to improve IOSCO's policy output (and to dominate IOSCO's policy-making process) failed to generate mutual benefits or to foster cooperation. More fundamentally, it did not increase the SEC's policy influence and further inhibited policy formation. The absence of prior agreements meant that IOSCO's membership did not have a history of cooperation through IOSCO on which to build.

Private sector policy networks present an ambivalent picture. European communities promoted international cooperation but, frustrated by IOSCO's frailties and pressed by regional political priorities, they opted for a regional regulatory resolution. US communities appeared to discourage international cooperation by supporting the SEC. This claim (made by the SEC) is problematic, however, as it was in the securities firms' economic interest – and within their commercial expertise – to endorse EU states' preferred capital formulations.

US policy networks' failure to lobby IOSCO or the SEC is explained by several factors. First, opportunities to lobby IOSCO were limited. Second, IOSCO's governance weaknesses and SEC obstructionism encouraged policy networks (and EU members) to focus on the EU and 1992 priorities rather than on IOSCO. Finally, in the US, private actor commercial weakness and regulatory sensitivity, combined with the SEC's confident assertiveness, inhibited aggressive lobbying on capitalisation. As a result, the SEC was able, in this case, to act autonomously and to inhibit the development of

[84] As discussed previously, conversations with European participants indicate that they were motivated to establish an EU regulatory precedent ahead of IOSCO or the Basle Committee because the EU had been "surprised" by the contents of the Basle Capital Accord in 1987 and was determined not to be surprised again by exogenous regulatory announcements.

standards it could not accept. Individual state sovereignty was ensured and the mobilisation of sub-national interests was constrained.

Chapter 10

The SEC and the Structure of Domestic Authority

Introduction

Since the SEC had a prominent role in shaping IOSCO and EU negotiations, it is important to understand the composition and history of SEC authority. This history influenced SEC (and Richard Breeden's) responses during the IOSCO and EU negotiations. The present chapter observes that the SEC's authority was shaped by its legislative and regulatory origins, by the nature of its work, and by bureaucratic battles, managerial missteps and enforcement challenges. These factors gave the SEC considerable domestic authority, but they also placed it under pressure to respond to market developments and bureaucratic challenges. They shaped not only the SEC's authority, but also its response to international harmonisation initiatives.[1]

Identifying the sources and expression of institutional preferences is critical in analysing authority. Institutions are broadly construed to include bodies of rules and regulations as well as administrative agencies. State-centric perspectives argue that assessing the policy-making authority of state institutions is critical to understanding the development of authority and influence. Non-state centric approaches stress the influence of supra and sub-national interests. This chapter examines both perspectives in its assessment of the development and application of the SEC's regulatory authority and influence in the IOSCO negotiations.

The chapter concentrates analytically on the SEC. There are several reasons for this emphasis. The SEC and Breeden dominated IOSCO's capital adequacy negotiations by virtue of Breeden's successive chairmanships of the Executive and Technical Committees. The SEC's influence was also strengthened by IOSCO's relative

[1] The next chapter will focus on Richard Breeden and SEC-initiated responses to harmonisation initiatives.

inexperience with policy development and by its governance structure.[2] The SEC's discomfort with regulatory harmonisation further distinguished it from its international peers. The origins of the SEC's approach are found in its history and experience with domestic market crises. Finally, during the IOSCO negotiations, EU member-states were also focused on the development of the CAD and ISD and on related Basle Committee research. EU member-states prioritised 1992 Single Market objectives. Contributing to their decision was their judgement that the SEC would veto EU preferences in IOSCO. They effectively left the SEC to dominate IOSCO deliberations.

The analysis is divided into two parts. First, the character of the US domestic securities regulatory regime and the SEC are assessed. Second, the policy-making authority of the SEC is analysed through a review of regulatory challenges and responses.

The SEC's Authority

Between 1987 and 1993, the SEC's domestic political and economic authority was considerable.[3] Its powerful domestic position derived from its political independence, its regulatory authority, and strong industry and Congressional support.

The SEC was not, of course, immune from political influence or from conflict with the President, the Congress, other governmental agencies, or the private sector. Its independence varied over time and from issue to issue. Its domestic regulatory autonomy was also constrained by bureaucratic competition and weak leadership after the 1987 crash. However, a combination of factors, detailed in this and the following chapter, outlines how the SEC's autonomy remained intact in addressing international capital adequacy standards and globalisation more generally. Prominent amongst these factors

[2] This made adoption of policy recommendations problematic, since a powerful member, such as the SEC, could veto contentious policies and stalemate progress. It is, of course, also argued that agreement between the US and UK, the most prominent market regulators, was necessary for the successful implementation of international, harmonised regulatory standards.

[3] The SEC remains a prominent and influential government agency. However, today the SEC Chairman is greatly overshadowed in policy-making authority by the Treasury Secretary, the President's personal Economic Advisor and by the Chairman of the Federal Reserve Board. During Breeden's tenure as SEC Chairman, a new incumbent, Alan Greenspan, chaired the Federal Reserve and Nicholas Brady, a Washington outsider and investment banker (though, like Breeden, a close Bush friend), was Treasury Secretary. Consequently, Breeden, a Washington insider and loyal Bush political ally, enjoyed greater senior level access and, particularly international, policymaking influence than did his immediate predecessors (or, arguably, successors).

was Richard Breeden's personality and relationship with the President. However, securities industry weakness, recession, a successful regulatory track-record in preventing investment bank failures, industry division and market crises all reinforced SEC autonomy and domestic authority.

The SEC's prominence derived in no small measure from Breeden's close relationship with President Bush[4] and from his aggressiveness in asserting his regulatory preferences both domestically and internationally. These characteristics gave the SEC considerable independence and authority in developing policy positions and in representing the US in international regulatory forums.[5]

Mission and governance

Congress founded the SEC in 1934, decades before its international peers were created, to address market operations and practices that had contributed to the 1929 stock market crash. More specifically, the Commission's creation reflected a government desire to protect investors, to restore market confidence and to stimulate economic growth. Two laws adopted to address these concerns after the 1929 crash authorised the SEC to pursue market fraud or manipulation and to regulate the marketing, distribution and trading of securities.[6]

A committee of five individuals, including a designated chairman, all nominated by the President and approved by the Senate Banking Committee, governs the SEC. Three committee members may be from the same party as the sitting President. These provisions were designed to preserve the political independence of the SEC. The President and Congress jointly oversee SEC activities; however, in practice, the SEC operates largely independently.

[4] References to President Bush or the "Bush Administration" are to the 41st President of the U.S., George H.W. Bush. His administration extended from 1989-1993.
[5] This analysis is adapted from Anne M. Khademian, *The SEC and Capital Market Regulation: The Politics of Expertise* (Pittsburgh: University of Pittsburgh Press, 1992). and from Corinne Bronfman, Kenneth Lehn, and Robert A. Schwartz, "US Securities Markets Regulation: Regulatory Structure," in *International Financial Market Regulation*, ed. Benn Steil (Chichester: John Wiley and Sons, 1994).
[6] The Securities Act of 1933 ("'33 Act") and the Securities Exchange Act of 1934 ("'34 Act").

Political independence

The SEC's independence derives from the nature of its regulatory decisions, client bases and enforcement history.

SEC activities and budget authorisation are subject to the oversight of the House Energy and Commerce Committee and the Senate Banking Committee. These committees are responsible for the integrity of US financial services. As a result, Congress is involved administratively and has a limited degree of authority over the SEC. However, Congress' ability to influence SEC policy is limited, due to the politically sensitive and technical nature of the SEC's regulatory remit and decisions. Regulatory policies affect markets, public and private institutions, and political and economic constituencies. The fact that consequences of regulatory policy choices are often difficult to predict has made Congress reluctant to become too deeply involved in issues such as capital adequacy, where the impact of policy is uncertain and regulation often highly technical. Legislators have preferred to leave the majority of technical regulatory issues to the SEC's highly regarded legal staff. On capital adequacy, Congress was persuaded by Chairman Breeden's testimony that US standards should not be lowered through international harmonisation. Influencing their decision were recent market scandals and the absence of compelling arguments from market lobbyists that retaining existing US capitalisation standards would disadvantage US firms.

A second reason for the SEC's independence and authority is that the agency's clients are highly diversified, representing a broad cross-section of interests. Clients' regulatory preferences frequently compete, diluting their ability to influence SEC regulatory decisions. The securities industry comprises distinct constituencies: brokerages of varying size catering to individual and institutional investors, investment banks focused principally on the interests of large institutional and sovereign entities, and investment advisors, mutual funds and insurance interests. The preferences of this disparate group coincide in their preference for regulation promoting market stability and investor confidence. However, their preferences otherwise diverge, based on their size, client bases and trading objectives. Additionally, where their activities do overlap, intense competition further dilutes their ability to influence SEC regulatory actions.

SEC authority can also be found in its notable success in enforcing regulatory statutes.[7] Its strong track record has reinforced Congress' reluctance to become too closely associated with its investigations for fear of attracting negative publicity or tainting an investigation. Its effectiveness has also made Congress hesitant to politicise the agency.[8] Congress has generally left SEC enforcement and regulatory decisions to Commission experts.[9]

These characteristics traditionally afforded the SEC significant independence and authority in pursuing its domestic and international regulatory preferences.[10]

Regulatory principles and legislative influence

The SEC's perspective on regulatory priorities helps define the Commission's reluctance to cooperate internationally in the development of harmonised capital adequacy standards.

Prior to the 1929 stock market crash, exchanges in the US were governed by a combination of state laws, market customs and private governing organisations.[11] Laws adopted in 1933 and 1934 principally addressed practices that hurt individual investors.[12]

[7] The SEC's investigation of Bernard Cornfeld and Robert Vesco's investment companies revealed that President Nixon's 1972 re-election campaign received contributions from Vesco. In the late 1970s, the SEC investigated foreign bribes allegedly made by major US companies including Lockheed, Exxon and Gulf Oil. During the Carter administration, the SEC investigated the finances of Bert Lance, President Carter's Budget Director. The SEC participated in investigations leading to indictments of Dennis Levine, Ivan Boesky and Michael Milken. In each instance, the SEC successfully concluded high profile investigations. This track record was enormously attractive to Congress, which enjoyed any association with the SEC's success. See: Khademian, *The SEC and Capital Market Regulation: The Politics of Expertise.*

[8] SEC Chairman John Shad (appointed by President Reagan) was the first Chairman with an overtly political agenda (principally deregulation) evident in his policy preferences.

[9] Recent (2002/2003) US regulatory scandals (the Enron bankruptcy, the compensation and accounting scandals involving, *inter alia*, Global Crossing, WorldCom and Tyco, the concern about connections between investment banking business and favourable equity research, and insider trading concerns with Imclone) have animated Congressional interest in SEC oversight and regulatory weaknesses and compelled the SEC Chairman's (Harvey Pitt) resignation.

[10] Notwithstanding these comments, the SEC was not insensitive to private sector preferences or, potentially, capture, as the discussion in the immediately preceding chapters highlights, nor to competition from other federal, state and supranational competitors (see below).

[11] Similar to European bourses up to the late 1980s.

[12] A core principle of the '33 Act was that investors needed to make informed investment decisions. To achieve this, securities issued in the US were required to be registered with a federal agency and meet prescribed disclosure standards. Initially this was the Federal Trade Commission and, after 1934, the SEC. The '34 Act brought exchanges under federal supervision. Early enforcement actions were used primarily to implement disclosure regulations rather than change exchange trading practices, although margin requirements, a notorious source of exchange problems, were changed. This reflected the SEC's desire to objectively address its varied constituencies - Wall Street firms, Congress and investors, both individual

However, the SEC was not insensitive to market developments. In 1975, in response to the confrontation of domestic trading growth with antiquated settlement and clearance procedures, the SEC proposed legislation to update market practices, simultaneously addressing varied SEC, market and Congressional regulatory concerns. The review process produced a legislative package that enhanced the SEC's enforcement, rule-making and market oversight capacities. This legislation strengthened the agency's domestic reputation and its authority.

The SEC's technical expertise and proactive role in legislative development and enforcement gave it the profile of a powerful law firm. Because much of its work involved investigation and enforcement of securities laws, many of the SEC's staff were securities lawyers.[13] Attorneys often joined the SEC following law school, worked with the Commission for a number of years and then left to pursue private practices, frequently with law firms that worked with the SEC. As a consequence, the SEC trained many prominent private securities lawyers, a relationship that reinforced the support of the private legal community for the SEC's operations and created a large policy community.

The securities industry was itself a strong Commission advocate. The SEC's rules-based approach to securities regulation provided unambiguous operating guidelines for a highly competitive industry. This helped to minimise industry conflicts, and it provided confidence and clarity to market operations. Additionally, the SEC's well-publicised enforcement successes increased public confidence and bolstered markets by reminding market participants of the SEC's powerful policing resources.

SEC staffers were also highly regarded, principally because they were apolitical. The staff maintained a professional distance from its politically-appointed commissioners and paid scrupulous attention to the independence of its regulatory judgements.

---

and institutional - and promote economic recovery. The '33 and '34 Acts also emphasised that SEC rules meet very high legal standards and explicitly address investor concerns. This further encouraged an SEC focus on investor and disclosure legislation rather than market structure or trading practices. See generally: Khademian, *The SEC and Capital Market Regulation: The Politics of Expertise.*

[13] In 1988, 62 percent of the SEC's professional staff were securities lawyers. (SEC, *Self-Funding Study*, 1988, II-1)

This combination of factors contributed to the SEC's powerful reputation in Washington. There was a closely related perception that the SEC's endorsement was critical for the passage of securities–related legislation. As noted, the SEC's opposition to Glass-Steagall reform was instrumental in delaying formal legislative reform until 1998/99.

The SEC's enforcement activities encouraged legislative development. SEC actions brought against Drexel Burnham Lambert were considered critical in the adoption of the 1988 Insider Trading Bill, which had not attracted significant attention before SEC indictments and legislative endorsement. A former SEC Commissioner commented on the SEC's legislative authority, "It is just short of being decisive...It almost totally has a veto on securities legislation that it opposes...When [legislation] passes, it is always satisfactory to the Commission. Part of it is the agency's expertise...it is also that the Commission is seen as... responsible, prudent.... Congress gives a great deal of weight to its opinion."[14] But despite the SEC's authority, its powers were limited: by Congress, by domestic courts and by the ambitions of other domestic regulatory agencies.

Comparing the SEC with non-US Regulators

Because the SEC's regulatory mandate grew out the 1929 stock market crash, its regulatory priorities differed from those of its European peers. The SEC focused on investor protection rather than support for the commercial preferences of securities institutions. This perspective led the SEC to develop a detailed set of rules and procedures stressing disclosure and operational transparency for securities registration, issuance and trading well before its international peers did. As discussed in Chapter 2, the SEC's conservative capitalisation requirements were inflexible and unilateral. They were also effective. Defaults by US securities firms, even during periods of financial stress, were rare. The SEC's regulatory perspective was also influenced by the significant roles of securities markets and of private individual and institutional investors

[14] Khademian, *The SEC and Capital Market Regulation: The Politics of Expertise.*

in funding US economic growth. This contrasted sharply with the more prominent political and economic role of bank lending in European markets.[15]

In Europe and Japan, domestic securities market development, with few exceptions, remained rudimentary until the development of the Euromarkets in the 1960s. In contrast to the comprehensively regulated US markets, the Euromarkets were substantially unregulated. Such rules as existed for securities issuance and trading were developed in response to market and institutional, as opposed to investor, preferences. Domestic markets were operated by cartels under idiosyncratic rules designed largely to accommodate the interests of market participants, governments and large institutions rather than those of investors. The proximity of European domestic markets to each other encouraged regulatory competition. The relatively isolated US capital markets operated under an entirely different, longer-standing and more highly codified regulatory regime that emphasised investor, rather than institutional, interests.

US Regulatory Preferences

Scandals and crises affecting US financial services during the late 1980s confirmed the value of the SEC's regulatory regime and discouraged domestic regulatory reform that would liberalise capital calculation methodologies. In the opinion of US legislators and the SEC, regulatory capital conservatism had minimised long-term damage from the 1987 stock market crash. They also believed that deregulation had been responsible for the 1988 domestic savings & loan ("S&L") crisis. Additional events – the bankruptcy of investment bank Drexel Burnham Lambert, the Salomon Brothers Treasury auction rigging scandal, and suspicion that the Basle Accord had contributed to the 1989-1991 recession – corroborated the SEC's and Chairman Breeden's belief that changing the US capital adequacy regime was foolhardy. More significantly, these events convinced US regulators that the appropriate US response to international regulatory harmonisation initiatives was to export US regulatory norms. The SEC, despite Congressional and private sector support for regulatory export initiatives, still confronted domestic bureaucratic constraints. These were reflected in domestic

[15] Ibid.

competition over resources and regulatory jurisdiction. These events established the shape of US regulatory authority.[16]

International regulatory leadership

In the US, the 1987 crash generated numerous government investigations and proposals for better managing market crises.[17] Most proposals recommended some form of supervisory and regulatory consolidation. These recommendations intensified the competition already existing between governmental regulators over the scope of their responsibilities. But one issue not considered problematic was capital adequacy. Research indicated that domestic markets and securities firms had survived the crash relatively unscathed. The crash did, however, highlight the connection between market globalisation and increased price volatility. As a result, many regulators recommended that international regulatory coordination be increased and that certain technical market amendments be considered. Changes to domestic securities regulation were focused primarily on settlement and trading issues. These conclusions dampened enthusiasm for significant regulatory reform of the domestic securities industry but encouraged the export of the US regulatory regime. The GAO, in a 1988 summary of issues affecting the financial services industry, recommended that the US "take the lead in developing mechanisms for establishing and enforcing any necessary international standards for regulation of financial markets." Their report urged the US to lead the development of cooperative international information and coordination initiatives.[18] The SEC adopted the GAO's recommendation and announced its intention to lead international regulatory harmonisation at the 1989 IOSCO annual meeting.

But SEC vulnerabilities are revealed by the crash

At the time of the 1987 crash, the SEC chairman was David Ruder, a law professor who had little market experience. On the day of the crash, he publicly contemplated a temporary closure of the securities markets. It was pointed out to him that he did not have the authority to close markets, and he came under considerable personal criticism; and his comments were blamed for exacerbating the market's decline.

[16] See below and Chapter 11 for discussion of these events.
[17] See below for further discussion.
[18] GAO, "Financial Services Industry Issues," (Washington, D.C.: United States General Accounting Office, 1988).

His gaffe cast him as a "slightly dazed academic" to both Wall Street and Washington. It damaged his credibility and, briefly, the SEC's as well.[19]

The market crash highlighted other problems with the SEC. The agency's declining manpower and outdated market monitoring technology were noted in Congressional testimony.[20] The GAO commented, "We think their [SEC's] resources have been outstripped by the market. Since 1980, the markets have exploded, the number of (securities-related) employees has skyrocketed and trading volume has gone off the scale. You've got to wonder if they can handle it."[21] These observations prompted a re-examination of the regulatory preferences of former SEC Chairman John Shad.[22] Richard Jenrette,[23] a respected banker, observed, "The mass pursuit of deregulation has been dealt a blow. There will be some re-regulation."[24] But any attempt by Ruder, the current chairman, to change regulatory philosophy would need the support of the four other SEC Commissioners, all appointed by President Reagan.

Response to the crash

The 1987 crash and the 1988 collapse of US securities firm Drexel Burnham Lambert intensified domestic examination of market risk and securities firm capitalisation.[25] The SEC, having decided to initiate rather than react to regulatory concerns, focused its attention on domestic legislation and the export of US regulatory precedents.

Reflecting this decision, SEC Chairman Ruder requested a 1990 SEC budget US$10 million greater than the US$168 million proposed by the new Bush administration. Ruder requested the extra funding for a special SEC group organised to anticipate significant risks to US markets and investors and to encourage greater

[19] Thomas E. Ricks and Tim Carrington, "Challenging Job: In Aftermath of Crash, Many Ask If SEC Chief Is up to His New Post," *The Wall Street Journal*, 11/3/87.
[20] As part of Reagan-era government "downsizing," the SEC's budget had been constrained and the agency's resources had not kept pace with market growth.
[21] Ricks and Carrington, "Challenging Job: In Aftermath of Crash, Many Ask If SEC Chief Is up to His New Post."
[22] Shad, like many Reagan appointees, believed strongly in de-regulation.
[23] Jenrette was a founder of the investment bank Donaldson, Lufkin and Jenrette.
[24] Ricks and Carrington, "Challenging Job: In Aftermath of Crash, Many Ask If SEC Chief Is up to His New Post."
[25] Drexel's collapse was not, however, associated with the crash. See longer discussion of Drexel collapse below.

international regulatory cooperation.[26] In September 1989, the Senate Banking Committee approved Ruder's request, granting a 25% increase in the SEC's fiscal year 1990 budget[27] and a 19% increase in the fiscal 1991 budget.[28] The increases confirmed continued Senate support for the SEC, its regulatory initiatives and its increased responsiveness to market internationalisation.

Domestic legislative initiatives targeted causes of the crash. The 1988 Insider Trading and Securities Fraud Enforcement Act authorised the SEC to cooperate with foreign governments in investigating securities fraud cases.[29] The bill reflected Congress' growing awareness of cross-border trading and acknowledged that the SEC was virtually alone in vigorously enforcing insider-trading statutes. It also reflected Congressional and SEC concern that cross-border efforts to regulate international capital markets should promote American interests, if possible by extending domestic regulatory standards beyond national boundaries. The presence of existing reciprocal cooperation agreements between governments, and the potential for cooperation to "prejudice the public interest of the United States," were to be considered in any future international cooperative efforts.[30]

Of the eight bills drafted to address regulatory concerns raised by the crash, only one made it out of committee for wider debate. The complexity of the issues underlying the crash defied straightforward regulatory solutions. Other factors had discouraged new legislation as well: the waning Reagan administration had been divided over financial services regulatory initiatives, the medium-term consequences of the crash were not considered dire, Wall Street – a traditional supporter of Republican administrations – resisted regulatory change, and it had been an election year. Finally, conflicting regulatory reform recommendations hindered legislative development.

The Brady Commission had endorsed the creation of an intermarket regulator to improve emergency domestic regulatory coordination. But support for the Brady commission's recommendation waned in the face of strong disagreement from regulatory

---

[26] Peter Riddell, "Ruder Explains SEC's Stance on Drexel," *Financial Times*, 4/19/89.
[27] To $178 million.
[28] To $212.6 million.
[29] Drexel's securities law violations had come to light because of foreign regulatory cooperation.
[30] John R. Cranford, "Drexel Case Seen Spurring Support: House Votes 410-0 to Stiffen Penalties for Insider Trading," *Congressional Quarterly Weekly Report*, 9/17/88.

agency chairmen.[31] President Reagan had requested a second study,[32] which reached the same conclusions as an earlier GAO study: increased regulatory co-ordination was desirable, but an intermarket regulator was unnecessary. The conflicting recommendations resulted in legislative gridlock. Inaction, however, had also prevented a political confrontation over the scope of SEC regulatory jurisdiction. And this, given Chairman Ruder's indifferent leadership, benefited the SEC. The second study also noted the transitory nature of damage from the crash and the absence of a compelling rationale for dramatic regulatory change.

Following the 1988 Presidential election, the path was cleared for new financial services legislative initiatives. The SEC submitted the International Securities Enforcement Cooperation Act of 1989 to Congress, which built on the 1988 Insider Trading Act.[33] The bill authorised the SEC to conduct domestic investigations on behalf of non-US regulatory agencies. But its objective was, in fact, reciprocity. The bill was designed to encourage foreign regulators to cooperate with SEC investigations, which increasingly extended beyond US borders.[34] Because many non-US jurisdictions had little experience with securities fraud investigations or enforcement, the legislation further facilitated the export of US regulatory norms and enhanced the SEC's ability to strengthen bilateral regulatory enforcement agreements - as it had been encouraged to do by the GAO.[35]

In recommending the legislation, the SEC noted instances where the negotiation of bilateral assistance agreements had been impossible due to the SEC's inability to

---

[31] Brady may have been persuaded by his former colleagues in the securities industry to retreat from his recommendation for an intermarket regulator, particularly if that regulator was to be the Federal Reserve and not the SEC. It is also possible the Federal Reserve indicated its discomfort at being nominated for the role. See below under "Intermarket regulator debate".

[32] The study was chaired by Treasury Under-Secretary George Gould.

[33] ISRR, "SEC Funding, Data-Sharing Bill Receives Senate Panel's OK," September 27, 1989.

[34] Key provisions of the bill gave the SEC authority to exempt from US disclosure requirements confidential documents received from foreign regulators and included a reciprocal right for the SEC to provide confidential documents to overseas regulators. The bill gave the SEC broad discretion in cooperating with foreign regulators, extended its investigative capabilities, granted emergency powers, and mandated closer cooperation among domestic regulators. See: Pamela Jimenez, "International Securities Enforcement Cooperation Act and Memoranda of Understanding," *Harvard International Law Journal* 31, no. 1 (Winter 1990).

[35] The SEC's earlier efforts to establish bilateral agreements had been frustrated by foreign regulators' concern with US disclosure laws. See: ISRR, "SEC Asks for More Authority in International Investigations." March 15, 1989.

ensure the confidentiality of information provided by foreign authorities.[36] This observation was particularly significant because a 1988 version of the bill, which coincided with the SEC's Drexel investigation, had died just as the House published a report concluding that the SEC did not investigate the majority of suspicious securities trades of non-US origin brought to its attention by US exchanges.[37]

The legislation was one of several bills the SEC sent to Congress in response to the internationalisation of securities markets and recent market scandals.[38] Key Congressional Democrats and the securities industry trade association, the SIA, supported the SEC's International Securities Enforcement Cooperation initiative.[39] This support, viewed together with the SEC's budget increase, confirmed continuing Congressional and private sector endorsement of SEC sponsored legislation and regulatory objectives – despite Ruder's weak leadership.

The Treasury Department positioned the US to export its regulatory values. Speaking at the World Financial Summit in September 1989, Treasury Under-Secretary Glauber urged that US regulators[40] develop a domestic forum where they could discuss regulatory issues and build a consensus on "common rules of the road" for international regulatory discussions.[41] Glauber's proposal acknowledged the increasing integration of securities with options, futures and commodities, but it also highlighted Congressional opposition to an SEC/CFTC merger.[42] Glauber's recommendation was not adopted, but it confirmed US intentions to develop and promote international regulatory standards.

[36] ISRR, "SEC Asks for More Authority in International Investigations."
[37] "SEC and Congress Again Seek Foreign Co-Operation," *Australian Financial Review*, 3/10/89. The House committee was the Government Operations Sub-committee.
[38] See below for discussion of Drexel, S&L, and Salomon scandals.
[39] Representative Dingell (D-MI), Chairman of the House Energy and Commerce Committee, and Representative Markey, together with Senator Dodd (D-CT), Senate Securities sub-committee Chairman, and Senator Riegel (D-MI), Chairman of the Senate Banking Committee, all endorsed the legislation. See: "Riegel Promises Prompt Action on Securities Legislation," *Dow Jones News Service - Ticker*, 4/18/89. and "Dingell, Markey Intent on Stock Market Reform Legislation," *Dow Jones News Service - Ticker*, 4/4/89.
[40] Glauber recommended the CFTC, Federal Reserve, SEC, and commodities and securities exchanges create the forum. See also discussion immediately below: "Domestic Turf Wars" and "SEC/CFTC Jurisdictional Conflicts."
[41] Securities Week, "US Regulators Need Forum for International Issues, Glauber Says," in *Securities Week* (New York: McGraw-Hill, Inc., 1989).
[42] House and Senate Agriculture Committees and the powerful House Ways and Means Committee all opposed a merger.

In October 1989, an SEC official, speaking at a legal conference, noted that US regulators needed to harmonise their regulatory response to market internationalisation. Other speakers suggested that the SEC and CFTC might be under pressure to cooperate as a consequence of competitive pressures stemming from the EU's 1992 objective. SEC official Brandon Becker agreed, "There is pressure from globalisation to have our [domestic] standards harmonised in terms of entry and exit. The US deals with two regulators and the rest of the world may be able to speak with one voice."[43] CFTC Commissioner William Albrecht was more direct. Commenting on pressure to harmonise regulations in response to the Single Market, he noted, "What we're going to need to see in the future is an international super-regulator."[44]

Congress had reconfirmed its support for the SEC's objectives and operations in the wake of the crash and scandals. Nevertheless, the Commission was under pressure to improve its performance and to better position itself, domestically to respond to potential financial services and regulatory consolidation, and, internationally, to respond to regulatory harmonisation.

Domestic turf wars

Competition between federal bureaucracies responsible for the regulation of financial services in the US was intense, made worse by the rapidly blurring operational lines between the securities, banking and insurance industries. The desire of regulatory bureaucracies to maintain and expand their jurisdictional footprints provoked domestic institutional conflicts.

In December 1987, two months after the stock market crash, Alan Greenspan, the new Chairman of the Federal Reserve Board, had testified before the Senate Banking Committee that he endorsed the concept of an umbrella regulatory agency to supervise US financial markets, a recommendation also made by the Brady Commission.[45] Greenspan also proposed the liberalisation of Glass-Steagall, but, addressing concern that regulatory reform would provoke an SEC/Federal Reserve turf battle, he also

[43] ISRR, "1992 Spurs US Agencies to Regulatory Cooperation."
[44] Ibid.
[45] The Brady Commission, headed by investment banker Nicholas Brady (subsequently Treasury Secretary under President Bush), was established by President Reagan to investigate the causes of the Crash.

recommended the functional separation of lending and underwriting.[46] His recommendation attempted to combine two related Senate bills proposed in the wake of the crash.[47]

These three proposals, all closely following the 1987 crash and reflecting cross-party support, made it appear probable that Congress would adopt major banking reform legislation. This prospect raised sensitive domestic regulatory jurisdictional issues. It was possible the SEC would remain sole regulator of functional securities-related activities, as Greenspan had recommended, but there was also the possibility that Greenspan's proposal was intended to position the Federal Reserve to become the senior domestic regulator. The SEC's concerns were complicated by the recent missteps of Chairman Ruder.

Domestic regulatory competition was further intensified by legislative changes, adopted in the late 1980s, that expanded the permitted activities of commercial banks. These activities included the ability to solicit brokerage business, to underwrite and distribute commercial paper, and to establish separate subsidiaries to underwrite a broad range of securities.[48] These changes presaged the emergence of bank-led financial conglomerates that owned securities firms, but for which the Fed had primary regulatory oversight.[49] Regulation of commercial bank securities underwriting by the Fed or Comptroller of the Currency[50] posed a clear jurisdictional conflict with the SEC. Anticipating these developments, the SEC had asked Congress in 1987 for unambiguous authority to regulate commercial bank brokerage activities. Then-SEC Chairman Shad argued that the Commission was not seeking to regulate the "internal activities" of commercial banks, but was seeking to clarify "functional regulation." His objective was to have banking regulators oversee credit functions and the SEC supervise securities

[46] Greenspan's proposal was also endorsed by FRBNY President Corrigan. See: "Greenspan Backs Move for New Regulatory Body," *Australian Financial Review*, 12/3/87. Ironically, his proposal was similar to one made by SEC Chairman Shad several years earlier.

[47] The first by Senators Wirth (D-CO) and Graham (D-FL) and the second by Senators Proxmire (D-WI) and Garn (R-UT) both permitted affiliations of commercial banks and securities firms through bank holding companies but did not recommend an intermarket regulator. See: "Issue of Capital Adequacy May Improve Outlook for Glass-Steagall Repeal," *Securities Week*, 11/30/87.

[48] These changes were approved by the Federal Reserve.

[49] Financial conglomerates (entities with significant securities and lending operations) did not come into existence in the US until the mid-1990s.

[50] The Comptroller of the Currency supervised national banks together with the Fed.

activities.[51] Although Shad's initiative failed, the SEC successfully deflected further bureaucratic encroachment.[52]

SEC/CFTC jurisdictional conflicts

This was not the SEC's first encounter with bureaucratic encroachment. The SEC had a history of aggressively – if not always successfully – protecting its self-defined regulatory jurisdiction. The most prominent of these efforts was reflected in the SEC's acrimonious relationship with the CFTC.[53] Over an eight-year period, the SEC lost three court battles with the CFTC over regulatory jurisdiction.[54] The jurisdictional fights culminated in an awkward 1982 ceasefire agreement, known as the "Johnson/Shad Accord," which formally allocated jurisdiction between the SEC and CFTC.[55]

The SEC's attempt to expand its jurisdiction was a response to market change, bureaucratic ambition, and jurisdictional overlap. The 1987 stock market crash reignited these conflicts by stimulating recommendations for regulatory consolidation.

[51] Bruce Ingersoll, "SEC Will Seek Authority from Congress to Regulate Bank Brokerage Activities," *The Wall Street Journal*, April 30, 1987.

[52] The SEC had previously attempted to have a federal court impose a registration requirement on the banking industry when their powers were expanded to encompass brokerage, which would have brought banks' brokerage activities within the SEC's regulatory ambit. However, the courts ruled against the SEC. The Commission responded by requesting Congress adopt legislation giving them regulatory authority. However, they failed to wrest regulatory authority away from powerful banking regulators.

[53] In 1974 Congress authorised the CFTC to regulate futures transactions in economically significant commodities such as wheat and sugar. The mandate effectively excluded the SEC from jurisdiction over commodity options, which the SEC had previously attempted to obtain.

[54] In 1975, the SEC objected to the CFTC granting the Chicago Board of Trade's ("CBOT") request for permission to trade futures contracts on Government National Mortgage Association ("GNMA") certificates. The SEC lost. In 1978, the SEC again attempted to gain responsibility for a CFTC regulated product by asking Congress to grant it jurisdiction for derivative products (futures) with securities as their underlying instrument. The SEC again lost. The SEC's failures reflected the CFTC's powerful Congressional (Agricultural Committee) support and the rapidly increasing complexity of financial products that did not adhere to defined regulatory boundaries. After their 1978 setback, the SEC adopted new tactics. That year, the SEC approved the Chicago Board Options Exchange's ("CBOE") application to trade GNMA options, creating an instrument similar to the GNMA futures contract already traded on the CBOT. The CBOT and CFTC sued to halt trading in the new instrument. The courts concurred and declared that options fell within the CFTC's exclusive jurisdiction. See: Coffee, "Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation,".

[55] The agreement granted the CFTC exclusive jurisdiction over futures contracts and options contracts on commodities and currencies. However, each agency was granted jurisdiction over instruments related to securities indices, the SEC over options on equity indices and the CFTC over futures on securities indices. As markets and products evolved, securities that represented combinations of options and futures were developed, re-opening jurisdictional conflicts. As a result, the agreement only survived until the 1987 stock market crash. See: Philip M. Johnson, "Reflections on the CFTC/SEC Jurisdictional Dispute," in *Regulating International Financial Markets: Issues and Policies*, ed. Franklin R. Edwards and Hugh T. Patrick (Norwell, Massachusetts: Kluwer Academic Publishers, 1992).

The intermarket regulator debate

Speaking at the 1987 Senate Banking Committee hearings on the crash, Ruder argued for tighter statutory market regulation to discourage equity trading practices the SEC had concluded were a major cause of the crash. Ruder supported the Brady Commission's intermarket regulator recommendation, but he disagreed with its nomination of the Federal Reserve to fill that role. Ruder argued that Congress should transform the SEC into a super-regulator with powers to halt trading in equity and options markets during emergencies. Ruder also asked for legislation to transfer the CFTC's authority to regulate equity index futures to the SEC.[56] But, underscoring Ruder's political weakness, his recommendations were not unanimously supported by the other SEC Commissioners.[57] Ruder's nomination of the SEC for intermarket regulator also ran counter to the SEC's traditional political neutrality. These disputes isolated Ruder within the Commission and made it unlikely that his proposals would be adopted.[58]

The Fed and CFTC had reacted differently to the proposal for an intermarket regulator. The Fed, like the SEC, was proud of its reputation for independence and political neutrality and was unenthusiastic about assuming a role with major political characteristics. In recommending the creation of an intermarket regulator, the Fed had endorsed the idea but had assumed that its traditional policy independence would protect it against interference from an umbrella supervisor.[59]

But the CFTC's new Chairwoman, Wendy Gramm, told Congress she would not accept a secondary regulatory role. Speaking at an industry conference, she argued

[56] "SEC Chief Urges Congress to Expand Agency's Power," *Houston Chronicle*, 2/4/88.

[57] Including Edward Fleischmann, who spoke out against the SEC and CFTC turf battle. The internal SEC debate surfaced again during a Commission meeting where Ruder and Commissioner Joseph Grundfest argued over Ruder's desire to reduce CFTC regulatory responsibilities. Grundfest and Fleischman both objected and called for greater domestic regulatory cooperation. See: Deborah Hargreaves, "Futures Industry Chief Fights Off Regulation," *Financial Times*, March 11,1988.

[58] Ruder failed to win a majority on several other proposals including increasing margin and minimum payment requirements for futures. His lone success was in finding internal agreement to ask Congress for authority to halt stock trading in emergencies. David A. Vise, "Battling for Market Control; SEC, Led by Ruder, Votes to Ask Congress for Index Futures Role," *The Washington Post*, 5/27/88.

[59] Lionel Barber, "Survey of Financial Futures and Options: Brady Sets Framework for Debate - the Regulatory Impact," *Financial Times*, 3/10/88 1988.

against dramatic regulatory changes and said she would resist attempts to merge the SEC and CFTC.[60]

At the conclusion of hearings on the crash two options for amending the US financial services regulatory apparatus were proposed. The first, as we have seen, was to create a federal intermarket regulator. The second, based on the argument that existing market regulatory mechanisms had managed the crisis well, was a more modest encouragement of closer agency cooperation. A 1988 GAO report endorsed the second option, recommending that preparation be made for future market crises by improving domestic regulatory coordination.[61] The report also urged US leadership in establishing international regulatory harmonisation modalities and cited the Cooke Committee as a potential model.[62]

SEC capitalisation regulations had helped firms and markets weather the 1987 crash and contemporaneous scandals. Nevertheless, the agency was under domestic political pressure to consolidate market supervision.

Market Events Shape the SEC's Authority

Despite lukewarm support for regulatory change in Congress and in the new Bush Administration, domestic capital adequacy standards for securities firms remained an important political topic following the crash. The immediate reason was related to fall-out from the massive case brought in 1989 by the SEC against domestic securities broker-dealer Drexel Burnham Lambert, Inc. ("Drexel"). Additionally, the collapse of the savings and loan industry, a US equity market mini-crash, a Treasury bond price-

---

[60] The intermarket regulator debate extended to the conflicting conclusions drawn on causes of the 1987 crash. The futures industry (represented by the CFTC) argued its blamelessness in responding to accusations that heavy trading volumes in stock index futures had provoked equity price swings. The accusation was that stock index futures trading had led to growth of stock index futures on cash equity securities. Trading strategies based on futures had, in turn, significantly increased the velocity and concentration of equity trading. These strategies increased trading risks for exchange specialists and strained their ability to provide market liquidity and to smooth trading volatility. Traders in cash markets, regulated by the SEC, blamed derivatives. (See Glossary. Derivatives represent transactions whose value is derived from an index or unrelated market transaction or event.) The SEC's analysis focused on the consequences of rapid growth in futures, related products and trading strategies. The SEC concluded that equity and equity related products should be subject to coordinated "mandated" regulation. See: Janet Bush, "Smoke Starts to Rise over the Battle for Regulation of US Markets," *Financial Times*, 2/4/88.

[61] See: GAO, "Financial Services Industry Issues." pp. 1-22. Washington, D.C., 1988.

[62] The SEC reiterated this objective in Chairman Ruder's presentation to the next IOSCO annual meeting. Barber, "Survey of Financial Futures and Options: Brady Sets Framework for Debate - the Regulatory Impact."

rigging scandal, and concern with the Basle Accord's unanticipated impact on bank credit allocation reminded regulators and legislators of the critical value of capital.[63]

The Drexel scandal

Initiated by insider trading charges brought against Drexel investment banker Dennis Levine in 1986, the SEC built a case against Drexel that accused the firm of committing the "most massive and pervasive scheme of fraud on Wall Street since the 1920s."[64] Levine's indictment and guilty plea were quickly followed by the indictment on insider trading charges of Ivan Boesky, the head of a private firm that speculated in shares of public companies. Other prominent traders and, by association, their firms were implicated in the investigation.[65] In January 1988, Drexel was advised that the SEC intended to bring insider trading and other charges against the firm and certain employees, including Michael Milken, the head of its hugely profitable and influential "junk bond"[66] operation. Indictments followed in September.

At the time of the indictments, there was speculation that the SEC's actions would provoke a junk bond market collapse, potentially harming other firms active in trading junk securities.[67] SEC officials, together with the New York Stock Exchange, indicated that they would carefully monitor market developments.[68] The power and profitability of junk bonds had seduced many firms on Wall Street, most notably Drexel, into building large junk bond positions. When the market soured, many securities firms found themselves hurriedly seeking new capital.[69]

---

[63] The "mini-crash" came in October 1989.
[64] Bruce Ingersoll, "The SEC's Case against Drexel: Charges Likely to Add Pressure for Tougher Insider-Trading Law," *The Wall Street Journal*, September 8, 1988.
[65] The firms included Kidder Peabody and Goldman Sachs.
[66] See Glossary: Typically rated below investment grade, investors historically shunned speculative high-yield bonds – so-called "junk bonds". Milken became famous, powerful and wealthy by developing investor interest in these previously obscure, risky financial instruments. Thru merger and acquisition junk bond financing he was responsible for a significant segment of domestic corporate restructuring and created huge profits for Drexel by dominating the underwriting, distribution and trading of these instruments.
[67] If junk bond portfolios became illiquid, it would make day-to-day funding difficult for securities firms heavily engaged in that market as junk securities would no longer be accepted as collateral for borrowing. This would increase capitalisation requirements.
[68] Milken and Drexel were responsible for providing liquidity to the junk bond market. Milken's indictment did reduce liquidity and lowered the market value of junk bond portfolios. Ingersoll, "The SEC's Case against Drexel: Charges Likely to Add Pressure for Tougher Insider-Trading Law."
[69] On February 2, 1990 the SEC became aware that Drexel (the broker-dealer) had "up-streamed" approximately US$400 million in excess capital to its parent company, the DBL Group ("DBL"). This was necessary because DBL was experiencing liquidity problems following a US$650 million legal settlement

The broker-dealer subsidiary of DBL[70] was subject to the SEC's capital requirements – but the parent company was not. Significantly, it was Drexel's parent company that experienced confidence and liquidity problems, not its subsidiary, when the junk bond market did – temporarily – collapse. For domestic legislators and regulators, the Drexel crisis reaffirmed the value of SEC-mandated capital regulation and the potential value of expanding SEC regulatory jurisdiction. The experience also reaffirmed the expertise of the SEC's investigative and enforcement arms. Despite Drexel's dramatic failure, the firm's peers and the markets where they operated continued to function normally.[71] The SEC's rules also functioned as predicted; Drexel's assets were rapidly liquidated to reduce its liabilities and the company ceased to operate.[72]

The savings and loan crisis

A disastrously designed deregulation of the US savings and loan ("S&L") industry in the early 1980s, combined with mismanagement, fraud, and depressed local economies, had, by 1988, left almost one third of the domestic S&L[73] industry insolvent. Deregulation had permitted S&Ls to expand funding sources beyond their traditional long-term deposit base and dramatically increase leverage and lending parameters. When interest rates on borrowed funds rose in the late 1980s, interest expenses exceeded the return that thrifts earned on home mortgages, and many institutions were forced into bankruptcy. Other industry problems included the capture of the federal thrift supervisor, the Federal Home Loan Bank Board ("FHLBB"), by the thrift industry trade association, the US League of Trade Associations, and Congress' timidity in interfering with a

---

with the US Government stemming from the insider trading investigation. However, rather than reduce securities trading and lending operations, DBL continued to rely on external borrowing to keep operating. A significant percentage of that borrowing was collateralised by junk bonds. Drexel's legal settlement temporarily damaged the viability of the junk bond market by decreasing market liquidity and making junk bonds unacceptable as loan collateral. As confidence in Drexel's viability waned, its risk profile increased and lenders withdrew financial support. As a result, DBL's financing, commercial paper and repurchase agreements that relied on the support of securities firms, banks and brokers, dried up. This forced DBL to seek emergency funding from its more financially stable broker-dealer subsidiary. The parent company was finally forced to file for bankruptcy protection after its attempt to secure a bank loan failed.

[70] The DBL Group ("DBL")was Drexel's parent company. See footnote 69 in this chapter.

[71] The junk bond market effectively disappeared for several years following the Drexel scandal but reappeared in the mid-1990s.

[72] The Drexel case (brought September 7, 1988) encouraged a unanimous vote in the House of Representatives on September 14, 1988 to increase penalties for insider trading and to pressure securities firms to more closely police their employees trading activities.

[73] See Glossary. S&Ls are also referred to as "thrifts."

federal agency responsible for promoting home ownership, a powerful force in US politics.[74]

Like the contemporaneous Drexel crisis, the S&L crisis was a seminal event for Congress and US regulators, in particular for Richard Breeden, who, before he became SEC Chairman in 1989, was a senior member of the task force appointed by President Bush to assess and to develop solutions to the S&L crisis. Breeden's task force findings reinforced for him the value of conservative capitalisation, and drove home the importance of high core capital and the potential folly of dramatically altering existing US financial services regulatory standards, whether in the S&L industry or elsewhere.[75]

The expense and political damage from the industry bailout served as a warning for regulators supervising domestic financial institutions. Richard Breeden was closely associated with the thrift bailout, and he concluded that thrift deregulation had been politically motivated rather than based on improving the S&L's financial performance or capabilities. To Breeden, political exigency, rather than thoughtful practice, had motivated S&L reforms. Federal administrators and legislators damaged by the scandals agreed. But the sensitivity to regulatory change induced among Washington's elected and appointed officials by the cost of the thrift bailout was enormous. The crisis encouraged elected and appointed officials to resist proposals to amend prudential financial services regulation or risk being called to explain their actions to Congress.

The Salomon scandal

In 1990, the SEC began to investigate market rumours that the prominent Wall Street firm of Salomon Brothers was rigging its bids on US Treasury bill auctions. Salomon was eventually found to have falsified bids in an attempt to manipulate the Treasury auction market. The SEC pursued the allegations aggressively and expanded its investigation to determine whether other parts of the US debt markets were subject to

---

74 L. William Seidman, *Full Faith & Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Beard Books, 2000).

75 During 1989, Congress committed US$150 billion of taxpayers' funds to bail out bankrupt domestic savings and loans. Less than US$4.0 billion in tangible capital backed over US$1.3 trillion in deposits. The Federal Savings and Loan Insurance Corporation, the federal agency guaranteeing S&L deposits, had liabilities exceeding assets of US$14.0 billion. In 1988, it had been estimated US$50.0 billion was needed to bail out bankrupt thrifts. The final total would approach US$500 billion. GAO, "Financial Services Industry Issues."

collusion or manipulation. Ultimately, Salomon was fined, and several senior executives were forced to resign.

The scandal was particularly damaging to Wall Street because it revealed that the lessons of the earlier Drexel crisis had not been learned. It was also a blow to the federal government, for which an honest and open Treasury market was crucial. If the Treasury market were deemed unfair, the result would be higher federal government borrowing costs. The scandal further damaged Wall Street's reputation. Nevertheless, the regulatory system appeared to have worked, and the Treasury market recovered unscathed. Gerald Corrigan, head of the FRBNY, noted, "Until this unfortunate, tragic event, the auction system has worked incredibly well..."[76] The effect was to strengthen the hand of those in the Bush administration who preferred a continuation of the existing regulatory regime and to undermine any nascent private sector support for regulatory liberalisation in the securities industry.

Unanticipated consequences of regulatory reform[77]

The 1988 Basle Capital Accord, an affirmative precedent for international regulatory harmonisation, had the contradictory effect of discouraging SEC Chairman Breeden from promoting international harmonisation. Richard Breeden and others within the SEC focused on the Accord's unanticipated side effect – bank credit allocation policies that, in their view, contributed to global recession in 1990/91.[78] The Accord addressed only bank credit risk, setting aside market and related risks. As a result, for the SEC, the Accord represented a political compromise, a result of the Basle Committee's discomfort in addressing politically sensitive rating issues. An SEC Commissioner commented, "This led to the anomalous situation where the risk of a loan to the world's

[76] Jack Egan, "A Bond Scandal That Won't Stop," *US News & World Report*, 9/16/91.

[77] See detailed discussion in: Granirer, "A Modern Great Power Concert: New York, Tokyo, London and the Political Economy of Transnational Regulatory Cooperation".

[78] The US/UK collaboration that preceded detailed Basle Committee capital discussions served as a positive model for subsequent cooperative actions initiated by securities regulators. Through the Capital Accord, the Fed and Bank of England were able to achieve both domestic and international regulatory objectives. Commercial banks were compelled to raise capital and Japanese regulators obliged to change domestic capital calculation procedures. Additionally, the Basle Committee served as a model for Breeden's recommendation that IOSCO's undertake a Strategic Assessment. However, for Breeden, the Basle Accords were also examples of unanticipated problems associated with harmonising international regulations. (See generally: Kapstein, *Governing the Global Economy: International Finance and the State.* and Oatley and Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord,".)

strongest company was considered higher than a loan to the world's weakest nation."[79] This exaggerated the Accord's intent but accurately characterised market concern; the Accord encouraged banks to favour higher-rated borrowers and to adjust their portfolios accordingly.[80] Some observers even blamed the recession on banks' decision to curtail lending to lower rated borrowers in order to meet new Basle requirements.[81]

The SEC was not alone in criticising the Basle Accord. However, the SEC acted on its criticism by developing a bilateral approach to international regulatory harmonisation that competed with multilateral efforts. The "Basle Problem" further encouraged the SEC to conclude that weakening US securities regulation to achieve international harmonisation was misguided. As described in the next chapter, the SEC decided the best response to harmonisation pressures was to promote US regulatory norms, as they were clearly superior – or so the SEC concluded.

Conclusions

These events and the SEC's history shaped the agency's willingness to exercise its authority domestically and influenced its international regulatory harmonisation efforts. As mentioned above, the 1987 market crash highlighted the SEC's limitations as well as missteps by its Commissioners and bureaucratic challenges. The SEC was unwilling to import foreign regulatory norms because that might threaten its domestic jurisdiction. With this as background, and convinced that US norms were superior, it responded to international harmonisation pressure by exporting US regulatory standards (See Chapter 11).

The developments and observations described define the contours of SEC domestic authority. The SEC was, despite its powerful standing in Washington, under domestic pressure to improve oversight and regulation of securities firms and markets.

[79] Confidential interview, New York, February 2001.
[80] See Peter Cooke, "Bank Capital Adequacy and Capital Convergence," (London: Price Waterhouse, 1991).
[81] The SEC cited additional problems caused by the Accord. In order to meet implementation deadlines, commercial banks had to scramble to raise capital. Capricious equity and fixed income markets, combined with recession, made new capital very expensive. (See: Simon London, "Banks Struggle to Achieve Capital Adequacy," *Financial Times*, 30 November 1990.) These factors, combined with weak commercial bank loan portfolios and poor profitability, were blamed for poor overall bank performance. (See: Simon London, "Banks Face Hope and Frustration - Moves on the Stony Road to Capital Adequacy," *Financial Times*, 27 March 1991.)

At the same time, it was fighting to protect and to expand its domestic regulatory jurisdiction and to respond to industry and government pressure for regulatory reform and consolidation. Market events had encouraged the SEC to export existing domestic regulatory precedents despite the fact that both the crash and securities scandals had focused attention on international and domestic regulatory coordination and harmonisation. These observations define the complex pressures on the SEC's domestic authority – and its response. The SEC was powerful and well respected, but its domestic authority was circumscribed by bureaucratic competition, Congressional and institutional pressure for regulatory reform, and the need to revitalise the agency.

The contours of SEC authority were shaped by the agency's long history and strongly-held regulatory preferences, by market events (such as the crash), and by bureaucratic in-fighting (with the CFTC and over the selection of an intermarket regulator). The SEC was a flash-point for domestic political/regulatory turf battles, for private sector preferences and for market events (both positive and negative). Richard Breeden carried this history into the IOSCO negotiations convinced that the US should export domestic regulatory norms rather than harmonise standards internationally and risk undermining his – or the SEC's – bureaucratic authority and regulatory legacy.

The next chapter will explore the origins and content of the SEC's international regulatory harmonisation strategy and its implications for the location of authority.

Chapter 11

Richard Breeden and the SEC's Response to Globalisation

Introduction

This chapter addresses the responses of the SEC to Commission weaknesses, market internationalisation and pressures to harmonise regulatory standards. The structure and efficacy of the SEC's response further define the agency's domestic and international authority and influence. Rather than harmonise internationally, the SEC developed or encouraged a series of policies designed to export domestic regulatory norms. This enabled the SEC to avoid the politically undesirable course of persuading the Bush Administration and the Congress to support domestic regulatory liberalisation. This strategy was complicated by the fact that the SEC was recovering from the political impact of market crises, bureaucratic battles and market scandals.

Richard Breeden joins the SEC

David Ruder never recovered from his costly gaffes and administrative confrontations, and he resigned in the summer of 1989 after only two years as SEC chairman. Richard Breeden, a close ally of President Bush, was appointed to replace him in October.

Background

Breeden's career included service in the public and private sectors. His public sector career began when he joined the Reagan Administration in December 1982 as staff director of the Special Task Force on Regulation of Financial Services. The task force was headed by then Vice President Bush and included senior members of the government's financial services regulatory agencies. The task force's goal was to examine the US financial services' regulatory apparatus and to recommend steps to reduce inefficiencies and regulatory burdens. The task force concluded that regulatory agency consolidation was unwise because it conflicted with a US bureaucratic tradition of reposing regulatory authority within discrete independent agencies. This practice prevented the consolidation of regulatory power. Breeden had concluded that bureaucratic consolidation risked removing administrative and bureaucratic conflicts from public scrutiny, which could constrain democratic oversight. Breeden's task force experience expanded his understanding of domestic capital markets and regulatory bureaucracies. It helps to explain his resistance to recommendations that the US regulatory infrastructure be consolidated in the aftermath of the 1987 crash and that the US harmonise regulatory standards internationally.

Breeden had close ties to President Bush, who worked with him on the task force and appointed him to investigate the S&L bailout before nominating him as SEC Chairman in 1989. Following his Senate confirmation, Breeden immediately encountered a market crisis. On October 13, 1989 the Dow Jones Industrial Average dropped 190 points, the second largest point and percentage decline in its history.[1] This "mini-crash" highlighted SEC administrative shortcomings in monitoring and responding to market crises. However, Breeden's adroit handling of the crisis was a significant improvement over the less assured style of his predecessor.

In response to the market decline, Breeden pursued an agenda intended to modernise securities regulation and to give the SEC better tools to monitor market activity and improve US firms' global competitiveness.[2] His objective was the aggressive promotion of US regulatory and commercial interests rather than harmonisation. Breeden's agenda was considered achievable based on his effective management of thrift bailout legislation, his close relationships with the White House and Congress, and his positive handling of the mini-crash.

[1] The 1987 market crash was, at that point, the largest point and percentage decline in the Exchange's history.
[2] Kevin G. Salwen, "Breeden Turns Plunge in Stock Market to Advantage in Pushing SEC Agenda," *The Wall Street Journal*, 10/26/89.

Breeden's First Year

Richard Breeden's initial domestic priority was to reassert SEC regulatory authority after the Ruder years. His objectives were shaped by his experiences on federal task forces, by recent market events, and by a desire to maintain Congressional support. Breeden also planned to continue his predecessor's efforts to assert the SEC's authority internationally. But Breeden's objectives were not universally shared by his domestic regulatory peers or by all members of the Congress. During Breeden's early SEC tenure he clashed with domestic peers over responses to the mini-crash, to Wall Street trading practices, and to bureaucratic and regulatory reform. As a consequence, his international options were constrained by the extent to which they would undermine his domestic base of support.

Domestic initiatives

Shortly after the 1989 mini-crash, Breeden endorsed legislation, opposed by the powerful Treasury Department, that would compel Wall Street firms to disclose information about their financing of risky corporate takeovers and would allow the SEC to limit program trading during periods of market turbulence.[3] Breeden also disagreed with the Treasury Department and with Ruder over granting the SEC emergency power to close stock markets. At the time, only the President could close markets. Continuing debates also revealed continuing disagreement among domestic regulators over Glass-Steagall reform. All of these issues highlighted Breeden's legislative independence, as well as the depth of divergence within the government and the private sector over reform of market governance and regulatory authority.

[3] The bankruptcy of the Campeau Corporation demonstrated the lengths to which Wall Street firms would go (and the risks to which they would expose themselves) in financing corporate takeovers. In 1988, The First Boston Corporation assembled a US$1.1 billion bridge loan to finance Campeau's acquisition of Federated Department Stores. Initially hailed as an audacious example of Wall Street's financing expertise, the short-term bridge loan remained unpaid for two years as Campeau suffered from economic recession and the benefits of its acquisition failed to appear. First Boston retained a US$250 million exposure to Campeau, large enough to threaten its capitalisation. Breeden expressed concern that Campeau illustrated the risks inherent in bridge credit facilities, the need to closely monitor securities firms' capital, and the related requirement that the SEC monitor the capital of securities firms' holding companies, which were frequently the lender for bridge loans but were supervised only indirectly by the SEC. See: "Campeau Debacle May Fuel Debate over Market Reform Bill," *Dow Jones News Service - Ticker*, 1/18/90. "Program trading" referred to securities trading triggered by computer programs that monitored capital market movements. Program trading was accused of creating a "herd trading mentality" on Wall Street.

The market closure issue arose as part of Congressional[4] consideration of the Market Reform Act of 1989 (S.648).[5] The bill would have increased the information the SEC received from market participants and would have broadened the Commission's emergency powers, particularly its authority to halt trading. Breeden had concluded that giving the SEC expansive discretionary authority would increase market uncertainty. He preferred predictable automatic "circuit breakers," triggered when markets exceeded predetermined trading or pricing thresholds.

Treasury Secretary Brady disagreed with Breeden, but he hedged his recommendation to the Senate Banking Committee, indicating that the SEC's authority should require consultation with the President, the Federal Reserve and securities SROs.[6]

Private sector opinion was split. The NASD called the proposal unnecessary, while the New York and American stock exchanges supported it. Breeden agreed with the NASD and argued that SROs had already taken steps to address problems raised by the 1987 crash. In light of these conflicting opinions, House and Senate versions of the bill were allowed to die. Congressional Committees would, however, revive this proposal in 1990.[7]

On Glass-Steagall reform, opinions over the future structure of financial services in the US were polarised. Advocates for repeal included senior members of the Bush administration, who argued that financial services deregulation and regulatory consolidation were needed if the US were to compete internationally. This view confronted a long history of Congressional resistance to change in financial services regulation, which was reflected in two failed attempts by the Reagan administration to repeal Glass-Steagall. It was also seen in opposition to new regulations addressing problems associated with the market crashes of 1987 and 1989 and with the thrift crisis. In addition, Glass-Steagall split private sector opinion on Wall Street. The securities industry vehemently opposed any infringement of their securities underwriting

[4] By the Senate Banking Committee and the House Telecommunications and Finance Sub-committee.
[5] Also called the Securities Market Stabilisation Act of 1989, HR 1609.
[6] SROs would include both the American and New York stock exchanges.
[7] ISRR, "House Panel Passes Bill to Expand SEC Authority," November 22, 1989.

monopoly, while commercial banks used every opportunity to chip away at their franchise.[8]

Breeden's concerns with Glass-Steagall liberalisation and regulatory consolidation were raised in testimony before Congress in July 1990. He argued for the alteration of the current securities regulatory structure, but he stopped short of advocating a complete overhaul, urging "two-way" deregulation instead. If Glass-Steagall were repealed, he argued, the Bank Holding Company Act should also be repealed, so that non-banks could acquire banks, thereby levelling the financial services playing field.

Breeden also revealed his negative opinion of universal banking and his association of expanded bank powers with the thrift crisis. He described universal banking as "fatally flawed," arguing that it would extend federal deposit insurance guarantees to risky insurance and securities activities and would increase potential taxpayer liability. He noted that it would be impossible for a single federal regulator to assemble the expertise necessary to supervise the disparate activities of universal banks.[9] Breeden argued for clear operating and regulatory distinctions between lending, underwriting and insurance.

Following his confirmation by the Senate, Breeden aggressively asserted his domestic priorities. He asked for expanded powers to police securities trading,[10] urged that trading rules for equity index futures be changed and that regulatory jurisdiction for futures-related products be extended to the SEC.[11] Breeden's goal was to put the SEC into the strongest possible position in the domestic regulatory bureaucracy and, subsequently, to improve the SEC's ability to promote its regulatory preferences internationally.

[8] As discussed earlier, the securities industry would drop its opposition to Glass-Steagall reform late in 1989 (see p. 279).
[9] John M. Doyle, "SEC Chief to Congress: Banking, Securities Regulation Must Change," *The Associated Press*, 7/11/1990.
[10] Associated Press, "SEC Chief as Congress to Broaden His Powers," *The Atlanta Journal Constitution*, 2/2/90.
[11] Treasury Secretary Brady and Breeden both saw the division of responsibilities between the SEC and the CFTC as weakening US credibility in international regulatory forums. David A. Vise, "SEC Chairman Warns Congress on Futures," *The Washington Post*, 2/2/90.

Breeden affirmed his concern that continuing jurisdictional disputes with the CFTC were keeping innovative financial products, such as derivatives, out of US markets. He cited a federal appeals court ruling in Chicago, which concluded that the SEC had overstepped its authority in approving a new hybrid financial instrument.[12] Until the litigation was resolved, the courts would not permit the instrument to be traded in the US. Litigation over new financial instruments was "a direct threat to American competitiveness," stated Breeden, who noted further, "Our foreign competitors have not imposed this type of restriction on themselves."[13]

As part of its effort to gain control of equity index futures, the SEC brought suit against the CFTC, contending that the SEC should have authority to regulate index participations. However, the Supreme Court ruled in favour of the CFTC.[14] The ruling was not surprising, as the Supreme Court was not expected to overturn an earlier Appeals Court ruling. The protracted lawsuit underscored the extent to which the SEC was determined to expand its regulatory authority.

Breeden's stature and aggressiveness combined with the challenges facing the CFTC[15] led observers to predict that the SEC would achieve its domestic objectives. Treasury Secretary Brady, a Breeden supporter, testified, "We don't need more regulation. But we do need to move toward more unified regulation."[16] Fed Chairman Greenspan also supported Breeden. In testimony before Congress,[17] Breeden clashed with CFTC Chairwoman Gramm over CFTC independence. Breeden testified that the SEC was unable to investigate intermarket fraud because it could not get information about futures trading. Gramm retorted that any market information the SEC did receive came through the CFTC, because the SEC did not have adequate monitoring capabilities. Their conflict was exacerbated by an SEC Staff Report on the October 1989 mini-crash

[12] The instrument was an "index participation," which combined elements of securities and commodities futures.
[13] "SEC Creates Overseas Office to Work with Foreign Regulators," *Star-Tribune Newspaper of the Twin Cities*, December 19, 1989.
[14] "Futures Commission Wins Crucial Ruling, Battle with SEC Now Shifts to Congress," *The San Francisco Chronicle*, 6/19/1990.
[15]The CFTC was in the midst of a two-year long probe by the Federal Bureau of Investigation into allegations of fraud and inadequate monitoring of the CBOT and Chicago Mercantile Exchange (CME). Additionally, the Chicago-based exchanges were losing market share to foreign exchanges. These challenges arose just as the CFTC was undergoing its reauthorisation examination by Congress.
[16] Kevin G. Salwen, "SEC, Seeking Hostile Takeover of CFTC's Power to Regulate Financial Markets, Is Favored to Win," *The Wall Street Journal*, 4/20/90.
[17] Before the House Energy and Commerce Committee.

that blamed the CFTC for the market fall.[18] The CFTC's own study provided starkly different conclusions.[19]

In June 1990, the Bush administration sent a revised Market Reform Act (S.648) to Congress. The bill sought to transfer equity index futures jurisdiction from the CFTC to the SEC. It also gave the SEC the right to review and approve margins on commodity exchanges.[20] Senator Leahy (D-VT),[21] a prominent CFTC supporter, attacked the bill, arguing that it was "riddled with loopholes and legal inconsistencies."[22] Breeden maintained that it would protect investors and reiterated the SEC's objective of increasing international regulatory cooperation. His comments reaffirmed his belief that expanded domestic powers would yield greater international influence.[23] He noted that later in June he would be travelling to Luxembourg, to sign a cooperation agreement, and to Hungary, where he would speak at the re-opening of the Budapest Stock Exchange. He informed the Senators that an advisory committee on East European markets would hold its first meeting in Washington later in June under SEC auspices.[24]

In July 1990, the GAO released a study that criticised both agencies for their conflicting analyses of the mini-crash. The GAO's report concluded that the agencies used the same data to derive self-serving conclusions. This led Senator Dodd (D-CT) to conclude, the "SEC-CFTC jurisdictional dispute continues to detract from their working relationship... This untenable situation must be resolved."[25] Breeden took a considerable risk in antagonising Senators. In addition to controlling his budget, the Senate Banking Committee would have to approve any significant change in the structure of the US financial services industry. Breeden's ability to position the SEC to benefit from Glass-Steagall reform would depend on his relationship with the Congress.

[18] The report concluded that equity index arbitrage, which was transacted through futures markets, had accelerated the market decline. Instead of stabilising markets, equity index floor traders had sold their positions into a falling market. Equity index floor traders had represented over 50 percent of sell volumes.
[19] Reports cited in Gregory Robb, "SEC, CFTC Chiefs Fight in Congress," *The New York Times*, 5/25/90.
[20] Low margins were held responsible for excessive trading and volatility.
[21] Chairman of the Senate Agricultural Committee.
[22] John M. Doyle, "SEC Chief Rebuts Critics of Bill to Shift Power on Stock Index Futures," *The Associated Press*, 6/7/90.
[23] The bill was adopted in October 1991. It increased market monitoring, established the Large Trade Reporting System and improved clearance and settlement procedures. However, the SEC's CFTC dispute remained unresolved.
[24] The committee would represent "some of the best and the brightest" in the U.S. financial industry. See: Doyle, "SEC Chief Rebuts Critics of Bill to Shift Power on Stock Index Futures."
[25] John M. Doyle, "GAO Criticizes 2 Agencies for Conflicting Views of Crash," *Associated Press - Los Angeles Daily News*, 7/24/1990.

The Office of International Affairs

Breeden announced the creation of an SEC Office of International Affairs in December 1989, two months after taking office. Michael Mann, from the SEC's Enforcement Division, was named to head the office. The new office was designed to carry out the SEC's goals of responding to market globalisation, expanding cooperative ties with foreign peers, and, through the selection of Mann, extending SEC enforcement authority offshore. Mann commented that IOSCO would be an appropriate venue for international regulatory discussions, saying, ".... the players are coming to IOSCO, ... and are asking IOSCO to provide a multilateral infrastructure for... discussions."[26]

In talking about his office's role, Mann provided insight into the SEC's international priorities and into IOSCO's place in their plans. He commented that the SEC's authority in developing trade and Eastern European policies should be expanded owing to the role of financial services in trade and economic development. He also wanted to formalise and publicise the SEC's leadership in international securities regulatory matters, and he confirmed his desire to expand the SEC's role in the negotiation of international trade agreements. "As, more and more, financial services is a component of bilateral and multilateral trade agreements, it's critical that the views of a regulatory agency, like the SEC, be taken into account."[27] This objective placed the SEC in conflict with the US Trade Representative's office, further demonstrating the SEC's aggressive posture toward the scope of its regulatory responsibilities.

Mann prioritised his office's roles, and thereby defined the SEC's perspective on regulatory harmonisation, international regulatory authority and IOSCO's capabilities: "If we were to order these, we started with Eastern Europe and coordination; MOUs, and expanding them to develop contacts abroad; coordinating foreign country needs within the Commission; GATT trade and financial services negotiations; and IOSCO. I think IOSCO is growing into a much more mature organisation .... we're really working very hard to try to develop within IOSCO a context for developing multilateral initiatives."[28] Mann's listing placed IOSCO dead last in order of priority.

[26] ISRR, "Re-Regulation Trend Emerging in the Financial Markets."
[27] ISRR, "Interview: SEC's Michael Mann Sets Active Pace and New Initiatives for the Recently Formed Office of International Affairs," April 23, 1990.
[28] Ibid.

The SEC concluded that it would be more effective in promoting US regulatory standards abroad through bilateral agreements than through multilateral organisations. IOSCO was an important venue for international discussion, but it came last in Mann's ordering of international priorities. More important were efforts to influence the development of securities regulatory standards in Eastern European countries and to monitor international trade negotiations.[29]

Breeden's reformist enthusiasms were tempered by his desire to maintain a positive relationship with the Congress. In addition, a mild recession between 1989 and 1991 dampened Administration enthusiasm for regulatory liberalisation. These factors further moderated Breeden's willingness to enter into international, particularly multilateral, agreements that would "weaken," in Breeden's or Congress' opinion, domestic securities legislation.

In his first year as SEC Chairman, Breeden expanded the SEC's authority and repositioned the agency within Washington's regulatory hierarchy. His personal successes included the revival and passage of two pieces of legislation, the Market Reform Act[30] and the Securities Enforcement Remedies and Penny Stock Reform Act,[31] both of which dramatically strengthened the SEC. These laws represented the most significant changes to securities laws in twenty years. Breeden's close relationship with President Bush and his ability to cultivate important representatives were critical to their success.[32]

Breeden's forcefulness brought critics, however. His desire to absorb the CFTC, to expand the international reach of the SEC, and to shape the direction of domestic and

[29] The SEC's interest in GATT negotiations arose for two reasons. The SEC argued that its expertise should be utilised because the negotiations addressed financial services and because the SEC's involvement in high profile international trade negotiations would enhance the agency's international and domestic stature.
[30] The Market Reform Act amended the Securities Exchange Act of 1934 and provided additional discretionary power to the SEC to prevent disruptions in national securities markets, particularly during a market crisis. The grant of power represented a substantial degree of Congressional deference to the SEC.
[31] The Remedies Act amended the Securities Act of 1933 and the Federal Deposit Insurance Act to add a requirement that federal banking agencies notify the SEC of any instances where federal banking regulators became aware of activities by banks or individuals that might pose a threat to firms regulated by the SEC.
[32] Kathleen Day, "Tough Cop at the SEC; Chairman Richard Breeden, in Office a Year, Aggressively Seeks to Expand Agency's Authority," *The Washington Post*, 10/14/90 1990.

international regulatory evolution generated controversy. Nevertheless, his support from Congress and the Administration appeared solid. Senator Dodd compared Breeden to the "trust-busting, reform-minded Republicans of Teddy Roosevelt's Cabinet."[33] His first year as chairman solidified his domestic institutional authority and positioned him to promote initiatives aimed at extending the SEC's regulatory authority abroad.

Breeden's Second Year

In Breeden's second year, he tackled a simmering domestic debate over the international competitiveness of the US securities industry and began aggressively to encourage international regulatory initiatives begun by former Chairman Ruder. These initiatives were designed to promote US capital markets to foreign issuers and investors. Another objective was to export domestic securities regulatory norms, exploiting the SEC's authority and the US securities industry's market expertise. Breeden built on the pending MJDS agreement with Canada[34] and initiated bilateral MJDS discussions with Japan and the UK. Expansion of existing MOUs with Japan and other countries were also discussed.[35] The SEC examined proposals for the inclusion of US investors in foreign equity rights offerings[36] pursuant to Rule 144A,[37] further opening US markets to foreign issuers.[i] As described in Chapter 10, the SEC began the aggressive reform of IOSCO's governance structure and introduced proposals to encourage greater cooperation between securities regulators.

Evidence of declining US market authority

A 1989 SEC-sponsored study[38] examining the international competitiveness of US securities markets concluded that US capital markets had seen their pre-eminent international position diminish. According to the study, global stock market capitalisation had grown from US$2.5 trillion in 1980 to US$8.2 trillion in 1988, but US market share had declined from 56 percent to 34 percent over the same period. Between 1980 and 1988, the study reported, Japanese equity markets had replaced US markets as the world's largest. The study also reported that US stock exchanges "lagged (behind)

[33] Ibid.
[34] The SEC approved the MJDS on May 30, 1991. Approval by Canadian authorities came in June 1991.
[35] ISRR, "SEC and MoF Expand Enforcement Coordination; Multijurisdictional Disclosure Pact Expected Soon," January 14, 1991.
[36] See Glossary. An offering of a "right" or claim to purchase equity shares at a point in the future, typically at a pre-agreed price.
[37] See below for discussion of Rule 144A.
[38] Chuppe, Haworth, and Watkins, "The Securities Markets in the 1980s: A Global Perspective."

foreign markets in their ability to attract new foreign listings."[39] It went on to point out that foreign companies might be reluctant to list on a US exchange owing to differences in disclosure standards between US and foreign markets.[40] The study also identified longer-term securitisation trends in capital-raising, re-emphasising the importance of securities markets and related regulation. While the decline in the US share of international stock market capitalisation may have been due, in part, to exchange rate fluctuation and the rapid growth of less mature markets, the message to US lawmakers and regulators was that US capital markets, in order to remain pre-eminent in an increasingly competitive global market, needed to consider responsive strategies.

Adding to Congressional and SEC concerns, Japanese inroads into US markets had become front-page news, raising the political significance of international financial services leadership. Japanese-owned financial institutions controlled 25 percent of the California bank market. Tokyo-headquartered Dai-Ichi Kangyo Bank had invested US$1.4 billion in the US finance company CIT,[41] gaining a 60 percent ownership position. After the 1989 mini-crash, rumours had circulated that Japanese investors were responsible for halting the market's slide. Landmark purchases by Japanese investors of New York's Rockefeller Center and California's Pebble Beach golf course captured tabloid headlines. Worries were expressed on Wall Street that Tokyo had more influence over world markets than New York or London.

Concern with EU efforts to harmonise financial regulation added to these worries about the competitiveness of US institutions. The chief economist of Security Pacific Bank, who was also chairman of the American Bankers Association's economic advisory committee, told Congress, "The EU is proceeding with financial modernisation. The US must do so as well if our financial institutions are to remain competitive domestically and internationally."[42]

Widely followed international rankings appeared to confirm the shrinking stature of US commercial banks and securities firms. In 1985 Citicorp, the largest US bank,

[39] Ibid.
[40] See Daimler Benz below.
[41] At the time, CIT was a subsidiary of US money-centre bank Manufacturers Hanover Trust Company.
[42] Peter Koenig, "Has the US Got the Bottle for a Fight?" *Euromoney*, January 1, 1990.

ranked as the largest commercial bank in the world by total assets. Another American,[43] three French and five Japanese banks rounded out the top ten. By 1989, by the same measure, Citicorp had fallen to tenth and was now preceded by one French and eight Japanese banks. Securities firm rankings revealed a similar picture. In 1989, six of the world's ten largest securities firms ranked by capitalisation were headquartered in the US. The other four were Japanese. However, the profitability of these same firms indicated a different story. The six US firms were estimated to have collectively earned US$1.9 billion in 1988. The four Japanese firms reported consolidated net income of US$3.9 billion, twice that of the US firms. The numbers underlined the growing financial power of Japanese firms. "It would be impossible politically, but in purely economic terms the Japanese could buy the world's financial system,"[44] said Robin Monro-Davies, a senior bank analyst.

Senate testimony ensured that Congress was aware of the changing nature of international securities markets and the implications these changes had for both regulatory evolution and the competitiveness and influence of US firms and markets. SEC domestic and international regulatory initiatives coincided with increasing Congressional concern, incentivising Congress to support SEC actions. "Today the US has lost to international competition" in the securities field, commented Senator Dodd (D-CT) in June 1989. Dodd indicated that reversing the US decline required "action at home" rather than erecting barriers to market entry. Bills introduced by Senators Heinz (R-PA) and Dodd were intended to reverse the "reactive" posture taken by Congress on financial services issues.[45] In addition to the International Securities Enforcement Cooperation Act, Dodd and Heinz introduced five additional bills. These included measures to increase the SEC's budget[46] and to provide the SEC with emergency authority during periods of market turmoil.[47]

Alan Greenspan spoke before Dodd's subcommittee, saying, "Cross-border trading in securities will continue to expand rapidly for the foreseeable future. As a

---

[43] Bank of America.
[44] Koenig, "Has the US Got the Bottle for a Fight?
[45] ISRR, "Lawmakers Set Agenda Amid Growing Worry That US Has Lost Edge in Global Capital Markets," June 21, 1989.
[46] The bill was intended to increase the SEC's budget by up to US$168 million and lift pay ceilings for SEC employees.
[47] The Market Reform Act of 1989 (S. 648).

consequence, we can expect to see the move to around the clock trading extending to more securities."[48] Greenspan listed three necessary responses: first, modernisation of the domestic settlement system; second, renewed focus on the financial soundness of large multinational securities firms, particularly the strength of their capital positions; and finally, Glass-Steagall reform.

While disagreeing on Glass-Steagall, Robert Hormats, vice-chairman of Goldman Sachs International, testified before the same subcommittee that common international regulatory standards would prevent regulatory arbitrage. Hormats noted that recent market events confirmed the vulnerability of financial markets in one country to events in other countries. This was a "compelling argument to come to common standards." Hormats also stated that the US needed "a parallel effort internationally as the EU effort is going on."[49] He urged the US to develop its own international regulatory agenda, either in competition or in cooperation with the EU, to ensure US interests were not relegated to a secondary position.

Breeden demurs

Breeden disagreed with evidence of US securities industry decline, citing securities firms' successful domestic and international track record in winning new business and in entering new markets. But he supported a proactive international policy agenda. He noted that, unlike the concerns that had prompted the Basle Accord,[50] no similar vulnerabilities affected US securities firms, other than expressed concern with international income rankings. US firms had survived the 1987 and 1989 market declines in good shape. Drexel Burnham Lambert's bankruptcy had disrupted the junk bond market but without long-term negative consequences. A 1990 GAO report on the implications of the EU's 1992 program provided a basis for Breeden's conclusions and a rationale for SEC initiatives.[51] US securities firms had long complained that domestic regulation put them at a competitive disadvantage relative to European firms, particularly to universal banks. The GAO report concluded that the EU's 1992 plan actually afforded US financial services firms many new business opportunities. The report supported the

[48] ISRR, "Lawmakers Set Agenda Amid Growing Worry That US Has Lost Edge in Global Capital Markets."
[49] Ibid.
[50] Generally, these were commercial bank leverage and loan portfolio concentration problems.
[51] GAO, "European Community: U.S. Financial Services' Competitiveness under the Single Market Program."

SEC's view that US securities firms were competitive internationally, but it also concluded that US markets could be made more competitive. The report found that US securities firms were well represented in the EU's major capital markets and, in particular, it found that they ranked favourably against non-US firms in a number of significant product categories:

- 5 of the top 10 lead managers (50%) of international equity offerings were US firms.
- 7 of the top 20 lead and co-lead managers (35%) of international equity offerings were US firms.
- 12 of the top 25 mergers and acquisitions ("M&A") advisers (48%) worldwide were US firms.
- 11 of the top 20 M&A advisers (55%) for European acquisitions in the US were US firms.
- The top 5 M&A advisers (100%) for US acquisitions in Europe were all US firms.[52]

The report supported Breeden's contention that US securities firms were global leaders in M&A and equity underwriting. These were the most profitable and visible areas of investment banking. More importantly, Breeden contended that US securities regulations had not hindered US firms' performance or competitiveness. To the contrary, Breeden argued that US regulations, particularly capitalisation regulations, actually enhanced the competitiveness of US securities firms by enabling their entry into new markets. He concluded that international regulatory harmonisation was, in fact, an attempt to level the regulatory playing field by making non-US securities firms more competitive with successful, highly-capitalised US firms.

The GAO report did, however, confirm the findings of a 1989 SEC report[53] that US disclosure regulations made US markets less attractive to foreign issuers and US investment products less attractive to foreign investors.[54] These findings shaped the

[52] Source: *Euromoney*, February, March 1989.
[53] Chuppe, Haworth, and Watkins, "The Securities Markets in the 1980s: A Global Perspective,".
[54] Non-US investors preferred to hold bearer securities, which were prohibited in US markets. Additionally, European investors, accustomed to the anonymity of bearer securities, were put off by US requirements for mandatory investor disclosure on acquisitions in excess of 5 percent of capital or

SEC's response to market globalisation and multilateral harmonisation initiatives: improving the attractiveness of domestic markets to foreign investors and issuers and influencing the development of international regulatory standards.

The first piece of the SEC's response involved amending domestic regulation in a targeted way. Rather than make regulatory changes that ran counter to the mood of a Congress sensitised by financial scandals, the SEC amended domestic regulation incrementally, with changes driven by SEC objectives and not by external pressure. The GAO's observations meshed well with two SEC domestic regulatory initiatives, Rule 144A and Regulation S.[55] The second piece, exporting domestic norms, included multilateral and bilateral components and helped define the SEC's objectives in influencing international regulatory development.

The SEC's response to globalisation

Richard Breeden extended regulatory initiatives begun by his predecessor, most significantly, Rule 144A, Regulation S and the MJDS plan with Canada.[56] He shared Ruder's perspective on promoting multilateral regulatory harmonisation around US standards.[57] Breeden did not, however, accept arguments that domestic deregulation and concessionary international harmonisation were necessary to improve domestic firms' competitiveness. More critically, he felt international regulatory harmonisation would dilute US regulatory standards that had helped US firms withstand market volatility and build strong international franchises. He also felt that harmonisation could damage the SEC's relationship with Congress and the Administration. He based his beliefs on his work with the 1982 Bush Task Force, as well as on more recent experience with the S&L crisis. Rather than harmonise domestic regulation, Breeden argued that other countries should adopt US norms, which had proven themselves over time through crises and scandals. Breeden concluded that international harmonisation of securities regulation, to the extent it resulted in divergence from US regulatory norms, was dangerous.

following a takeover. Also difficult for foreign issuers were SEC requirements that financial statement disclosure conform to US GAAP.

[55] See below.

[56] See below.

[57] See: Durie, "Regulation Easy as SEC".

Rule 144A and Regulation S

Beginning in 1988, the SEC initiated a series of domestic securities rule changes that represented a dramatic effort to make US markets more competitive with the Euromarkets and thereby influence the evolution of securities underwriting, trading, and regulation outside the US.

In October 1988, the SEC released for public comment its proposed Rule 144A, which exempted from SEC registration requirements[58] securities issued in US markets to "institutional investors" pursuant to "private placement" rules.[59] The rule, crafted in response to comments from public and private sector market participants, was aimed at non-US securities issuers that had resisted entering US markets because of concern about the scope of corporate, particularly financial, disclosure required by the SEC.[60]

Rule 144A proposed that private placements, offered to a potentially large pool of "qualified institutional investors,"[61] could trade freely in the secondary market. Because the proposed rule widened the universe of potential investors and reduced secondary trading restrictions, Rule 144A securities would be priced similarly to SEC-registered securities, but without needing to meet onerous public disclosure standards. Foreign borrowers had resisted issuing securities in the US because public disclosure requirements mandated detailed analyses of hidden reserves, executive compensation packages and segment revenue and expense figures. The new rule would permit non-US companies to issue securities in the largest and deepest capital market in the world

[58] Securities "registration" with the SEC involves the filing of detailed disclosure documentation, according to detailed rules laid down by the SEC, regarding the issuer and the offering and the payment of a filing fee. If the material is "accepted" by the SEC (deemed adequate) a "public" offering a securities can be made.

[59] See Glossary for definitions of "institutional investor" and "private placement."

[60] Issuers ("Issuer" and "borrower" are interchangeable in a securities issuance context) of securities in US markets had two principal offering methodologies: either "publicly" register securities with the SEC in accordance with stringent disclosure guidelines, or issue securities in a "private placement." A private placement was neither registered with the SEC nor required to meet SEC disclosure standards. A significant difference between the two offering methodologies was reflected in who could purchase the securities. SEC-registered securities could be offered and traded without significant restriction on investors. However, the offering, sale and trading of private placements was restricted to a limited number of pre-qualified, "sophisticated," typically institutional, investors. The maximum "number" of investors in a traditional private placement was dependant on several variables including the terms and size of the offering and counsel opinions. Typically, the number ranged from 5 to 100 potential investors. "Institutional investors" typically had a net worth in excess of US$1.25 million. For Rule 144A, qualified institutional investors were required to manage at least US$100 million in assets. These characteristics made private placements less attractive because their lack of liquidity was reflected in higher borrowing costs.

[61] See Glossary and footnote 58 above.

without necessarily disclosing sensitive information. The SEC's proposal had the potential to galvanise foreign interest in US capital markets.

The SEC also released for comment proposed Regulation S ("Reg. S"), which further amended US securities issuance regulations. Regulation S provided a "safe harbour" for certain types of securities offerings made outside the United States. This regulation clarified offering procedures for non-US entities, ensuring that issuers' securities did not fall within the regulatory ambit of the SEC.[62]

These two complicated rules had important goals and implications. First, they were designed to open US markets to disclosure-shy foreign issuers. Second, they created a global methodology for offering securities, but on US regulatory terms. Previously, issuers of securities would tap discrete domestic markets to meet their funding requirements. Now they could structure a single offering to tap into markets around the globe. Efficiency gains promised to be significant. Third, because they facilitated global offerings, the rules would influence the standardisation of corporate disclosure for securities offerings in markets around the world. If an issuer could prepare one offering document to serve both the US and other capital markets, the cost savings would be major. Most significantly, this had the effect of moving non-US borrowers closer to US regulatory issuance standards by extending US regulation extraterritorially. Rule 144A's disclosure standard, despite being "looser" than the SEC's registered "public" disclosure standard, was still generally tougher than disclosure standards for either a typical Euromarket offering or conventional US private placement.[63]

---

[62] A "safe harbour" was an exemption, if certain procedures were followed, from SEC registration requirements for a non-US offering of securities (a securities offering made outside the US by either a US or non-US entity). The need for a safe harbour arose as a consequence of an SEC rule stipulating that simultaneous private US and "public" offshore offerings (so-called "global" offerings) could be deemed "integrated," or unitary rather than separate, by the SEC, if the two offerings were similar enough that an investor could not easily distinguish between them (Regulation S assumed the offerings would be made by related corporate entities simultaneously). A finding of integration could result in the SEC requiring that both offerings, which had been structured according to less onerous private placement and Euromarket disclosure and offering standards, be amended to meet US *public* offering and disclosure requirements. This was an exceptionally risky proposition for issuers, as it would occur coincident with or shortly after offerings were completed. Euromarket securities offerings were also sold in bearer form (see Glossary), which was prohibited in the US. Consequently, an SEC integration finding would be both embarrassing and extremely costly to rectify.

[63] Rule 144A's influence on disclosure – and international precedent – was clearest in legal opinions. To minimise their legal liability in distributing "private" securities in a "registered" manner, underwriters of Rule 144A securities asked attorneys to issue SEC-registered "style" legal opinions covering the adequacy of issuer disclosure. Such opinions were standard on SEC-registered public offerings but atypical for private placements. To obtain the legal opinions, attorneys insisted that "registered" issuer disclosure

The potential impact of Rule 144A and Reg. S on non-US markets was not lost on international regulators. According to these observers, the SEC was not accommodating foreign issuer disclosure concerns. Rather, they were updating outmoded market practices and, more significantly, extending the SEC's regulatory authority offshore, a practice the SEC had also followed with insider trading regulations.[64] A US NASDAQ executive, speaking at a Paris conference, commented that Rule 144A did not fully address foreign investor concerns with US market regulation: "unless the SEC is prepared to harmonize, there will never be true internationalisation of trading."[65] However, in proposing Rule 144A and Regulation S, the SEC indicated its intention to lead regulatory evolution rather than harmonise with other jurisdictions. This approach was reflected in the standoff between the US and EU member-states in IOSCO.

The SEC re-proposed Rule 144A and Regulation S in July 1989, following the public comment period. In 1990, Former SEC Chairman Ruder described Rule 144A as "dramatic; it leapfrogs both the accounting and disclosure questions to create a liquid secondary market for foreign issuers." He also noted that the new rules might promote competitive inequality. "To the extent you relax SEC rules and regulation to mollify international issuers...to what extent will this create competitive burdens for domestic companies in this market?"[66] Ruder's comment reflected concern over potential domestic differences with the SEC's approach to international securities regulation. The SEC had made it easier for non-US issuers to enter domestic markets but had not changed corresponding regulations applicable to domestic firms. However, the SEC was not creating a two-tier domestic market. By taking its initiative with international securities offerings, the SEC was molding regulation into a form it found acceptable. The powerful desire of international issuers to enter US markets, combined with US legal liability and the extraterritorial reach of US courts,[67] encouraged a convergence on US regulatory

accompany Rule 144A offerings, which, of course, conflicted with Rule 144A's original objective. This led to lengthy negotiations between issuers, underwriters and attorneys over appropriate disclosure. However, ultimately, attorneys' demands for "public-like" disclosure prevailed, permanently influencing non-US issuers' approach to disclosure.

[64] McCahery, "Market Regulation and Particularistic Interests: The Dynamics of Insider Trading Regulation in the US and Europe."

[65] ISRR, "European Exchanges Look to 1992, Some Question Commission's Role."

[66] ISRR, "Implementation of Rule 144A and Reg. S Expected Soon," March 26, 1990.

[67] See below under "Extraterritoriality."

standards rather than a true harmonisation of national standards.[68] This in fact did not happen. Euromarket disclosure standards did not change in response to the SEC's new rules. This is not surprising, because Euromarket standards were always less onerous than US standards.

The SEC approved Reg. S and Rule 144A in April 1990. SEC Chairman Breeden noted the rules would enhance the competitiveness and efficiency of US markets.[69] Rule 144A and Reg. S offerings grew in popularity over the next three years.[70]

The Multijurisdictional Disclosure System ("MJDS")

Following the June 1989 launch of the Rule 144A/Reg. S initiative, SEC Chairman Ruder testified before the Senate Banking Committee that the agency was considering further regulatory experiments to expand investment and borrowing options for market participants. The next trial involved the deployment of a multi-jurisdictional securities registration procedure, which was prepared in reaction to EU prospectus directives. This procedure, established initially with Canada would, if successful, be expanded to other jurisdictions. The core of the SEC's proposal was the recognition by Canada and the US of each other's regulatory standards and their use as a basis for accessing each other's capital markets. The proposal represented the successful conclusion of two years of negotiations between Canadian and US regulatory authorities.

The experiment was based on the principle that Canada and the US could agree to harmonised issuance regulations, inasmuch as they had roughly comparable securities registration and offering procedures, and could create a multijurisdictional disclosure system applicable to securities issuers in both countries.[71] Ruder noted that the initial trial could lead to MJDS agreements with other jurisdictions, but only with those whose accounting, auditing and disclosure standards provided information similar to that required in the US.

Thus, MJDS was intended to be a further inducement to convergence on US regulatory norms and an SEC "endorsement" of selected national regulatory standards.

---

[68] See: "Daimler Benz" below.
[69] ISRR, "Rule 144A Will Shift Some Euromarket Business to U.S.," May 7, 1990.
[70] See below.
[71] "Ruder - Rules to Be Re-Proposed," *Dow Jones News Service - Ticker*, 6/15/89.

Because more Canadian issuers wanted to access US markets than US issuers wanted to utilise Canadian markets, it became a means of promoting SEC standards extraterritorially. In this respect, MJDS represented, as did Rule 144A/Reg. S, an SEC effort to direct the course of international regulatory harmonisation.[72]

The initial trial stalled over accounting reconciliation. A basic assumption of MJDS had been that the US and Canada would recognise the validity of each other's accounting principles. However, while the proposed regulation did not require reconciliation of Canadian statements to US GAAP for investment grade debt securities,[73] it did require reconciliation for below investment grade and equity securities. The SEC justified different accounting treatments by noting that equity and junk bonds were riskier than high-grade debt. Greater risk implied greater potential legal liability for issuers and underwriters, mandating higher disclosure standards.[74] As with Rule 144A disclosure, the SEC proved intractable when asked to amend domestic regulations considered crucial for investor protection.[75] Though inspired by standardised documentation used in Euromarket offerings, the MJDS regulatory regime was "captured" by US legal liability principles endorsed by the SEC.

The MJDS trial's promotion of the US regulatory model was facilitated by the attractiveness of US markets in comparison with Canadian markets. In the MJDS' first two years of operation, no US issuer used it to access Canadian capital markets.[76] In contrast, US$3.5 billion of debt securities and US$0.6 billion of equity securities were registered with the SEC under MJDS in 1993 alone. MJDS encouraged the closer integration of North American markets – but on the SEC's terms.[77]

[72] Jordan, "Regulation of Canadian Capital Markets in the 1990s: The United States in the Driver's Seat".
[73] See Glossary.
[74] Very generally speaking, investment decisions in debt securities are based on issuer creditworthiness, tenor and yield considerations. Equity and junk bond investment decisions are typically based on a wider range of factors because those investments are deemed riskier than investment grade debt.
[75] ISRR, "Accounting Reconciliation Key to U.S.-Canada Pact," March 26, 1990. The same US legal opinion issues that arose in Rule 144A offerings, arose in MJDS offerings. US attorneys, steeped in the legal bases of US securities regulation, refused to offer full legal opinions (covering, *inter alia*, the adequacy of disclosure) on MJDS securities unless offering materials were conformed in certain respects to US mandated public disclosure standards.
[76] MJDS implementation was in 1991.
[77] Jordan, "Regulation of Canadian Capital Markets in the 1990s: The United States in the Driver's Seat,". p. 590-592.

The MJDS concept was initially well received in London although no agreement was ever signed. Stewart Douglas-Mann, Director of the LSE, indicated the SEC's initiative was "receiving substantial political support." Commenting on negotiations between the UK and the US, Douglas-Mann noted inconsistencies between the two systems but argued the benefits of a common approach. "Agreement on this matter should result in an end-product which is simple to use – but there must be genuine equivalence."[78] Press commentary focused on the possibility of the MJDS being extended to Japan.

The utilisation of bilateral agreements with prominent trading partners as precedents (or substitutes) for multilateral agreements or harmonisation, a practice pioneered with the Basle Accord, lies behind the MJDS. However, critical to MJDS "success" in promoting SEC standards was the extent of foreign borrowers' interest in gaining access to US capital markets. At the time MJDS was implemented, the SEC's scepticism of IOSCO's ability to develop acceptable regulatory standards was growing. This encouraged the SEC to execute bilateral regulatory precedents in order to protect their regulatory preferences.

In promoting bilateral agreements, the SEC attempted to encourage convergence to a US model. Their attempt, however, was unsuccessful. Only one country signed an MJDS agreement with the US.

Memoranda of Understanding[79]

To further extend its regulatory authority extraterritorially, the SEC executed numerous informal, bilateral agreements, called Memoranda of Understanding ("MOUs"). The SEC was a leader in establishing MOUs, which addressed a range of issues including insider trading, the exchange of financial information, and cross-border investigations.[80] Because the SEC's regulatory regime was more robust, more focused on

---

[78] ISRR, "U.K. Place Strong Political Support on Achieving U.S. Multijurisdictional Pact," March 12, 1990.

[79] See: Jimenez, "International Securities Enforcement Cooperation Act and Memoranda of Understanding".

[80] As of June 1989, the SEC had entered into MOUs with four countries; Switzerland (1982), Japan (1986), Brazil (1988) and the United Kingdom (1986), and with three Canadian provinces: Ontario, Quebec and British Columbia (all in 1988), and was negotiating MOUs with France, Italy, Mexico, the Netherlands, Australia and New Zealand. The Swiss MOU addressed insider trading, MOUs with Japan and the UK addressed the exchange of financial information, and the Brazilian MOU permitted investigation into financial matters on each country's behalf. MOUs with Canadian provinces went further than those with

enforcement and more pro-active than the regimes of its bilateral partners, MOUs served to extend SEC regulatory norms and influence offshore.

Predominantly US concern with insider trading and other securities frauds, prosecuted almost exclusively by the SEC, encouraged the use of MOUs to establish bilateral agreements on a variety of matters including securities law enforcement and information sharing.[81] Rapid globalisation created situations where cross-border securities trading provoked cross-jurisdictional problems; information needed to be shared, for example, when individuals from one jurisdiction, trading in a second jurisdiction, violated its laws. MOUs provided an efficient, informal vehicle for addressing such issues. The scope of MOUs varied, but they shared a basic objective: improved cooperation between securities regulators in the administration and enforcement of securities laws.[82]

MOUs were not treaties. They did not have to be ratified and could be executed by national regulatory agencies such as the SEC, SIB or COB. Thus they were more flexible and executable than publicly debated treaties. MOU enforcement could be kept confidential, for instance, while treaties required legislative or court procedures.

Late in 1989, shortly after Richard Breeden became chairman, the SEC signed bilateral agreements with French and Dutch regulators that confirmed the Commission's desire to export domestic regulatory norms. Both accords were far stronger than previous bilateral agreements. Earlier MOUs had called for "best efforts" cooperation. The new agreements established a requirement for cooperation, which, in the case of the Dutch agreement, became part of Dutch domestic legislation.[83] Since the SEC was more concerned with enforcement than were French or Dutch regulators, cooperation was more likely to be triggered by US regulatory requirements than by either French or Dutch concerns.

---

sovereign entities, permitting information gathering on individuals. The UK was also a leader in the use of MOUs, but principally to address information exchange rather than the extraterritorial application of British securities regulations.

[81] Dennis Levine was caught through a cooperative cross-border investigation.

[82] This section is adapted from: "Capital Market Globalization and the SEC's Use of Memoranda of Understanding," *Brown & Wood - Corporate Newsletter*, (1995-96). and ISRR, "Constitution Issues Posed by Extraterritorial Enforcement," June 21, 1989.

[83] ISRR, "SEC Signs Assistance Pacts with France, the Netherlands," January 3, 1990.

The adoption of MOUs accelerated after 1989, and by 1995 the SEC had signed more than 20 agreements. While providing an effective mechanism for addressing specific SEC regulatory objectives, MOUs also extended the SEC's jurisdictional purview and regulatory authority across borders.[84]

The SEC's Definition of International Harmonisation

Speaking in January 1992, Linda Quinn, an SEC Director,[85] remarked that the SEC was not changing its requirement that foreign companies issuing registered securities in the US reconcile their accounting statements to US GAAP. Her statement clashed with the intent of the MJDS initiative, which encouraged recognition of other countries' disclosure standards.[86] She indicated that the SEC's primary concerns remained protection of US investors and maintenance of a level playing field for US companies. Despite European objections that US disclosure standards were onerous and harmful to US market interests, Quinn argued that disclosure should be based on equivalence, not mutual recognition. "Why should US firms be held to a higher standard than foreign issuers?" Quinn asked rhetorically.[87] She rejected harmonisation, noting pessimistically that mutual recognition based on universally accepted accounting standards could not be achieved. Referring to her experience at IOSCO Technical Committee meetings, she noted, "It is difficult to look at the same standard and have 13 people agree on what the standard requires."[88] Quinn's statements reaffirmed the SEC's unwillingness to compromise domestic standards, even where SEC standards were more burdensome than others' or where harmonisation had prompted bilateral discussions.

Breeden also indicated that the SEC would maintain its inflexible stance on accounting standards. "Some propose total reciprocity in accounting and disclosure requirements with any country, no matter how low its own standards of investor protection. That type of blanket abolition of US rules is not an attractive option

---

[84] MOUs addressed specific bilateral issues and were, as a consequence, of limited multilateral utility. Also, despite their ability to encourage regulatory norm migration to US standards, their impact was specific and incremental, focused on issues of concern to US regulators. Consequently, while MOUs reflected SEC policies encouraging convergence on US regulatory norms, they did not materially affect capital harmonisation negotiations. They did, nevertheless, highlight the SEC's policy objectives, its international authority, and its lack of enthusiasm for multilateral harmonisation.
[85] For the SEC's Division of Corporate Finance.
[86] See Glossary and below. MJDS also promoted US regulatory values.
[87] ISRR, "SEC Official Sees No Near-Term Change to Reconciliation Rules," January 28, 1992.
[88] Ibid.

compared with the more targeted policy of flexibility that we have been pursuing."[89] Breeden restated his position at a meeting of the SEC's Congressional Market Oversight and Financial Services Advisory Committee in July 1992. Relaxing US standards would extend "overt and quite substantial preference" to foreign companies. Breeden singled out Germany and Japan as examples of countries unwilling to expand domestic disclosure standards to incorporate information required by the SEC.[90]

Responding to critics who argued that SEC standards discouraged foreign companies from entering US markets, Breeden noted a dramatic increase in foreign entities issuing both Rule 144A and registered securities in US capital markets. Since the adoption of Rule 144A, 174 issuers had made 167 placements of Rule 144A securities, totalling US$18.2 billion. Since October 1989, 121 foreign issuers from 24 countries had entered US markets publicly, registering US$47.8 billion with the SEC in approximately 175 offerings of debt and equity securities.[91] These statistics confirmed for Breeden that the SEC's strategy of amending domestic securities regulations in line with SEC preferences, rather than as defined by international forums such as IOSCO or the Basle Committee, had been successful. This reinforced his belief that domestic regulatory compromises were largely unnecessary in negotiating international regulatory standards.

US courts apply securities laws extraterritorially

A further example of the international extension of US securities authority can be seen in the extraterritorial application of US securities laws.[92]

The US Court of Appeals for the Second Circuit ("Second Circuit")[93] resolved jurisdictional issues concerning the application of US securities laws to extraterritorial transactions. The Second Circuit adopted an expansive view of the appropriate international reach of US securities laws.[94] Two examples, Consolidated Gold Fields PLC v. Minorco, SA[95] and MCG, Inc. v. Great Western Energy Corporation[96], both

[89] ISRR, "SEC Chairman Urges Capital Rules That Cover All Types of Securities".
[90] Ibid.
[91] ISRR, "SEC Stands Firm on Requiring Foreign Reconciliation to GAAP," July 14, 1992.
[92] See, for example: Symposium, "The Internationalization of Securities Markets," *Maryland Journal of International Law and Trade* 11 (1987).
[93] This court is located in New York City.
[94] Gunnar Schuster, "Extraterritoriality of Securities Laws: An Economic Analysis of Jurisdictional Conflicts," *Law & Policy in International Business* 26 (1994).
[95] 871 F.2d 252 (2nd Cir. 1989).
[96] 896 F.2d 252, 261 (2nd Cir. 1989).

adjudicated in 1989, highlight the aggressive application of US extraterritorial jurisdiction.

In the first case Minorco, a Luxembourg company, attempted to acquire a British company, Consolidated Goldfields. As part of its bid, Minorco sent offering documents to British nominees of American owners of Consolidated Goldfields shares. Minorco did this specifically to avoid coming under US jurisdiction.[97] The documents were, however, subsequently forwarded to the American owners. Based on the documents coming into the possession of US citizens, Consolidated Goldfields sued Minorco in US federal court to halt the acquisition.[98] On appeal, the Second Circuit issued an injunction halting Minorco's acquisition.

In the second instance, MCG, a US company, purchased shares in Great Western, another US company, on the London Stock Exchange. The shares subsequently lost much of their value. MCG sued in US courts, claiming that it had purchased the shares based on fraudulent statements, including a statement that the sellers were not citizens or residents of the United States. Despite the transaction occurring entirely outside the US, the lawsuit was heard by the federal district court, which dismissed the suit. The Second Circuit upheld the decision.

In both cases, defendants had taken specific steps to avoid direct contact with US shareholders in order to avoid falling within the jurisdictional reach of US courts. Despite these efforts, the Second Circuit extended its jurisdiction outside the US. It felt comfortable doing so because of a US tradition imbuing regulatory agencies with extensive enforcement powers, which US courts actively supported and administered domestically and extraterritorially.

Because capital markets in the UK, Germany and other countries were largely self-regulating, there had been little development of a regulatory enforcement infrastructure or culture. As a result, British and German courts were rarely called upon to resolve capital markets conflicts. This had retarded the development of legal precedents that might have guided regulators and courts in resolving securities disputes.

[97] If the documents had been mailed to Consolidated Goldfields shareholders in the US, they would have come under US jurisdiction automatically.
[98] On anti-trust and anti-fraud grounds.

In the US however, securities regulation had evolved into a powerful tool, supported by voluminous precedents, for US courts to use in resolving conflicts arising in non-US markets, even when only a tenuous connection to US markets existed.

Contractual choice-of-law provisions are another example of US assertion of extraterritorial jurisdiction. International jurisdictional conflicts arise when courts in different countries attempt to adjudicate the same dispute, particularly when there is no generally accepted standard for allocating jurisdiction.

When conflicts over securities regulatory standards arose, US courts generally refused to recognise even previously agreed contractual choice of law provisions that required the use of non-US laws for adjudication.[99] This practice was amended by a 1974 US Supreme Court decision that accepted foreign court adjudication for sophisticated business professionals.[100] However, US courts continued to apply a different standard for private investors,[101] reflecting their preference for US legal precedents, their endorsement of the SEC's long-standing regulatory focus on investor protection, and the extraterritorial extension of US domestic regulatory authority. Such practices are not, of course, confined to the US. The European Court of Justice generously applies EU competition laws internationally. British and German courts have also issued judgements with international consequences. However, these courts have not been as aggressive as US courts in applying domestic regulation internationally.

US sponsored training programs

The 1989 collapse of the Soviet Union afforded the SEC an opportunity to export regulatory norms directly to formerly socialist states. The SEC and US State Department both developed programs to educate non-US bankers and regulators in developing the regulatory infrastructure necessary to operate US-style capital markets. One US attorney who worked in the State Department's program described his participation by saying, "We wrote the rules and regulations of the Polish stock market."[102]

[99] See generally: Schuster, "Extraterritoriality of Securities Laws: An Economic Analysis of Jurisdictional Conflicts,". p.169ff.
[100] Scherk v. Alberto Culver, 417 US 506 (1974).
[101] US courts referred to this as the "conduct and effects test."
[102] Confidential interview, New York, 1996.

The SEC's aggressiveness in promoting the export of US regulatory norms encouraged Richard Breeden in 1990 to pick a fight with the State Department over the responsibilities of the two newly created international securities advisory groups. The objectives of the State Department's Financial Services Volunteer Corps ("FSVC") overlapped with the objectives of the SEC's newly formed Emerging Markets Advisory Committee.[103] The dispute was resolved by imposing conditions on FSVC missions that increased SEC participation and oversight of their work. The dispute underlined Breeden's sensitivity to the boundaries of the SEC's authority and his interest in extending and managing the SEC's international advisory activities.[104]

Breeden's Third Year

The SEC's international negotiating activities during Breeden's third year as chairman are described in chapters 8 and 9. Breeden's increasingly adamant refusal to contemplate liberalisation of domestic capital adequacy regulations was evident in multilateral meetings throughout 1992. The regulatory inflexibility of Breeden and the SEC and their success in imposing their preferences on international actors, were demonstrated by their ability to resist pressure from the international and domestic private and public sectors to alter SEC listing and disclosure requirements.

German industry pressures the SEC

The most prominent examples of foreign pressure for US regulatory harmonisation came from blue-chip German companies seeking access to US public markets. A public equity listing in the US demonstrated the international stature of a non-US company and dramatically broadened its investor base. However, a US listing required that German companies amend their financial statements to disclose business segment revenue and profitability as well as "hidden reserves."[105]

---

[103] ISRR, "SEC Questions Role of FSVC Emerging Markets Effort," July 2, 1990.

[104] ISRR, "FSVC, SEC Resolve Differences; Hungary Mission to Depart," September 10, 1990.

[105] Typically, "hidden reserves" refers to unexplained entries on corporate balance sheets which, among other transactions, represent investments in shares of other companies. Although these investments may have appreciated (or depreciated) substantially from their original acquisition cost, balance sheets did not reflect the difference between their carrying cost and their market value. Consequently, the true net worth of companies holding these investments was often impossible to discern. Additionally, these accounts could be debited or credited in order to smooth corporate earnings during volatile periods. As well, public knowledge of the extent of one company's holdings of other companies shares might provoke inquiries into other aspects of their relationship, including supposedly "arms-length" transactions. As a result,

In October 1992, Ernst Welteke, Hesse Economics Minister and the official responsible for supervision of the Frankfurt Stock Exchange, met with SEC officials to argue for liberalising US disclosure requirements. Welteke, like his predecessors, was unsuccessful. "More political pressure – reciprocity action – has to be placed on the SEC," threatened Rutbert Reisch, treasurer of the Volkswagen group. "It's a disgrace. We must insist on reciprocity from the United States," argued Rolf Breuer, a senior director of Deutsche Bank. The SEC's response was that Germany lacked a federal securities regulator and, owing to the prevalence of hidden reserves at German companies, also lacked adequate disclosure standards. German officials retorted that the SEC misunderstood fundamental differences in German and American commercial perspectives. In the US, investor protection was paramount; in Germany, universal banks focused on lending[106] and creditor protection, an arrangement reinforced by cross-shareholdings between banks and corporations.[107]

Daimler Benz

The SEC's regulatory objectives and authority were illustrated by the agency's insistence that the German company Daimler Benz, the tenth largest company in the world, conform its accounting practices to SEC standards in order to list on the New York Stock Exchange. The SEC was repeatedly lobbied, over many years, by accounting firms, multinational investment banks,[108] the New York Stock Exchange and other German companies to permit Daimler to list its shares without conforming its German financial statements to US disclosure standards.[109] The SEC consistently refused and, finally, in 1993 Daimler capitulated and made the necessary accounting changes. Later, when Daimler's restated accounts revealed a weakened financial condition, the SEC argued that its intransigence had been justified.

The SEC's inflexibility reflected simple political and business calculations. US equity markets were deep and liquid and, as a result, very attractive to international companies seeking to expand capital access. The SEC was also aware that its domestic disclosure standards had not prevented more than 200 foreign companies from publicly

---

hidden reserves were a highly sensitive indicator of competitiveness and creditworthiness. German and Swiss companies, in particular, maintained hidden reserves, a practice that obscured the true performance and value of these companies.

[106] Which generated higher earnings than securities underwriting.

[107] See: ISRR, "Germany: Businesses Urge Retaliation against SEC's Listing Policy," October 20, 1992.

[108] Including leading US investment banks.

[109] Confidential interviews, New York, April 2001.

registering securities in order to raise capital in the US.[110] In addition, there was substantial domestic political resistance to weakening standards. As a result, the SEC was consistently able to resist pressure from foreign corporations, regulators and state officials to amend domestic regulations. The SEC's European peers could not afford to adopt a similar stance, as they were subject to competitive pressure from borrowers who could easily move their capital-raising efforts from one domestic market to another. Europe was experiencing a modified regulatory race to the bottom, while US capital markets and regulations operated in relative isolation and remained substantially unchanged. This observation provides further evidence against arguments that globalisation promotes regulatory convergence. It also highlights constraints on market internationalisation and the relationship between market power and state authority.

A report released by the GAO in March 1992[111] concluded, "International efforts to harmonise securities capital standards have had no effect on US securities markets or US securities capital standards."[112] The report traced the history of US capital standards and observed that modification of domestic capital rules had been motivated by investor protection concerns and the SEC's historic mission, rather than by issues of internationalisation, securitisation, product developments or foreign pressure. The GAO cited the SEC's 1987 market crash study.[113] That report had concluded that required capital levels, plus substantial, voluntarily maintained, excess capital, had provided a safety margin for securities firms. The GAO observed that the SEC had improved the competitiveness of US markets, but that "none of the changes previously discussed have been made to meet international capital requirements."[114] The report and recent market developments reinforced the wisdom of Breeden's focus on protecting domestic capital standards.

[110] Peter Lee, "Daimler Listing Opens the Door," *Euromoney*, May 1993.
[111] GAO, "Securities Markets: Challenges to Harmonising International Capital Standards Remain," (Washington, D.C.: United States General Accounting Office, 1992).
[112] Ibid, p.5.
[113] SEC, "Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce: Internationalization of Securities Markets Ii-36,", (Washington, D.C.: United States Securities and Exchange Commission, 1987).
[114] GAO, "Securities Markets: Challenges to Harmonising International Capital Standards Remain," p.43.

Conclusions

Richard Breeden bolstered the SEC's domestic authority through a series of domestic and international regulatory and bureaucratic initiatives. These efforts redressed the gaffes of Ruder's tenure and built on regulatory proposals designed to enhance the attractiveness of US markets to foreign borrowers. The SEC's regulatory authority was revealed in a number of ways: in its strategy of domestic regulatory export and incremental domestic regulatory change, in the support it received from US courts, in state-sponsored "training programs," and in its successful regulatory harmonisation intransigence. The SEC's actions and authority were motivated by Breeden's firm conviction that regulatory harmonisation around international norms would weaken the US securities industry and would weaken domestic investor protections.

Consistent with state-centric hypotheses, the SEC was able to impose its preferences on other international actors and institutions through bilateral regulatory initiatives, thus ensuring its individual regulatory sovereignty. However, Breeden was unable to achieve his policy preferences through collective decision-making. As a result, international regulatory convergence was limited and what little did occur took place around US regulatory norms. SEC authority was enabled by US market attractiveness and the competitiveness of US securities firms. More significantly, it was encouraged by domestic political considerations and by Breeden's political clout in Washington. Decision-making was not shared between levels of government or with non-state actors. Sub-national actors did mobilise internationally but had a minimal effect on the SEC's capitalisation policy. As noted earlier, the SEC's ability to act autonomously was issue specific. On issues other than capitalisation, it was subject to domestic institutional challenges and to private sector influence.

Chapter 12

Conclusions and Observations

This thesis has several objectives. Empirically it is designed to assess the location and structure of authority in the case studies. This empirical objective is complemented by theoretical objectives. State and non-state centric analytical perspectives are used to generate contrasting hypotheses on the location of authority. The theoretical objectives are first, to determine the accuracy of state and non-state centric hypotheses and second, to determine whether non-state centric analytical perspectives are superior to more state centric perspectives in assessing this study's empirical questions. Third, the thesis considers whether a synthetic perspective, combining findings from state and non-state centric perspectives, generates observations not revealed by individual analytical perspectives. Fourth, the thesis examines whether the conflation of authority and influence in state/market theoretical perspectives benefits from refinement. This study also assesses related issues. Are non-state centric and synthetic perspectives superior to monocausal perspectives simply because they are comprehensive or because they generate new observations and highlight the limitations of narrower perspectives? Has globalisation transformed the state or encouraged regulatory convergence, as predicted by non-state centric theorists?

Summary

Empirically, this thesis observes that both state and non-state actors and institutions express authority in international policy-formation. The EU case offers inconsistent support for state and non-state-centric hypotheses, while the IOSCO case more consistently supports state-centric hypotheses. Consequently, there is no clear support for the argument that authority has migrated from state actors (that is, from the US and from EU member-states) to non-state actors and institutions. In both case studies, states retained their sovereignty and imposed their fundamental regulatory preferences on international actors. The thesis therefore concludes that in the case studies, state actor and institutional authority and influence predominated in policy formation.

Based on the empirical analysis, I have modified three arguments that are made by non-state centric theorists. First, state and non-state actors and institutions demonstrated influence and authority in the case studies. However, state preferences were decisive in policy formation and, as a consequence, determinative authority and influence resided with states.[1] State preferences were determined principally by national structural variables considered fundamental by the state and by the states' interest in insulating domestic institutions and actors from foreign encroachment. Second, the argument of state/market theorists that globalisation has "transformed" the state and/or state authority is, in light of the first observation, strained. Third, non-state theorists' prediction that globalisation will promote regulatory convergence is also over-stated. These observations are supported by non-state centric and synthetic analysis.

Theoretically, the thesis argues that non-state centric perspectives are analytically superior to narrower perspectives because they are more realistic and because they facilitate more accurate identification and evaluation of the variables that drive international policy-formation. The thesis argues that authority is multi-layered and originates from formal and informal state and non-state sources. A non-state centric analysis reveals relationships between these layers and the influence of state and non-state actors and institutions on state autonomy.

A synthetic analysis of empirical findings reveals limitations of individual analytical perspectives and distinctive relationships between their observations. Because of this, it may modify the conclusions of individual approaches regarding the process of international policy formation. It also demonstrates the role of non-state actors and institutions in shaping state preferences, in propelling policy negotiations, and in providing context-based expertise. This analysis highlights the dynamic process of policy-formation and confirms the value of assessing observations from several perspectives interactively.

[1] As noted earlier, this thesis is time-bound; consequently it is impossible to determine whether authority has "migrated over time." Nevertheless, it is possible to make a closely related argument, that both state and non-state actors and institutions express authority.

The thesis makes three additional arguments. First, EU integration perspectives are useful in assessing non-EU-related developments. Second, state/market theorists' conflation of authority and influence impedes identification of variables influencing international policy-formation. Third, neither non-state centric perspectives nor synthetic analysis is parsimonious. However, the complexity of these approaches is offset by their greater explanatory power and by their ability to identify weaknesses in narrower perspectives.

This chapter assesses the main empirical findings against the hypotheses and examines their implications for theoretical and empirical research. The benefits of synthetic analysis are also addressed. Finally, the chapter turns to a broader discussion of international regulatory harmonisation.

Empirical Observations and Hypotheses

State-centric hypotheses – summary

Core Argument: States dominate international norm/policy development.

Specific Hypotheses	IOSCO Observations	EU Observations
1. National governments impose preferences on international actors/institutions:	Yes. IOSCO failed to develop a regulatory standard due to the SEC's opposition to the preferences of EU members and the Basle Committee. This failure was abetted by IOSCO's lack of authority.	Yes/Mixed observations. The directives reflected input from private and EU sources as well as from states. State and non-state institutional/economic preferences were significant in shaping the directives even when state preferences predominated.
2. National governments are able to ensure their sovereignty:	Yes. IOSCO's failure was due in part to members' decisions to pursue harmonisation (and their sovereignty) elsewhere when agreement in IOSCO was deemed impossible.	Yes. Agreement on the CAD and ISD reflected numerous compromises based on national preferences as expressed by state and non-state actors. States avoided implementation, reflecting the subordination of regional authority to national sovereignty.
3. National governments control the mobilisation of sub-national interests:	Yes. Sub-national (private) interests did not mobilise in the IOSCO negotiations, either because they prioritised EU regional objectives or because US domestic considerations and the SEC inhibited mobilisation.	No. Sub-national interests worked directly with the EU Commission, DG XV, and with states.

Non state-centric hypotheses – summary

Core argument: Decision-making is shared among states, sub- and supra-national actors and institutions.

Specific Hypotheses	IOSCO Observations	EU Observations
1. There is a pattern of shared decision-making across levels of authority:	No. Decision-making overwhelmingly reflected the decisions of member-governments.	Mixed. Decision-making reflected the concerted lobbying of all three levels of authority, but decisions largely reflected state preferences and were made by states.
2. Individual state executives are unable to deliver policy preferences through collective decision-making:	Yes. The collective efforts of EU member-states failed. Breeden's objectives were realised, but not collectively.	No. Compromises arrived at by collective decision-making largely preserved state executives' preferences.
3. Sub-national interests mobilise directly in the supranational arena:	No. Sub-national interests mobilised in the EU rather than in IOSCO.	Yes. Sub-national interests lobbied directly with the EU.

Authority and influence in policy-formation

The summary analysis above indicates that the empirical observations predominantly support state-centric hypotheses. However, it also indicates that public, private and supranational actors and institutions exercised some authority and influence and that the interaction of state and non-state preferences did have an influence on policy-formation.[2] State actors expressed authority through the negotiation and adoption of directives. Non-state actors expressed influence and authority through lobbying and advocacy, particularly on issues where they had specialised expertise. They provided information to negotiators and multilateral agents on the consequences of regulatory options and thereby facilitated compromises. Their influence and their access to formal authority were a function of their context-based knowledge and their significance in national regulatory, economic and political structures. Though exercised ultimately through state decisions, the influence of non-state actors was expressed throughout the policy-formation process. However, in each case, the adoption or rejection of non-state recommendations was assessed against its potential effect on fundamental state preferences. These were determined by critical national structures or policies (economic,

[2] In the EU case, through the Council and Parliament – and, subsequently through national implementation. In IOSCO, theoretically, through Committee votes and national implementation.

political and regulatory) that were deemed public goods and served as minimum thresholds for determining whether to accept policy proposals.

The principal variables affecting harmonisation debates included embedded domestic and market relationships, national regulatory histories and operational practices. They also included domestic political considerations and institutional objectives and capabilities. Despite this empirical complexity, this study finds that the resolution of policy debates principally reflected state preferences.

This representation of international policy-formation – and of the composition of authority – is closer to Underhill's "condominium" than to Cerny or Strange's regulatory convergence projections.[3] A number of observations confirm the predominance of state authority in international policy-formation.

1. Fundamental state regulatory objectives remained unaltered throughout the process of international policy-formation. These objectives were based on critical national structures and were used as a minimum threshold to evaluate the acceptability of policy recommendations from other states and from non-state actors and institutions. This indicates that, in the negotiations, state objectives constituted minimum standards for acceptable policy.

States' fundamental policy preferences grew out of their desire to preserve national market and economic structures from foreign encroachment. Non-state preferences and policy recommendations helped to refine states' deliberations, but state preferences were predominant. The domestic economic and political risks posed by change to national structures dictated their critical status and conservative state policy objectives. Specific fundamental state preferences are discussed in detail below. (See page 345.)

2. Policy preferences of state and non-state actors and institutions often overlapped, but private actor influence was realised largely in conjunction with or

---

[3] International policy-making is built on a foundation comprised of state preferences. Non-state sources of authority and influence help determine the distinctive shape that policy assumes; however, state influence and authority predominate.

through state institutions and actors. While this confirms that state and non-state actors often agreed on policy options, it confirms neither public actor capture by non-state interests, nor that non-state interests persuaded public actors to adopt a course of action they would not have otherwise pursued.

Because of the overlaps of state and non-state preferences, bright-line identification of policy responsibility is difficult to establish. However, there were very few instances where conflicts between state and non-state actor or institutional preferences were resolved in non-state actors' favour.[4] Neither did states "rubber-stamp" non-state preferences. Only one instance of non-state actors compelling change in state preferences is noted.[5] Moreover, in the EU case, language conflicts between member-states were resolved by compromises that preserved national regulatory distinctiveness and national autonomy – an indication of the predominant role of state authority.

3. EU decision-making procedures were designed to encourage collective decision-making, but they protected state autonomy instead. In the EU case study, member-states approved regional harmonisation initiatives[6] but ensured that their eventual approval would be executed through intergovernmental institutions and be subject to national implementation.[7] In IOSCO, the US-sponsored Strategic Assessment was intended to improve IOSCO's policy output, but it concentrated decision-making authority instead, bringing member conflicts into sharper relief and impeding collective agreements. This indicated member-states' reluctance to relinquish national sovereignty.

The policy-formation procedures created by the SEA mandated coalition building. But this had the paradoxical effect of politicising policy-formation. Its objective of diluting state autonomy was weakened. The provisions prevented Germany from holding out for tougher capital standards, but they also impeded an unequivocal resolution of transparency and concentration debates.

[4] The reciprocity language debate is the notable exception.
[5] The *Patronat's* intercession on ISD language – however, the public/private sector distinction in France is very ambiguous and, ultimately, French state negotiators were able to preserve existing national regulatory norms.
[6] The Cockfield White Paper, the SEA and the 1992 objectives.
[7] The Council of Ministers and Parliament.

4. Private actors were generally in favour of harmonised regional regulatory standards, although their relative aggressiveness in promoting harmonisation differed significantly. Regulatory harmonisation would shrink home-market advantages and arbitrage opportunities and would increase competition. For more sophisticated financial institutions this prospect was attractive, as it would reduce costs and competition.[8] States, on the other hand, while initiating regionalisation and harmonisation discussions, responded to globalisation by enhancing domestic markets – a counter-intuitive action. This underscored states' anxiety that international harmonisation would marginalise home markets and/or increase economic and political risks. In the EU, states insisted on derogations, ambiguous language and delayed directive implementation, all of which impeded regulatory harmonisation. At IOSCO, the SEC refused to accept regulatory proposals it deemed risky, which led to the breakdown of negotiations. As a result of state actions in both cases, regulatory harmonisation goals were not achieved. Despite shared harmonisation objectives and collective negotiations, individual state political and economic concerns and authority predominated in international policy harmonisation outcomes.

5. The EU directives reflected compromises that preserved individual state structural preferences. This indicates that zero-sum decision-making did not replace lowest common denominator decision-making. This also confirms that policy preferences were nested within states. These conclusions indicate that states predominated in international policy formation.

These case study observations confirm that the contours of authority were multi-level and interconnected, built upon a base of state preferences, but shaped by non-state actor and institutional recommendations. Non-state preferences were significant in an "integrated ensemble of governance,"[9] but it was predominantly state preferences that determined policy outcomes.

Locating authority

These arguments underscore the difficulty of pinpointing precisely where "authority" lies. This is confirmed by an assessment that identifies whose preferences

[8] This included the US, UK, Swiss and, increasingly in the early 1990s, German and Benelux firms.
[9] Underhill, "States, Markets and Governance. Private Interests, the Public Good, and the Democratic Process."

were incorporated in the various agreements. The analysis below focuses on the EU negotiations since they, unlike the IOSCO deliberations, resulted in concrete agreements. Private actors, some of whose context-based preferences were adopted, lobbied the EU Commission and member governments. However, the EU directives reflected multiple, overlapping – state and non-state – preferences.[10]

Issue	**Preferences Incorporated**	**Preferences Not Incorporated**
Market access:	N. Europe Group Private sector	Club Med Group
Transparency:	Club Med Group	N. Europe Group Private sector
Concentration:	Club Med Group	N. Europe Group Private sector
Capitalisation:	London-operating institutions and most EU member-states, ex-Germany	German state and banks

This rough analysis of the EU case confirms the disparate beneficiaries of the negotiations. The resolution of market access did not significantly benefit any group; derogations were granted to Club Med states, reflecting the preferences of local firms and state regulators. The language of the transparency and concentration provisions was sufficiently ambiguous to leave operating methods in London and Club Med countries unchanged. This met UK, French and private institutional preferences. The CAD favoured UK-based banks and UK regulatory preferences, but German banks and regulators were not significantly disadvantaged by the results. Private actors influenced the final language of directives through lobbying, but their efforts were not completely successful. Member-states, working with the Commission, made final language decisions, and even they had to compromise with each other on many points.

[10] Private actors may be reluctant to lobby publicly for fear of eroding their continuing influence. Conversely, the relationship of authority, influence and legitimacy may also be subject to public actors being able to preserve the "façade" of authority while they are following guidelines laid down by private interests. Lobbying by the *Patronat* and by UK/US investment banks was clearly very private – to preserve the fragile relationship of public and private authority and the impression that policy decisions are made by "public" officials.

Despite IOSCO's failure to establish regulatory standards, the predominant source of authority in these negotiations is easier to identify. The SEC impeded IOSCO's endorsement of objectionable norms. The SEC's response to international harmonisation initiatives was shaped by US structural and historic considerations. Its influence derived from these same factors. For its part, IOSCO had little influence because it lacked formal authority and market expertise. Despite the contextual legitimacy and potential influence of non-state actors, they were ineffectual in the IOSCO deliberations. US financial services firms were inhibited by disagreements over preferences. Other private actors acknowledged the low probability of changing the SEC's stance. Once these factors became apparent, EU states and private actors concentrated their attention on the EU and the Basle Committee discussions, where they could have greater influence. This assessment confirms the predominant influence of the SEC in the IOSCO negotiations.

Fundamental policy preferences

Fundamental state policy preferences acted as a minimum threshold for determining the admissibility of non-state preferences.[11]

Fundamental state preferences consisted of the following: the preservation of the German state/banking sector relationships, which was achieved by Germany's insistence on a level regulatory playing field; French *dirigisme* which, although a failed policy, encouraged the protection of domestic operating norms through language compromises and derogations; preservation of London's market dominance and domestic operating norms, which consistently dictated UK negotiating positions; and the SEC's discomfort with domestic regulatory change, which was based on the US's domestic regulatory history and institutional structure. In each case fundamental state preferences were determined by domestic economic and regulatory structures that were historically based or economically critical to the state.

Examples of how these state preferences served as minimum thresholds for non-state policy proposals are provided below.

[11] Alan Greenspan, Chairman of the Federal Reserve, has endorsed States' use of fundamental preferences to establish parameters for acceptable policy options. Arguing against the creation of fixed monetary targets and in favour of discretionary decision-making, Mr. Greenspan observed that "the world economy was too complex and uncertain for simple policy prescriptions." He noted that "rules by their nature are simple. They cannot substitute for risk-management paradigms." See: Andrews, Edmund L., "Greenspan Argues Against Strict Rules for Fed," *The New York Times*, pp. C1, August 30, 2003.

1. Germany's level playing field objectives were not compromised by their acceptance of the trading book proposal recommended by DG XV. Once German level playing field objectives were met, Germany was largely neutral to other proposals.[12]

2. French domestic market protection objectives were not compromised by their acceptance of the *Patronat's* ISD recommendations. However, market protection was threatened by open-exchange access proposals, and the French sided with other Club-Med countries in seeking derogations.

3. The UK's objectives of preserving domestic and Euromarket operating norms (and revenue streams) and London's stature were not threatened by their agreement to derogations and ambiguous language in the final directives. However, the UK objected strenuously to proposals that would require capitalisation for small brokers – the backbone of the British domestic investment industry and a sensitive domestic constituency.

4. The US/SEC's fundamental regulatory objective (investor protection) was not compromised by their acceptance of "Euromarket" hedging techniques in calculating capital for debt products. But the SEC stopped short of permitting hedging for equity products, indicating their view that equity was a riskier investment than debt. Private actors preferred the inclusion of hedging for both products.

Non-state influence

At the sub-national level, non-state actors' influence varied from country to country and from issue to issue according to their context-based expertise and the economic and political significance of non-state actors to the state. Influence derived primarily from domestic economic/political and historic (structural) relationships.[13] These factors affected their access to formal authority. Influence derived from symbiotic state/private sector relationships (as in Germany), economically powerful business associations (such as the *Patronat*), the City's importance to the UK government in revenue terms, and from entrenched (and profitable) industry norms and practices (such

[12] Confidential interviews, London, 2001.
[13] This list is adapted from Cutler, Haufler, and Porter, *Private Authority and International Affairs*.

as Euromarket and French brokerage practices). Actors such as the *Patronat* or large UK or US investment banks had access to decision-makers based on their market stature and their expertise. They also represented the views of large private capital pools. In addition, certain markets, because they were attractive to foreign borrowers and important to national governments, bolstered the international influence of individual governments and of non-state actors. This applied especially to the US and Euro markets.

In the EU, state and private actor preferences overlapped significantly, producing little disagreement except on marginal issues. Where private actor influence was most manifest was in interstate negotiations, where governments worked to preserve their domestic operating norms against those of other states. Where state and non-state preferences diverged, states evaluated the possible application of non-state policy recommendations through the filter of existing domestic economic and political structures and through interrelated state objectives. In the IOSCO negotiations, private actors in the US disagreed with the SEC's position but were inhibited from domestic lobbying and turned their attention to the EU.

At the supranational level, the EU Commission and DG XV exercised influence through their staffs of experts and their supranational authority. Their influence was notable in the reciprocity debate, in the trading book proposal and in the development and promotion of successive compromise proposals on the directives. Arguably, their perseverance was decisive in the eventual adoption of the CAD and ISD. However, their recommendations were only realised through decisions negotiated by states in the intergovernmental Council and Parliament. The EU's influence and authority were predominantly manifested through their development of compromise policy proposals and through advocacy.

The structure of compromise solutions to policy conflicts indicates that non-state preferences and exogenous issues rarely circumscribed state autonomy. Compromises negotiated on the CAD and ISD did not violate fundamental state objectives. Where proposals would violate state objectives, the affected states raised objections and rejected language. States managed to preserve their decision-making autonomy and their historic domestic market relationships. States and EU Commission representatives were required to develop compromise solutions that reflected the subordination of regional and, in some cases, private, interests to individual state interests. The case studies indicate the influence of non-state actors in the refinement of directives but not in final decision-making.

In IOSCO, a similar, if starker, pattern is discerned. Supranational authority existed in IOSCO's working parties. However, the ability of these groups to pose recommendations was stymied by the SEC. The SEC's motivation can be traced predominantly to domestic political considerations and to Breeden's intransigence. Private actors were not prevented from lobbying IOSCO's working parties and the SEC. They elected not to – because of recent scandals, because of the SEC's firmly stated views and because of the greater likelihood of success in the EU negotiations. As with the EU case study, state authority was predominant and state autonomy was preserved.

In both case studies, fundamental state objectives determined the structure of policy and the contours of authority. Non-state preferences influenced and shaped state preferences. Primary state objectives, however, defined the scope of policy outcomes and the location of authority in policy formation. In the case studies, the preservation of national sovereignty took precedence over regional and international harmonisation

Regulatory convergence

Susan Strange predicted that globalisation would encourage regulatory convergence: "The common logic of integrated world markets [will]…. bring nationalist versions of capitalist production and exchange ever closer to a common pattern."[14] This statement underscores her belief in the transformative power of markets. Philip Cerny also emphasises the conforming power of markets: "National varieties of capitalism will be tolerated only so long as they do not undermine profits..."[15] The case studies indicate, however, that evidence of market or regulatory convergence was limited.[16] In IOSCO, harmonisation negotiations failed.[17] This was a testament to the SEC's and Breeden's intransigence and influence. In the EU, the use of derogation, differentiated domestic

---

[14] Strange, "The Future of Global Capitalism; or, Will Divergence Persist Forever?"
[15] Cerny, "International Finance and the Erosion of Capitalist Diversity."
[16] International regulatory convergence has occurred in certain technical areas of international finance. See: White, "International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues."
[17] However, as noted separately, shortly after Breeden left the SEC, international regulatory harmonisation talks started up again.

implementation and ambiguous language ensured that national regulatory distinctiveness would continue. Indeed, over a decade after 1992, a harmonised EU capital adequacy standard for investment firms is still under development,[18] a modification of the Basle Capital Accord begun in 1997 still awaits finalisation,[19] EU member-state domestic capital markets remain distinctive, a common securities regulator for the Euromarkets does not exist, and different private sector risk management models are being endorsed[20] to manage portfolio risk and capital adequacy. National varieties of capitalism and regulation persist, unmolested by "harmonising" globalisation, private, or market forces.

State transformation

The case studies reveal that state/market arguments stressing the ability of globalisation or market power to "transform" the state/market relationship are strained.[21] The use of globalisation to explain the perceived migration of authority away from the state can be construed as monocausal, economically deterministic and incomplete.[22] While significant non-state influence and authority were identified in the case studies, the thesis concludes that international policy was formed predominantly through the actions of state actors and institutions.[23] As noted above, private actor regulatory regimes have developed in technical and operational areas. Despite private actor involvement, however, the state's central role in setting capitalisation standards, standards that are

---

[18] A CAD 3 has been mooted.
[19] It is now predicted for early 2004. Revision discussions actually began in 1993.
[20] By public sector institutions.
[21] See, for example, Cerny, "Globalization and the Changing Logic of Collective Action," p. 597, "Structural differentiation increasingly is spreading across borders and economic sectors, driving other changes and resulting in the increasing predominance of political and economic structures that...(3) may permit actors to be decisionally autonomous of the state." And, as quoted previously, "National varieties of capitalism will be tolerated only so long as they do not undermine profits in international financial markets. If genuinely new forms of transnational regulation are not forthcoming from states acting in concert, then the transnational financial structure is increasingly likely to be run by a *de facto* private regime centred in the financial markets themselves." Cerny, "International Finance and the Erosion of Capitalist Diversity," p. 181. Cerny also argued that "The state is being not only being eroded but also fundamentally transformed." He subsequently modified this argument by observing that "the logic of collective action is becoming a heterogeneous, multi-layered logic; derived not from one particular core structure, such as the state, but from the structural complexity embedded in the global arena." (Cerny, "Globalization and the Changing Logic of Collective Action," p. 595) He also argued that unless states band together to develop new forms of transnational regulation, private firms will create their own *de facto* private regulatory regimes: See: Filipovic, *Governments, Banks and Global Capital: Securities Markets in Global Politics*. Cited in Cerny, "International Finance and the Erosion of Capitalist Diversity." V. Cutler notes "a general sense that we are in the midst of a structural transformation that is simply not captured by state-centric analysis." (Cutler, Haufler, and Porter, eds., *Private Authority and International Affairs*.) See also: Strange, "The Future of Global Capitalism; or, Will Divergence Persist Forever?".
[22] In this context, "globalisation" refers to the erosion of state power due to capital liberalisation.
[23] I agree, of course, with Cutler's principal observation, viz., that state-centric analysis is overly limiting. Ibid., p. 349.

closely associated with maintaining a public good (the viability of banking systems), has not changed.[24]

In the case studies, state negotiators selectively adopted non-state preferences in forming compromises that shaped policy. However, as noted, in the EU the directives were predominantly influenced by the need to meet 1992 deadlines, by the need to achieve a qualified voting majority, and by member-states' fundamental regulatory objectives. For example, German policy concessions were influenced through the efforts of the private sector to convince German regulators that the inclusion of hedging in calculating capital would not weaken German level playing field criteria. Private sector arguments were also used to persuade French regulators to accept compromise language on the ISD. But the final versions of the ISD and CAD preserved fundamental German and French state preferences. In the US, private sector hedging preferences for debt were accepted, but the state rejected hedging for equity. State sovereignty was preserved in the case studies.

The empirical evidence supports a more modest argument than state transformation. Rather than transform the state, globalisation expanded the policy-formation process, and influence was more dispersed. Globalisation constricted state autonomy, but states still predominated in sensitive risk management areas of policy formation. Such transformation as occurred in the case studies was incremental.

The fact that multiple sources of influence operated in policy-formation is neither a new phenomenon nor indicative of a transformation in state authority. States have collaborated with the private sector in policy-formation and have endorsed market-based regulation (principally through SROs[25]) for many years.[26] What is new is that the globalisation of finance has increased the breadth of markets and the complexity of products – and the potential influence of both on state policies and regulations. That in turn has increased the number of actors with context-based knowledge (and the

[24] See: W. White, "International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues." See also L. White, "International Regulation of Securities Markets: Competition or Harmonization." W. White makes the point that when regulation touches the public interest, state involvement and preferences are predominant in policy-formation.
[25] Such as stock exchanges – viz. the NYSE, the ASE, the NASDAQ and the LSE.
[26] An example is the Bank of England's traditional *laissez faire*, "consultative guidance" approach to regulation of City of London institutions.

significance of that knowledge). This has made international policy formation more complex. But, as the protracted CAD 2/3 and Basle II processes and development of the Basle Accord and DPG demonstrate, *de facto* private regulatory regimes and authority have not supplanted the authority of state actors – at least not yet.[27]

Theoretical Observations

What do these observations indicate about state and non-state centric perspectives and synthetic analysis?

Armstrong and Bulmer argue that, "The emergence of governance beyond the state has been a response to the inability of traditional formal state institutions to manage the size and complexity of the regulatory tasks facing them."[28] This study challenges their assertion. States, supplemented (but not superseded) by supranational and private institutions and actors, promoted international policy-formation. Does this mean, however, that intergovernmentalism is correct?

Moravcsik argues that state leaders pursue national interests, particularly powerful commercial and economic interests. National interests precede regional and supranational interests. He concludes that, "The integration process did not supersede or circumvent the political will of national leaders."[29] In this thesis I have argued that national interests did predominate in policy formation. But, in light of international regulatory harmonisation responses to globalisation and the demonstrated influence of non-state actors, Moravscik's argument is expanded. State preferences in policy formation were shaped by both exogenous and endogenous variables.[30] In both case

[27] The caveat noted in footnote 24 above applies to this statement.
[28] K. Armstrong and S. Bulmer, *The Governance of the Single European Market* (Manchester: Manchester University Press, 1998)., p. 259 quoted in Puchala, "Institutionalism, Intergovernmentalism and European Integration".
[29] Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht.*, p.4, quoted in Puchala, "Institutionalism, Intergovernmentalism and European Integration". This comment refers, of course, to the EU.
[30] Moravscik has amended his theoretical arguments to encompass the potential for non-state preferences to influence and shape state preferences. As noted in Chapter 3, Moravcsik added a third layer of analysis to his liberal intergovernmentalist framework, bringing his approach closer to constructivist perspectives and to the conclusions argued by this thesis. Within a rationalist structure defined by national preferences and intergovernmental bargaining, Moravcsik added a notion of institutional choice by acknowledging that institutions might enjoy agenda-setting powers and arguing that nation-states might pool their sovereignty – through institutions – to increase the "credibility" of their commitments. However, Moravscik still argues for a linear, one-direction, state policy formation process. This thesis agues that policy formation

studies, non-state preferences influenced state policy decisions. This conclusion confirms that combining state and non-state centric perspectives is necessary for accurate assessment. This is an argument for synthetic analysis.

Five theoretical observations are made. First, non-state centric perspectives are analytically superior to state-centric perspectives. A complex, non-parsimonious analysis is superior to a monocausal or narrower analysis, not solely because it is comprehensive, but because it develops deeper insights into policy formation and the limitations of individual perspectives. Second, as discussed above, predictions of non-state centric theorists are not wholly confirmed. Globalisation did not bring about regulatory convergence nor transform state authority. State authority remained predominant in international policy formation even while sources of regulatory influence expanded. Third, a synthetic perspective, which combines state and non-state centric observations, not only reveals limitations of both perspectives, but also develops a more accurate and dynamic assessment of authority and influence. Fourth, the theoretical conflation of authority and influence diminishes analysis of policy formation. Disaggregating these variables develops a more accurate assessment of regulatory development. Fifth, EU integration perspectives can be usefully employed in non-EU analyses.

State versus non-state centric perspectives

The case studies support the analytical superiority of non-state centric perspectives.

In the EU case, a narrow perspective focusing on unitary state interests or institutions does not identify the important roles of private and supranational actors in policy-formation. A focus on states or institutions also ignores the interaction of private actors with the Commission, the role of 1992 commitments, and the multifaceted role of the Commission itself. The unique structures and histories of domestic EU member-state political and economic institutions also shaped EU debates. Treating either the EU or its member-states as unitary, or ignoring the ability of sub-national or supranational actors and institutions to interact independently, ignores this critical complexity.

---

operates across and between levels of authority and influence. See: Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht.*

Similarly in the IOSCO case, a non-state centric perspective facilitates identification of the critical reasons why the SEC adopted the stance it did and why the negotiations failed. The institutional structure of the US financial services industry, IOSCO's governance weaknesses, competition from parallel EU and Basle negotiations, recent market crises and scandals, and the attraction of US markets to non-US borrowers, all influenced policy formation. State/market and MLG theses, while not supported empirically by the IOSCO case study, are confirmed by subsequent regulatory developments.[31] This supports the contention that the IOSCO case study may be exceptional.

Despite weaknesses, state-centric perspectives are also critical to appreciating the structure of authority. In the EU case, the competitive desire of the Commission and member-states to establish an international regulatory precedent is significant to understanding their drive to complete the directives and to meet their 1992 obligations. However, this analysis is incomplete, ignoring the role of domestic economic relationships and histories in shaping states' responses, and the role of private sector interaction with states and supranational actors. In the case of IOSCO, an emphasis primarily on interstate negotiations or on IOSCO's organisational weaknesses excludes the domestic structural background to the regulatory preferences and international harmonisation strategy of Richard Breeden and the SEC.

This thesis concludes that authority in policy-making resides predominantly with the state – a state-centric view. Paradoxically, it argues that non-state centric perspectives are superior to state-centric perspectives – a non-state centric view. If the conclusion is state-centric in nature, why are non-state centric perspectives important to consider in analysing policy-formation? The analysis above explains the paradox. It confirms the utility of perspectives that locate authority in a three-dimensional "condominium," rather than along a two-dimensional state/market continuum.[32] It avoids debate over whether authority has migrated or whether the state has been transformed.

[31] See Appendices. The DPG and VaR, in particular, indicated the increasing authority of non-state actors in market regulation. The private sector worked closely with multilateral organisations in developing these initiatives, often working directly with the Basle Committee, rather than with or through states, to express their preferences.
[32] Underhill, "States, Markets and Governance. Private Interests, the Public Good, and the Democratic Process".

Instead, it acknowledges the complex structure of authority and influence and directs attention to understanding the dynamic nature of policy-formation.

This approach moves analysis beyond the binary determination of the balance or location of authority and influence in policy-formation by accepting that they are multi-dimensional and that their composition varies from case to case. In each instance, influence was defined by public and private, state and non-state, variables. The contours of influence were determined by at least three variables: by state; by market/private factors; and by supranational actor and institutional variables. A fourth variable, which must be considered in any discussion of policy formation, is Odell's concept of "process." International policy negotiations take place over time and are dynamic. These characteristics imply that the contours of authority and influence may change over the course of a negotiation.

Synthetic analysis

This study's empirical and theoretical findings demonstrate that adoption of a single analytical focus may fail to reveal relationships and evidence critical to evaluating policy-formation. By discouraging multiple independent variable analysis, focused perspectives demonstrate both omitted variable and selection biases. As noted in Chapter 1, state/market and integration perspectives dramatically expand the number of independent variables and levels of analysis under consideration. They manage the resulting analytical complexity by concentrating on core topics and by identifying linkages between levels of analysis.[33] However, even these perspectives may evidence limitations. State/market approaches may over-emphasise the roles of private or market interests and ignore factors emphasised by integration approaches such as MLG and the role of economic or political structure. Additionally, the state/market focus on power relationships may ignore the importance of legitimacy and utility in locating influence and authority.

Similarly, integration approaches are, as noted earlier, middle-level analytical perspectives. They emphasise specific variables – policy networks, institutional

[33] See: King, Keohane, and Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research.* "Selecting observations for inclusion in a study according to the categories of the key causal explanatory variable causes no inference problems. The reason is that our selection procedure does not predetermine the outcome of our study, since we have not restricted the degree of variation in our dependent variable."

structure, or MLG – and may over-emphasise the roles of examined variables to the detriment of others. These observations argue for synthetic analysis, which examines the process of policy formation: particularly, how it incorporates context-based knowledge and how influence is exercised. Synthetic analysis encourages the expansion of empirical focus to encompass multiple perspectives, explanatory variables and case studies. It exposes aspects of policy development that are not revealed by state or non-state centric approaches alone. This thesis observes that conclusions drawn from individual perspectives, when juxtaposed, often modify each other, producing a more complex and nuanced understanding of international policy formation.

Synthetic analysis operates through the combination and assessment of observations drawn from defined theoretical approaches. For example, from a state-centric perspective, the decision by EU member-states to develop harmonised regional regulatory precedents represented the assertion of the EU's regional regulatory authority. From a non-state centric perspective the EU's effort reflected multiple influences and incentives: private actors' efforts to promote certain operating practices; the EU's 1992 objectives; the influence of the Basle Committee and the SEC; and EU domestic market responses to globalisation favouring the Euromarket. When juxtaposed, these two sets of observations generate a third perspective of policy formation, which highlights the *development* of state policy objectives.

For example, EU member-states'original objectives were designed to bolster both regional norms and the EU's international authority. During negotiations it became apparent that this objective conflicted with member-states' preference for preserving domestic institutions, relationships, and regulatory norms. It also became evident that the EU's work might be superseded by a Basle Committee proposal. The EU Commission recognised that its original harmonisation objectives were not achievable, and it negotiated a series of compromises in order to meet member-states' treaty-based obligation to establish the CAD and ISD. Synthetic analysis identifies how these observations modify each other. The interaction of private, state and multilateral actor and institutional preferences was evident in compromises on CAD and ISD language. Compromises were necessary in order to preserve state preferences dictated by national economic and regulatory institutions and to include constructive recommendations of private sector lobbyists and the EU Commission. The 1992 deadline and the competing

Basle process incentivised negotiators to establish a regulatory precedent that fixed EU preferences ahead of the Committee. This interaction was apparent in the lobbying of Commission, DG XV and national regulators by investment bankers and policy networks. Identifying interactions between actors and institutions in policy-formation indicates how authority and influence emerge and operate.

These actions achieved several goals. First, they established a regulatory precedent favouring Euromarket standards. Thus the directives more closely paralleled the evolving Basle Committee standards than they did those favoured by the SEC. It also meant that EU standards could potentially influence the Basle Committee's deliberations. Second, the adoption of the directives effectively ended any possibility of the SEC's capitalisation standards being implemented internationally. Private and public sector actors and institutions broadly favoured the directives' approach. Finally, the adoption of the directives reinforced the EU's ability to achieve difficult regional harmonisation objectives. This was particularly significant in light of the ongoing Maastricht debate. Based on these observations, this thesis concludes that predominant state preferences, influenced by private actors and EU institutions, modified the EU's harmonisation strategy.

The IOSCO case study also benefits from synthetic analysis. A state-centric view focuses on the SEC's international authority and international regulatory precedent-setting ambitions. It emphasises the size and attractiveness of US domestic markets, the SEC's long institutional tenure and well-established regulatory template, and Richard Breeden's unique individual authority. A non-state centric perspective identifies additional important sources of influence: IOSCO's history of domination by the US and its weak governance structure; the roots of the SEC's regulatory preferences; domestic challenges to SEC authority; debates within international policy communities over the efficacy of SEC capitalisation prescriptions; and EU member-states' own motivations for developing a different regulatory precedent from the SEC's.

Synthetic analysis suggests a third interpretation of IOSCO's failure, which also focuses on the *development* of state policy objectives. The SEC's initial response to market globalisation and pressure for an international regulatory harmonisation strategy was to seek to enhance IOSCO's policy formation capabilities so that IOSCO could serve as a stalking horse for US regulatory preferences as it had in the past. Under Ruder and Breeden, the SEC also staked out a regulatory harmonisation strategy that stressed the promotion of US regulatory values overseas. The SEC created a special high-level office for this purpose, established a separate group to promote US regulatory norms overseas, and initiated domestic regulatory reforms to take advantage of the attractiveness of US markets to non-US borrowers. However, the SEC's ability to promote its international regulatory preferences multilaterally was limited by IOSCO's governance structure – despite the US-sponsored Strategic Assessment – and by the opposition of EU member-states. The SEC was also distracted by domestic institutional competition, exacerbated by regulatory scandals and market events. As a result, the SEC found its multilateral regulatory objectives frustrated and its international authority constrained. These circumstances encouraged the agency to emphasise a bilateral regulatory harmonisation strategy built on domestic regulatory initiatives and standards. Finally, this analysis focuses attention on EU member-states' progressive disillusionment with the IOSCO negotiations and their prioritisation of a regional, rather than an international, regulatory precedent.

In the IOSCO case, authority did not migrate away from state institutions or actors. A synthetic analysis contributes significantly to this conclusion, because it identifies the interaction of the multiple reasons behind state dominance in policy-formation. Most importantly, it identifies the reasons for IOSCO's weak governance, as well as the bases for Breeden's unique independence and authority over international capital harmonisation initiatives. Conflicting state preferences, influenced by domestic and supranational considerations, brought about the collapse of the IOSCO negotiations.

If we did not examine non-state variables, would our interpretation of state predominance in policy-formation change? Our identification of state predominance and fundamental preferences would remain the same, but our understanding of policy formation would be very different. If we only examine state-centric variables, we are presented with a static portrait of policy formation based on power – the US's market power enabling it to stymie IOSCO's negotiations and balanced EU member-state power leading to regulatory compromises. These two-dimensional portraits do not provide insight into the dynamic process of the negotiations, into the roles of non-state actors in shaping state preferences and decisions, nor into how various actors (public and private) operated across levels of authority and propelled the negotiations forward.

Conversely, would a conventional non-state centric analysis change our interpretation of state predominance? The answer is again yes. While a non-state centric analysis focuses on the important role of non-state influence in state decision-making, this thesis has argued that a critical element in assessing policy formation is the identification of fundamental state preferences. These preferences determine whether non-state preferences are, or are not, acceptable to state decision-makers. International policy outcomes hinge on this relationship between state and non-state preferences.

We can now answer the central theoretical question: "What is the best way to understand both the exercise of authority and the resulting patterns of securities market governance across levels of analysis and a range of actors?" A synthetic approach, combining observations developed by a range of perspectives, provides a comprehensive appreciation of the factors influencing international policy-formation. More importantly, a synthetic approach reveals how these factors interrelate in policy-formation. This analysis also highlights the limitations of individual perspectives and facilitates weighing the significance of each perspective's contribution. These observations steer empirical analysis away from a focus on the location of authority to such broader questions as: "How is authority constituted?" and "How does it operate?", probing more deeply into the nature of authority and influence.[34]

This thesis has argued that state preferences were not shaped predominantly by state-centric considerations of power or market failure. Rather, they were based on the interaction of politically and economically important domestic institutional structures on larger state objectives. These structures are identified by state and non-state centric approaches.[35] Their importance to the state is revealed through analysis that identifies fundamental state motivations, combined with analysis of the dynamic interaction of

[34] For a longer discussion of authority see: Cutler, Haufler, and Porter, *Private Authority and International Affairs*.

[35] Domestic and bargaining approaches represent a middle-ground on the analytical continuum between state and non-state centric theoretical extremes. Structures are identified by these approaches as well as by state/market and integration perspectives. Consequently, analysis based on identification of critical structures and fundamental state preferences operates most effectively by combining these approaches in synthetic analysis.

state and non-state variables in policy formation. This is the essence of synthetic analysis. It leads to a conclusion that synthetic examination of state and non-state actor and institutional preferences is critical to understanding the structure of authority and influence.

As we have seen, synthetic analysis can modify our interpretation of authority and influence in policy formation. It also identifies why and where non-state actors and institutions have influence. In the case studies, the influence of non-state actors was exercised through their expertise and their economic significance, through their role in the achievement of state objectives, through proposing compromises or explaining the consequences of policy options, and through clarifying technical issues.[36] Analysis of non-state actors and institutions shows how domestic structures inform and influence state preferences, how policy networks operate in propelling negotiations, and how variables operate across levels of authority.[37]

Influence and authority

The conflation of authority and influence by state/market theorists benefits from an amended analytical approach. The objective is to identify the contours of authority and influence in policy-formation. Conflating authority and influence obscures the relationship between legitimate, formal authority and other sources of influence.

As argued in Chapter 3, narrowly defining authority as explicit and formal allows it to be treated as simply one form of influence over policy formation. This approach distinguishes authority from other potential sources of influence, including context-based expertise, which may be expressed by either public or private actors. As an example, the

[36] UK objectives for the Euromarkets (driven by status and revenue considerations) were supported by the domestic private sector, German public/private institutional relationships (vital to reconstruction and Germany's role in Europe) were preserved by shared level playing field objectives, French *dirigisme* resisted wholesale changes to domestic market practices and met limited resistance domestically. These domestic structures were important to the vitality of state and non-state actors and institutions. As a consequence, state arguments and decisions made in international forums were strengthened by their being supported by both state and non-state actors' objectives. This gave national negotiators the flexibility and negotiating leverage to resist disadvantageous compromise proposals. They could defer decisions and not risk debilitating domestic dissension. The interrelationship of domestic and state objectives is only revealed by synthetic analysis.

[37] State/market approaches point us in this analytic direction. However, their lack of precision hampers identification of critical variables. Integration approaches are more precise, but do not seek to synthesise perspectives.

Patronat had context-based legitimacy and therefore influence, but it did not have explicit authority. French state negotiators, evidently persuaded by the *Patronat's* ISD arguments, changed their position in the intergovernmental ISD debates. However, only the French government had the formal authority to approve a change in policy. More importantly, it was the French government that negotiated how the policy change would be reflected in the ISD. The change in French government policy was only one issue in larger ISD debates that were not influenced by the *Patronat*. Influence may be expressed by state and non-state agents in various forms. Distinguishing among these forms is important in understanding dynamic policy-formation.

Influence may be expressed by public, private or supranational agents and institutions and may take various forms, ranging from brute force to specialised knowledge. The conflation of authority and influence inhibits discrimination among sources and types of influence. More importantly, conflation distracts attention from the *process* of policy-formation, during which different sources of influence are identified. A process-oriented synthetic analysis enables us to identify which type of influence appears at different points in a negotiation and why.[38] For example, EU institutions, demonstrating their formal authority, established the 1992 goals. This was the only way these negotiations could be started, as the private securities sector had little interest (or authority) in harmonising their lightly regulated industry. State negotiators, through a combination of influence (persuasion/negotiation) and formal authority, negotiated the language of the directives. On technical issues, private actors influenced the negotiations by providing context-based expertise. But compromises were devised predominantly by actors and institutions with formal authority. Finally, the directives were adopted by states through the Council and Parliament. This brief summary delineates the different forms of influence and authority that helped bring the directives to conclusion.

The IOSCO case demonstrates little formal authority but significant influence. As in the EU negotiations, the IOSCO deliberations were initiated by states. However, IOSCO's structure and policy-making procedures undermined states' negotiating effectiveness and the authority (formal or otherwise) of the policy-formation process. EU member-states, influenced by European commitments and the Basle Committee, turned away from IOSCO. The SEC used its formal authority (bilateral treaties and MOUs),

[38] A related point is made in Odell, *Negotiating the World Economy*, 2000.

abetted by informal influences (attractive domestic markets, domestic political concerns, and Breeden's regulatory views), to undermine IOSCO's efforts.

EU integration perspectives

As discussed earlier, EU integration perspectives are presented as *sui generis* to EU research. Although the EU's structure and authority are, of course, *sui generis*, integration perspectives are useful in non-EU contexts, particularly for identifying empirical anomalies. Precursors to EU integration perspectives are located in the non-EU research of Moravcsik and Milner;[39] the early work of Katzenstein,[40] Gourevitch[41] and Zysman,[42] emphasising the comparative significance of domestic economic structures in shaping national responses to external stimuli; in Haas's work on epistemic communities; and in Keohane's work on institutions. These scholars' arguments were foreshadowed by Polanyi's emphasis on the close connection between markets and states.[43] In this sense, EU integration analyses, while obviously stimulated by the development of unique, powerful EU institutions, represent an extension of core analytical principles that originated in traditional IR/IPE studies. These approaches reflect "shared conceptual assumptions."[44] While they depart from structural assumptions, they represent a logical intellectual evolution when examined against the continuum of analytical perspectives. What distinguishes these research perspectives is their goal of combining domestic and international observations and the degree to which non-state actors are deemed influential.

MLG, new institutionalism and network perspectives provide direction to critical observations in both the EU and IOSCO cases, highlighting a basic but important difference between them; private sector and multilateral influence are prominent in the

---

[39] Milner, *Resisting Protectionism.*
[40] Katzenstein, *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States.*
[41] P Gourevitch, *Politics in Hard Times* (Ithaca: Cornell University Press, 1986).
Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics."
[42] John Zysman, *Governments, Markets and Growth* (Ithaca: Cornell University Press, 1983).
[43] K. Polanyi, *The Great Transformation* (Boston: Beacon Press, 1944). Noted in G.R.D. Underhill, "Conceptualizing the Changing Global Order," in *Political Economy and the Changing Global Order, 2nd ed.*, eds. Richard Stubbs and G.R.D. Underhill (Oxford: Oxford University Press, 2000).
[44] Political and economic domains are indivisible, economic structures are constructed and changed through political activity, and domestic and international levels of analysis are analytically indissoluble. Ibid., G.R.D. Underhill, "Conceptualizing the Changing Global Order," in *Political Economy and the Changing Global Order, 2nd ed.*. See also: Majone, "Cross-National Sources of Regulatory Policymaking in Europe and the United States."

EU negotiations but are absent from the IOSCO case.[45] Influence arises from three levels of governance/analysis in the EU case, but from only one level in the IOSCO case – an important observation inviting further investigation.

Another potential application for EU integration perspectives can be seen in the interaction of national agencies and private actors with supranational bodies such as the EU, the Basle Committee and the WTO. Research into the development of a transnational "market-polity,"[46] analogous to EU integration theory's "Euro-polity," could prove useful in further assessing theoretical predictions of regulatory convergence. This thesis' observation that US and UK investment banks lobbied state and supranational actors in favour of Euromarket preferences indicates potential support for this contention.

Complexity

As discussed above under "State-centric versus non-state centric perspectives" and under "Synthetic analysis," the complexity of non-state centric perspectives and synthetic analysis is justified by each perspective's ability to highlight limitations in narrower perspectives and to identify new relationships from empirical data.

The Basle Committee

Three institutions carried out capital harmonisation discussions: IOSCO, the EU and the Basle Committee. This section considers the significance for the EU and IOSCO of the Basle Committee's parallel discussions.

Given modest differences between the capital recommendations of the EU and the Basle Committee, and given the ultimate failure of the CAD and ISD directives,[47] it is useful to assess the Basle Committee's influence on EU deliberations. As described earlier, the EU and the Basle Committee differed significantly.[48] The Basle Committee's

[45] EU integration approaches cannot always be applied to non-EU case studies. MLG does not operate well in the IOSCO case as IOSCO lacked authority. However, MLG does highlight this observation.
[46] Comprised of private market actors sharing market, rather than state-based, preferences.
[47] See Appendix B. CAD 2 was initiated in 1995/96 when universal adoption of the original CAD failed. A CAD 3 is under development.
[48] See Chapter 6. Unlike the EU, the Basle Committee did not face time pressure, have a SEA/QMV incentive or a powerful institutional bureaucracy. The Committee's process was also less adversarial. Most

international stature and the successful implementation of the Basle Accord gave its policy formation processes superior authority, legitimacy and influence. Consequently, I have argued that the Committee's research initially incentivised the EU to establish its own capital precedent to influence the Committee's work. Ultimately however, the Committee's recommendations superseded the EU's precedent. Because EU member-states were aware that the Committee's pending regulatory release would supersede their own directives, the Committee's work encouraged EU member-states to adopt politically expedient "interim" compromise resolutions to CAD and ISD conflicts in order to meet 1992 objectives and in order to move on to more pressing Maastricht issues.

The general alignment of the EU and Basle Committee on capitalisation temporarily marginalised both IOSCO and the SEC.[49] Corrigan and Breeden differed over capitalisation, but Corrigan never publicly criticised the SEC.[50] After Breeden left the SEC, and after the IOSCO negotiations collapsed, both the SEC[51] and IOSCO began to align their work and their views more closely with the Basle Committee. This confirmed the seniority of the Basle Committee in international policy formation.

Research implications

The findings of this study suggest that research approaches should expand the number of variables assessed and incorporate observations from multiple perspectives. The continuum of factors affecting regulatory development should be viewed as interrelated rather than static or hierarchical. Policy-formation should be understood as a process, occurring and evolving across the spectrum between completion and failure, not as a binary outcome.

---

importantly, the Committee was comprised of senior central bankers, who, together with Finance or Treasury Secretaries, represented senior state financial services regulatory authority. EU member-state representatives to CAD and ISD discussions were generally securities market regulators or exchange representatives.

[49] The SEC's marginalisation was rapidly redressed when Breeden left the SEC in 1993 and was replaced by Arthur Levitt.

[50] He was constrained by the awkwardness of an apolitical FRBNY President (and Basle Committee Chairman) criticising the views of an SEC Chairman. Breeden indirectly criticised the Basle Committee by opposing EU member-states' perspectives on capitalisation. There is also speculation that Corrigan felt the EU might be going too far in its capital adequacy proposals. Source: Confidential interviews. New York, April 2000. Corrigan supported tougher capital rules than ultimately proposed by the EU. Corrigan and Breeden's "stress test" of the CAD, while criticised as flawed, may also have influenced Corrigan's preferences - even though the Committee's views on capitalisation closely paralleled the EU's. See Appendices.

[51] Under a new Chairman, Arthur Levitt.

The case studies reflect unique circumstances and this thesis' arguments should not be generalised without corroborating research. The governance structure of IOSCO, the exceptional conditions of the SEC's domestic and international authority, and the unique weaknesses of private actors in the US preclude using the IOSCO case study to generalise about the location of authority. In fact, following the conclusion of IOSCO's discussions, private actor authority increased, although in different venues.[52]

The EU case is exceptional as well. The compromises that characterised the resolution of EU policy deliberations were influenced by one-time events (states' commitment to the 1992 deadline and the competing importance of the Maastricht vote) as well as by the interaction of state and non-state authority. It would be important to compare conclusions from this case study with case studies unaffected by significant one-time events.

To test these findings, dynamic comparative analysis of rule-making over time is recommended. Research studies should examine international policy-formation over a range of international and regional harmonisation issues, including capital adequacy. Authority could be examined from different analytical perspectives and evidence compared. This would be a constructive addition to the debate between "British" and "American" approaches to IR and IPE.[53] Recent IPE scholarship has evidenced increasing use of multiple analytical perspectives, which could be expanded to assess their comparative analytic utility.[54]

Broader Considerations

The Basle Committee defined a fixed international capital standard for universal/commercial banks with the 1988 Basle Capital Accord. Those standards are now being modified to a hybrid form determined by market and institutional standards. Is this due to a decline in the authority of supranational or state regulatory institutions?

---

[52] See below and Appendix B.
[53] See: D.W. Miller, "Storming the Palace in Political Science," *The Chronicle of Higher Education*, September 21, 2001 for a discussion of the ongoing debate between theses two approaches to analysis.
[54] See, for example, Kapstein, *Governing the Global Economy: International Finance and the State.*, and Underhill, "Private Markets and Public Responsibility in a Global System: Conflict and Cooperation in Transnational Banking and Securities Regulation."

Or is it due to increasing market complexity and to the increasing velocity of change in financial markets? More specifically, did the creation of the private sector DPG confirm that regulators had been compelled to share regulatory responsibility with the private sector? A brief review of international regulatory harmonisation after 1992 will provide some answers.[55]

In the spring of 1993, the Basle Committee proposed tougher minimum capital standards for bank equity activities than had been included in the recently agreed CAD. In 1994, building on the DPG initiative supervised by the FRBNY, IOSCO and the Basle Committee released joint guidelines proposing the use of private proprietary VaR models for determining capitalisation for derivatives risk exposure.

Following the derivatives-associated collapse of Barings in 1995, national regulators and G-7 heads of state called for closer international regulatory cooperation, particularly between IOSCO and the Basle Committee. The Basle Committee and IOSCO continued to collaborate on derivatives, releasing joint reports in 1995 that formally endorsed VaR for risk management. Their recommendation was also endorsed by the DPG. Because the recommendation marked a clear advance over CAD technology, EU member-states delayed CAD implementation. By the January 1996 CAD adoption deadline, fewer than 50 percent of member-states had passed implementing legislation, and plans for a "CAD 2" were already in circulation. In 1998, the Basle Committee began work on "Basle II," a restructuring of the 1988 Capital Accord.[56] Five years later, neither the CAD, CAD 2 nor Basle II had been fully implemented – and a CAD 3 was under discussion.[57]

Two observations can be made. First, the development of the DPG and the endorsement of proprietary VaR risk models indicate that private actor influence is increasing over time. This does not, however, refute the predominance of state preferences in international policy-formation. States have insisted that they authorise VaR models used and the DPG was "supervised" by the FRBNY. But it does provide

[55] See also Appendix B.
[56] On top of revisions recommended in 1993 and 1995. It was still under development in 2003.
[57] As of August 2003, the SIA, the BBA and the London Investment Banking Association were complaining that proposed Basle II rules were "too complex and prescriptive" and would "seriously undermine liquidity in the capital markets." See: Pretzlik, Charles, "Basle II 'could damage banks' capital market liquidity, *Financial Times*, August 10, 2003.

support for the observation of state/market and EU integration theorists that authority is expanding.

Second, the EU's original CAD was inflexible, unable to adapt to market and institutional developments. The CAD's rigidity, combined with protracted regional harmonisation processes, exposed the directive to rapid obsolescence, encouraged in part by the Basle Committee and in part by the development of VaR models. A major rationale for EU regulatory harmonisation had been that it would increase the EU's international negotiating leverage. This strategy was only partially successful with respect to the CAD. Moreover, the glacial pace of other supranational regulatory harmonisation discussions confirms that the EU's CAD experience was not unique. This leads us back to the familiar hypothesis that traditional regulatory models and developmental processes, whether regional or supranational, cannot keep pace with rapidly changing markets. This hypothesis questions the continuing utility of the EU's original regulatory principles and the general feasibility of developing detailed harmonised regulatory standards for market-driven institutions.

One may well also ask whether full regional or international regulatory harmonisation is possible. This prompts a related question, "Can EU identification ever replace national identification?" The answer to both, based on evidence from the case studies, is a qualified no. National preferences were held so strongly that, in order to resolve disagreements, derogations and compromises preserving national distinctiveness were necessary. The directives were subject to national implementation, and more than half the member-states failed to meet the 1996 implementation deadline. Threats of fines were ineffective. The character of national implementation also varied, with "super-equivalent" measures implemented in some countries.[58] This points us to the basic impediment facing any regional or international harmonisation initiative; states are reluctant to alter embedded national commercial practices and structures, particularly when they are tied to national political and economic structures.

Nevertheless, the SEM, the Maastricht Treaty, the Euro, and the European central bank initiatives all indicate that regionalisation objectives can be achieved.[59] But if this is

[58] This reflected domestic opinion the CAD was inadequate. This was notably the case in the UK.
[59] This listing ignores, of course, other successful harmonisation initiatives outside the EU.

true, is it sufficient to say that securities regulations are difficult to harmonise simply because national structures resist change?[60] Or does the answer lie in the intensely competitive nature of financial services, in the rapidity of technological and product change in this industry, in its unceasing search for regulatory arbitrage, and even in the attractiveness of the industry to ambitious, intellectually aggressive, and entrepreneurial individuals? These are, of course, issues for further study.[61]

In highly technical areas such as financial services, trade and environmental regulation, there are aggressive advocates for transferring regulatory responsibility from the state to the "marketplace."[62] Market-driven regulatory solutions assume that private economic and commercial considerations outweigh public goods concerns in resolving issues involving an uneven allocation of benefits. This assumption, which prioritises competition in regulatory development, is both naïve and dangerous. Market-driven regulation has proven inadequate to meet the challenge of balancing the public good with private interests, notably in financial services, on numerous occasions.[63]

This returns us to the question of whether market globalisation has eroded the ability of states to regulate markets and financial institutions. When financial stability –

[60] The EU more closely resembles a federal state, albeit a loose and decentralised one, than it does an international one. The reconciliation of national preferences through compromise encourages analogising EU regulatory harmonisation to a *federal* (US or Canadian) legislative process rather than to an international negotiation. In a federal system, divergent state views are accommodated to preserve commitments and unity. Dissimilar views are rarely excluded. Conversely, the IOSCO process reflected an *international* negotiation in two important, respects: negotiating states could disagree and not risk fatally damaging inter-state relationships or domestic markets and, second, one negotiating state with sufficient structural power and domestic support could veto cooperation.

[61] In 2001, Alexandre Lamfalussy proposed a system of "committees and consultation" to accelerate development of EU securities legislation, but he did not recommend the creation of a pan-European securities supervisor The idea was championed by the French but opposed by the British. Lamfalussy's proposals accelerated development of new EU securities laws covering market abuse, prospectuses and investment services. Why? A regional securities supervisor would need pan-European enforcement powers, along with common civil and criminal laws, which currently do not exist for the EU. Their creation would require radically re-shaping existing national securities regulatory regimes, which is the issue that nearly scuttled the CAD and ISD. Although not recommended by Lamfalussy, debate about a possible pan-European securities supervisor has sparked concern, mainly in Britain, over "creeping EU federalism" and potential loss of national sovereignty and autonomy. It has also prompted the City to propose the British FSA as an alternative EU regulator. Domestic economic and regulatory structures continue to be impediments to the development of a more "federal" EU and to the development of harmonised regulation. See: "Trojan Horses," *The Economist*, February 13, 2003.

[62] See the 2002/3 debates within the administration of US President Bush over environmental legislation. Katherine Q. Seelye, "A Spectrum of Color-Coded Choices for the White House's E.P.A. Nominee," *The New York Times*, 26 May 2003.

[63] As noted earlier, scandals in financial services regularly appear in such lightly regulated areas as new products. Junk bonds and highly leveraged financing in the 1980s, derivatives in the late 1990s, and the collapse of the corporate finance/equity research "Chinese Wall" in the US early in the 21st century, all reflect the inability of the "market" to regulate financial services efficiently, fairly, or in the public interest.

domestic or international – is threatened, states intercede and encourage a move to greater regulation, redressing problems that are frequently market-driven (that is, private-sector in origin).[64] States address market crises predominantly on an *ad hoc* basis: through bilateral agreements; through state sponsored organisations such as the DPG; and through spontaneous coordinated efforts such as the bailout of LTCB and the resolution of the Asian financial crisis of the late 1990s.[65] These initiatives are often carried out in collaboration with the private sector and multilateral institutions. Thus, from an empirical perspective, regulatory responses to market evolution and to market crises continue to require the involvement primarily of state and secondarily of non-state actors.[66] Several interesting questions arise from this observation. What criteria do states use to determine when they will be involved in international policy development and when they can leave policy development to the private sector? Also, why are some issues resolved by states and some issues shifted to multilateral institutions?[67]

These questions focus attention on the policy-formation capabilities of multilateral, state and private actors, in particular on their respective incentives, strengths and weaknesses. Because each level is significant in resolving market issues, they need to be considered jointly when assessing international policy formation.

Looking forward

Based on the case studies and a review of international regulatory harmonisation after 1992,[68] several comments are ventured concerning the structure of future market

[64] In the US, the New York State Attorney General, Elliot Spitzer, moved aggressively to investigate and penalise financial institutions for equity sale and research irregularities in 2002/3. In response to the same concerns, the US Congress passed the Sarbanes-Oxley Bill, which dramatically increased accounting disclosure obligations for corporations filing financial statements in the US and penalties for failure to comply. Internationally, the Asian financial crisis of 1997 is an example of states being forced to address market failure.

[65] See generally: Thomas Oatley, "The Dilemmas of International Financial Regulation," *Regulation* 23, no. 4 (2000).

[66] The critical involvement of national and supranational regulators in the resolution of the Asian financial crisis, the re-building of Russian and Eastern European economies, the resolution of the Long-Term Capital Management crisis, the more recent Enron, Global Crossing, Tyco and accounting supervision issues – all confirm the thesis that state and multilateral regulators remain critical in regulatory application, development and crisis management.

[67] Thomas Oatley argues that national political and commercial incentives lie behind international policy-formation. States, unwilling to tackle distributional disagreements among domestic institutions (raised by arbitrage or related issues), push the process of resolution into the international arena. Oatley, "The Dilemmas of International Financial Regulation,".

[68] See Appendix B for a detailed description of the evolution of regulation and regulatory institutions after 1993.

regulation. Continued market growth and intensified competition will compel regulators to rely increasingly on a mixture of formal (state and supranational) and market regulation and supervision. Both forms of regulation have encouraged greater institutional, transactional and supervisory transparency as well as market-based regulation. These developments acknowledge that financial markets have, at least recently, outstripped the ability of static formal regulation to track trading activity, portfolio risk or to expeditiously address new product developments. It also indicates that distinctive national economic and commercial structures continue to impede international harmonisation. To address the limitations of formal regulation and the constraints of national structures, regulators are attempting to shift more of the responsibility for risk mitigation onto the marketplace. But it is not yet clear how regulatory leadership will be determined nor which areas will be subject to greater market or statutory regulation.[69]

IOSCO addressed its structural weaknesses in two ways: by working jointly with the Basle Committee to enhance its regulatory influence and by narrowly addressing technical securities issues. But IOSCO has never achieved the stature Richard Breeden hoped it would acquire when he recommended a strategic assessment in 1989. Considering the increasing market dominance of universal banks, IOSCO's future regulatory role will be increasingly dependent on the scope of the Basle Committee's work.
The Basle Committee remains the "senior" multilateral regulatory organisation, despite the fact that its public review processes have delayed international policy formation. (The composition of the Basle Committee is, however, considered illegitimate in Asia, where it is perceived as a narrowly Western body - an observation reinforced by the recent accession of Spain. (Comment from Dr. A.R. Walter, November 2002)). Delays have arisen from difficulties in accommodating changes in technology and product markets, as well as in organisational and governance preferences. Delays have also resulted from the Committee's effort to address legitimacy and democratic deficit concerns raised by its policy formation processes and membership. (As noted earlier, the Basle Committee's authority and influence derive largely from its small, powerful membership. This raises legitimacy and democratic deficit concerns with the Committee's recommendations. Research has noted the potentially undemocratic nature of supranational rule-making processes. However, the broad acceptance of Basle Committee recommendations indicates that legitimacy concerns are minimal. This may be a result of the Committee's policy development processes, which avoid regulatory regimes dominated by private or narrowly national interests. This observation should be examined by focusing on regulatory development over time. Increasingly, the Basle Committee's developmental work involves collaboration with other public and private regulatory forums including IOSCO, the IASC, the DPG and the IIF. Since the 1988 Capital Accord, the Committee has consistently sought and incorporated private sector opinion on draft recommendations. This is reflected in a 1995 Committee proposal to include a private supervisory option and in the Basle II exercise.
For recent Basle Committee research see: Kapstein, *Governing the Global Economy: International Finance and the State.*, Oatley and Nabors, "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord.", and Richards, "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets."

[69] Market evolution will continue to provide opportunities for regulatory arbitrage and risk-taking, leading to new market crises. The rapidity of market change and crisis development, and the slow pace of supranational regulatory deliberations, will confine supranational institutions to making general supervisory policy recommendations. This leaves large transnational markets, such as the foreign exchange market, subject predominantly to market-based regulation. But financial institutions will remain subject predominantly to national regulation. As a consequence (and as Richard Breeden surmised), it is probable that the quality of national regulation will influence the competitiveness of financial institutions. Rather than a race to the regulatory bottom, market competition should encourage migration to a regulatory middle ground dominated by standards set by the US and Euro markets. This is, however, not an immediate prospect as markets remain nationally differentiated. Nevertheless, as long as solvent financial institutions and open markets represent quasi-public goods, states, not the private sector, will lead in crisis

The ongoing Basle II exercise contemplates a combination of market and supervisory regulation.[70] However, by vesting aspects of regulatory responsibility with market practitioners, national supervisors potentially decrease accountability and regulatory legitimacy.[71] This may create further problems. While the financial services industry is sensitive to maintaining the public's confidence, the equity market run-up and collapse of the 1990s revealed that avarice continues to outweigh prudence in private sector decision-making. Over the same period, we witnessed the commercial and economic failures of institutions and states through financial mismanagement and malfeasance.

To monitor the public interest and to anticipate and respond to future crises, international and national regulators must maintain a predominant presence in regulatory evolution and market supervision. More importantly, the ability of regulators to supervise and monitor markets and institutions must continue to be enhanced, even as markets strive to diminish the supervisory capacity of states. To provide guidance to market actors and institutions, formal regulation should continue to increase market transparency and to simplify rules and regulations by establishing regulatory paradigms and parameters, rather than hard and fast rules. These objectives may be augmented through the greater formalisation of procedures to address market crises and by identifying institutions that would take leadership roles in a crisis.

---

resolution and in regulatory development; through moral suasion, through policy-formation, through intergovernmental actions, and through direct intervention For a longer discussion see: Pauly, *Who Elected the Bankers?* and Andrew Large, "The Future of Global Regulation," (Washington, D.C.: Group of Thirty, 1998).

[70] Charles Taylor argues the Basel II exercise will "create major problems," by increasing supervisory costs, exaggerating negative effects of business downturns and stimulating herd behaviours among banks. He suggests a simpler approach involving banks selecting a capital threshold and regulators imposing a second, "loss" threshold equal to capital multiplied by a loss parameter, which would constrain the amount of risk a bank could incur. His approach simplifies the 1,000+ page Basle II proposal - still in development - and may pre-empt Basle III, which has threatened to follow Basle II. See: http://www.csfi.org.uk and www.bis.org.

[71] Ironically, it also reposes an apparently unwelcome increase in supervisory responsibility on the private sector. When early drafts of Basle II were circulated, banks and, in particular, rating agencies, complained, not about transparency but about delegated regulatory responsibility, preferring regulatory authority remain (primarily) with the public sector. It may also argue for a supervisory formulation that applies different standards to firms' institutional and individual relationships, i.e., functional regulation, applying high, statutory standards to individual accounts, hybrid market/statutory standards to institutional accounts, and some mixture for an institution's own trading account – which increasingly represents a large portion of overall trading. This may allow financial services firms to combine profit objectives and the provision of public goods under one roof.

These steps would help avoid conflicts and redundant initiatives between *ad hoc* state crisis management agencies, public/private partnerships such as the DPG, and multilateral organisations. To enhance international regulatory capabilities, it will be useful to establish clear lines of regulatory demarcation between retail and institutional markets, to concentrate resources on the protection of less sophisticated capital market participants. Regulatory clarity, continuous supervision, and transactional transparency are the only available mechanisms for the detection of problems before they become crises. Finally, firms and their senior managements must be held accountable for institutional and personal failures to fulfil supervisory responsibilities.[72]

It would be a mistake for states to transfer a majority – much less all – of their supervisory responsibilities to the marketplace. The case studies show that states initiate, structure, and establish critical regulatory standards. Private expertise is essential in developing effective regulatory standards, but private firms promote their own interests over those of the state. Only states can be held accountable for the protection of the public interest.

[72] A salient case in point is the series of legal actions brought by New York State Attorney General Elliot Spitzer in 2002/2003 against Wall Street firms for their failure to adequately supervise conflicts of interest between equity research analysts and bankers from the same institutions. While these actions resulted in steep fines being levied against several firms, only modest penalties were levied against the offending firms' senior managers.

Appendix A

EU Integration Theory – A Brief History

"Regional integration theory," a significant field of IR theory and research during the 1960s and 1970s, focused principally on the EEC. Its leading advocates; Ernst Haas,[1] Leon Lindberg, and Stanley Hoffmann,[2] built their research in part on David Mitrany's research into informal bases of world confederation and governance.[3] Regional integration perspectives examined state institutions to understand the development of international authority. These theorists argued that international institutions were promoted by domestic groups and developed initially in functional and technical areas. Their accomplishments created momentum,[4] which encouraged the wider adoption of successful governance procedures. Despite its analytical attractiveness, shortly after 1970 Haas concluded that international developments and inherent theoretical biases precluded pursuing "functionalist"[5] integration theory further.[6] As the theory faded,

---

[1] E. Haas, *Beyond the Nation-State: Functionalism and International Organization* (Stanford: Stanford University Press, 1964).
E. Haas and P. Schmitter, "Economics and Differential Patterns of Political Integration: Projections About Unity in Latin America," in *International Political Communities: An Anthology* (New York: Doubleday, 1966)., and Ernst B. Haas, *The Uniting of Europe: Political, Social, and Economical Forces, 1950-1957, Library of World Affairs, No. 42* (London: Stevens, 1958).
[2] See: Karl Deutsch, et. al., *Political Community and the North Atlantic Area* (Princeton: Princeton University Press, 1957)., S. Hoffmann, "Obstinate or Obsolete? The Fate of the Nation-State and the Case of Western Europe," *Daedalus* 95, no. 3 (1966)., L. Lindberg, "Decision-Making and Integration in the European Community," *International Organization* 19, no. Winter (1965)., L. Lindberg, *The Political Dynamics of European Economic Integration* (Stanford: Stanford University Press, 1963)., Joseph S. Nye, Jr., "Comparative Regional Integration: Concepts and Measurement," *International Organization* XXII (1968)., and D. Puchala, "Of Blind Men , Elephants, and International Integration," *Journal of Common Market Studies* 10, no. 3 (1972).
[3] David Mitrany, *A Working Peace System* (1943).
[4] Referred to as "spill-over" effects.
[5] Termed "neo-functionalism" and "institutionalism" after 1985.
[6] Haas' approach had been attacked for normative content and inability to consistently predict the consequences or causes of regional integration. See: E. Haas, "Turbulent Fields and the Theory of Regional Integration," *International Organization* 30, no. 2 (1976).

interdependence,[7] regime[8] and neo-corporatist[9] perspectives, all, in part, outgrowths of functionalism, occupied scholars' attention – together with neo-realist and intergovernmentalist perspectives. With state-centric research predominant, focus on domestic, private or supranational sources of authority and governance waned.

In 1977, Webb criticised intergovernmentalist approaches for denying "the uniqueness of the EU as a framework for international cooperation...it (intergovernmentalism) denies that the national political and economic systems of Europe are so interdependent and so penetrated by the Communities that the governments cease to be the sole arbiters of their country's external future(s)...."[10] Despite Webb's critique, functionalist approaches did not regain favour until the mid-1980s.

The mid-1980s adoption of the Single European Act ("SEA") and the Treaty on Political Union ("TPU") re-kindled scholarly interest in Haas' ideas. These political developments blurred distinctions between domestic and international politics by empowering regional institutions and actors and stimulated research into the composition of EU member-states' sovereignty and autonomy. Scholarly consideration of both intergovernmentalist and neo-functionalist perspectives increased as the EU expanded regional decision-making authority, confirming its readiness to migrate authority from member-states to EU institutions. Research focused on specific topics,[11] in particular agreements (including the SEA and TPU[12]) that addressed the distribution of authority

[7] Keohane and Nye, *Power and Interdependence: World Politics in Transition.*
[8] John Gerard Ruggie, "International Responses to Technology. Concepts and Trends," *International Organization* 29, no. 4 (1975).
[9] P. Schmitter, "Still the Century of Corporatism?," *Review of Politics,* 36, no. 1 (1974).
[10] C. Webb, "Introduction: Variations on a Theoretical Theme," in *Policy-Making in the EC*, eds. C. Webb, et. al. (London: Wiley and Sons, 1977)., p.17, in J. Haaland-Matlary, "What Is Integration Theory, and Do We Need It?" (1994).
[11] These case studies included telecommunications, energy, regional and technology policy, and environmental concerns. See: Gary Marks, "Structural Policy and Multi-Level Governance in the European Community," in *The State of the European Community*, ed. A.W. Cafruny and G Rosenthal (Boulder: Lynne Rienner, 1993)., J. Matlary, "The EC Policy-Making Process in the Field of Energy: An Analysis with a View to Norwegian Interests," in *Norwegian Gas in the New Europe*, ed. O. Austvik (Oslo: Vett og Viten, 1991)., Sandholtz, "Choosing Union: Monetary Politics and Maastricht,"., and M. Sharp, "The Community and New Technologies," in *The EC and the Challenge of the Future*, ed. J. Lodge (London: Pinter, 1989). See additional case studies in: Haaland-Matlary, "What Is Integration Theory, and Do We Need It?"
[12] Moravcsik, "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community.", J. Pinder, "The Single Market: A Step Towards European Union," in *The EC and the Challenge of the Future*, ed. J. Lodge (London: Pinter, 1989)., Sandholtz, "Choosing Union: Monetary

between member-states and EU institutions. The adoption of QMV procedures, the development of formal EU regional competencies,[13] and the agreement to proceed to monetary union differentiated these developments from increased integration in functional, "technical" fields by virtue of the transfer of member-state autonomy to the EU implicit, if not explicit, in these latter events.

Politics and Maastricht.", and P. Taylor, "The New Dynamics of EC Integration in the 1980s," in *The EC and the Challenge of the Future*, ed. J. Lodge (London: Pinter, 1989).

[13] In areas such as the environment.

Appendix B

What Happened After the Negotiations Stopped?

Introduction

The European Parliament's ratification of the CAD and ISD in the spring of 1993 coincided with IOSCO's decision to abandon its capital adequacy discussions. The EU's "success" and IOSCO's "failure" in their respective regulatory harmonisation efforts appeared unambiguous. However, we are aware this conclusion is inaccurate. This appendix addresses what happened to the CAD and ISD following Parliamentary ratification, IOSCO's subsequent attempts to develop harmonised regulatory standards, and the Basle Committee's subsequent harmonisation activities. This overview is not exhaustive. Rather, it is designed to address an important question, what happened after negotiations ceased and, more significantly, why? This will place the negotiations at the heart of this study into a larger context, will solidify observations regarding the "success" or "failure" of the negotiations, and will provide an insight into the impact of globalisation on regulatory evolution.

The EU's CAD and ISD, the subject of so much intense negotiation, were never fully implemented by the majority of member-state legislatures following Parliamentary ratification. Instead, shortly after ratification, the EU found itself in the awkward position of watching while the Basle Committee released regulatory capital proposals addressing equity market risk, the issue over which Richard Breeden and Leon Brittan had argued so vehemently, that made the EU's directives appear both outdated and overly restrictive. In 1994 discussion on the need for a revised CAD, "CAD-2," had already begun. By January 1, 1996, the deadline for implementation of the CAD and ISD, fewer than half of all EU member-states had adopted domestic implementation legislation. By 1996/97 formal discussions to amend the CAD had started.

Following the collapse of the IOSCO capital adequacy discussions in 1992, IOSCO's Technical Committee continued to actively publish research on regulatory issues arising from the globalisation of securities firms. However, IOSCO was not prepared to re-address the harmonisation of capital adequacy standards on its own. As a result, IOSCO's work immediately following 1992 generally focused on less sensitive issues - operational, disclosure and accounting concerns. IOSCO's efforts to influence regulatory harmonisation of capital adequacy standards and supervision were carried out on a joint basis, predominantly with the Basle Committee, but also including the IAIS. IOSCO and the Basle Committee began jointly issuing guidelines on risk management for OTC derivatives in 1994.

Events Refocus Harmonisation onto the Basle Committee

The first major blow to the EU's regulatory harmonisation achievements, as well as to IOSCO's efforts, was the April 1993 release by the Basle Committee of a consultative paper on equity market risk. The EU attempted to pressure the Basle Committee to produce a joint report but the Committee decided to move ahead on its own.[1] The paper was intended to establish common minimum capital levels for banks trading in equity securities. The proposal incorporated complex guidelines covering interest rate, foreign exchange and specific[2] risks in calculating required capital. Despite the proposal being patterned after the CAD's building block structure, it was criticised by bankers as potentially costly to implement and operate and as unreflective of market risks. The Basle Committee was unrepentant even though its proposal was also considerably tougher than the CAD. The Committee's new proposal came to be called the "standard approach" to market risk and capital adequacy.

Despite the proposal's provocative content, it also contained an olive branch aimed at IOSCO, "These proposals contain certain features which bank supervisors acting on their own would not necessarily favour but are prepared to adopt in the hope

[1] Filip Moerman, "Ruffles on the Level Playing Field," *Euromoney* November 1993.
[2] Specific risk is the risk that a specific stock's value will move out of line relative to similar market instruments.

that further convergence with securities regulators will be achieved at some future date. Thus, while the focus of the consultative process is the banking industry, the overall approach has been designed with a view toward its ultimate application to a wider spectrum of institutions."[3]

In 1994, the Basle Committee and IOSCO jointly released guidelines on risk management for OTC derivatives.[4] This represented one of the first joint reports issued by IOSCO and the Basle Committee. Shortly after the report was released an article published in *Institutional Investor*[5] magazine described new risk management techniques being developed by commercial banks. The most radical of these techniques was called "value-at-risk" or "VaR". Under VaR, required capital levels were correlated to the financial riskiness of the businesses a bank was engaged in based on measures of income volatility. JP Morgan and Bankers Trust, two large, US commercial banks aggressively pushing into investment banking, were said to be setting up internal VaR risk management systems because they found them to be accurate gauges of market and business risk.

This development was significant for two reasons. First, because it reflected the early application of internally developed risk management models. Second, because it presaged the evolution of international regulation over the 1990s to a hybrid model based on a mixture of market and statutory regulation.

In September 1994, the FRBNY, the Bank of Japan and several European central banks, in a follow-up to the IOSCO/Basle Committee report and to publicity surrounding internal risk models, asked several financial institutions active in derivatives markets to run a portfolio of approximately 300 derivative contracts through their proprietary VaR models to determine how closely the risk profiles generated by the models were to each other. If the risk profiles were close enough the Basle Committee would consider supporting VaR as an alternative to the "standard" market risk model it released in 1993. After the tests were run the Chairman of the Basle Committee, Tommaso Padoa-

[3] Basle Committee on Banking Supervision, "The Supervisory Treatment of Market Risks, Consultative Proposal," (Basle: April 1993).
[4] Basle Committee on Banking Supervision and Technical Committee of IOSCO, "Joint Report, Framework for Supervisory Information About Derivatives Activities," (Basle: May 1994).
[5] David Fairlamb, "High-Tech Capital Adequacy," *Institutional Investor* August 1994.

Schioppa, announced "The Committee decided the differences between the results of these tests were not too wide to make them unacceptable." Padoa-Schioppa went on to note, "It is unfeasible to oblige those sophisticated banks to stick with the standardised approach. No one model can be 'right' in this new, evolving field."[6]

These developments put institutions and regulators subject to the EU's CAD in an uncomfortable position. The evolving regulatory landscape clearly signalled the arrival of new risk management technology yet EU member-states had barely begun national implementation of the CAD, which was looking increasingly outdated. EU institutions faced the ugly prospect of being subject to both new and CAD standards. EU regulators had very little interest in reopening the CAD considering how difficult it had been to craft compromises in the first place. Added to this was regulators' improved appreciation of the nature of new market risks to which financial institutions were exposed, particularly in the field of derivatives. These complex risks encouraged centralised risk management programs, a development reflected in the radical decision taken by Germany's leading bank, Deutsche Bank, to move its investment banking headquarters to London from Frankfurt. The move reflected both the centralisation of risk management trading and supervision in London as well as London's attractive regulatory environment, which had evolved with market developments more rapidly than Germany's.

Further complicating directive adoption for EU institutions were two additional factors, distinctive national regulatory implementation regimes and delays in the implementation of the CAD.

The UK published domestic CAD implementation proposals in 1994 and, in an implicit criticism of the CAD, included many "super-equivalent"[7] items in their proposal. In response to subsequent industry complaints that UK markets would be over-regulated relative to their continental peers and that regulatory distortions were being created, the Bank of England and SFA modified their recommendations in final proposals released in 1995. Nevertheless, the final proposals contained super-equivalent provisions covering target and trigger capital ratios, the employment of internal risk models, equity position

---

[6] "Basle's Model for Success," *International Financial Review* 15/4/95.
[7] Meaning more stringent than required by the final directive.

risk, consolidation and the definition of trading books.[8] The discretion afforded UK (and other EU) authorities in the implementation of the CAD reinforced national regulatory distinctions rather than encouraging harmonisation. One scholar noted, "Competition among rules is itself seen as a necessary but regrettable consequence of the EU's inability to legislate full harmonisation."[9] The prospect loomed of each EU member-state implementing its own version of the CAD, encouraging, rather than inhibiting, regulatory arbitrage.

By mid-1995, Italy and Spain had implemented portions of the CAD. The UK had published guidelines. However, France, the Netherlands and Germany were behind on implementation. The reasons given for delays were numerous but perhaps summed up best by a UK banker who commented about the CAD, "it all looks terribly 1970s or 1980s."[10] The CAD's inflexibility, ambiguous language and lengthy implementation process, all designed to ensure member-states' agreement, appeared to be rapidly undermining its potential effectiveness. Calls for a "CAD-2" circulated in Brussels and EU financial capitals.

In early 1995, the Basle Committee and IOSCO had jointly issued guidelines on disclosure necessary to evaluate derivatives. In April the Basle Committee released amendments to its 1993 proposals for market risk. The amended proposal reflected a dramatic endorsement of VaR proprietary models for risk management. The proposal added an "internal models" approach to risk management to join the standard approach released in 1993. The new approach would allow banks, subject to certain conditions,[11] to use proprietary models to determine VaR in trading portfolios to calculate regulatory capital. Padoa-Schioppa declared the new proposal, "a profound innovation in the methods and philosophy of regulation."[12]

In June 1995, at a meeting in Halifax, Nova Scotia, the G-7 heads of government called for greater cooperation between the Basle Committee and IOSCO to avoid the

[8] Dale and Wolfe, "Capital Standards"., p. 244.
[9] Benn Steil, quoted in David Shirreff, "Regulatory Overload," *Euromoney* June 1995.
[10] Ibid.
[11] These included the bank meeting certain minimum qualitative risk management criteria and the bank using specified parameters to calculate VaR (10 day holding periods for calculation, 99% confidence levels).
[12] "Basle's Model for Success," *International Financial Review* 15/4/95.

rapid spread of financial problems. The G-7 request was stimulated primarily by the May 1995 collapse of Barings Bank, but also by well-publicised earlier contretemps between IOSCO and the Basle Committee. The Barings collapse had revealed huge gaps in communication between regulators and exchanges.

The Baring collapse prompted the May 1995 release of the Windsor Declaration, which urged greater international regulatory cooperation. The Declaration, issued by regulators from sixteen major futures and options markets, established agreed procedures for information sharing, emergency cooperation, defaults and investor protection.

A month after the release of the Basle Committee's amended market risk proposal, the Committee and IOSCO published a further joint derivatives report that detailed the collaboration between the two agencies on OTC derivatives regulation and included VaR as a regulatory option. Shortly afterward, the Derivatives Policy Group ("DPG")[13] announced it would endorse the Basle Committee's standards for derivatives, including VaR. IOSCO, asked for its formal opinion on VaR models, reserved judgement, stating that it would wait for the results of ongoing DPG studies. Subsequently however, IOSCO issued its own report on VaR models.[14] The release of IOSCO's report, combined with the observations that the firms comprising the DPG all actively employed internal risk models and were expected to endorse their usage, led to the conclusion that IOSCO had endorsed VaR models on a *de facto* basis.[15]

The Basle Committee's recognition of internal models represented an historic shift in the development of international regulatory standards. It reflected regulators' acknowledgement that market evolution was outpacing standard fixed regulatory models, which, in the future, would have to be supplemented by market-driven regulation rather than by regulation developed by state or supranational institutions.

[13] "DPG", See Glossary. The DPG was an *ad hoc* securities industry group established in 1994 to forestall formal regulatory intrusions into the derivatives industry by establishing "market" regulatory standards in conjunction with the FRBNY.
[14] IOSCO Technical Committee, "The Implications for Securities Regulators of the Increased Use of Value at Risk Models by Securities Firms," (Montreal: International Organization for Securities Commissions, July 13, 1995).
[15] Joseph J. Norton and Christopher D. Olive, "The Ongoing Process of Bank and Regulatory Supervisory Convergence: A New Regulatory-Market "Partnership"," *Annual Review of Banking Law* 16 (1997).

The revolutionary Basle Committee approach eliminated any semblance of a level regulatory playing field for EU institutions implementing the CAD. EU firms would be subject to the "old-fashioned" CAD while Japanese and American institutions would be subject to home country rules until the Basle Committee worked out final capital regulations. As the deadline for implementation of the CAD approached, it became clear that many member-states would not have implemented the directives by the deadline. The UK, Ireland and Belgium passed national laws on time, but France, Germany, Spain and Italy, among others, delayed implementation. As of December 1995, 10 EU member-states were behind schedule on CAD implementation and 8 were behind on the ISD. Embarrassingly, in January 1996, the same month the CAD and ISD were to take effect, the Basle Committee published its final capital standards for market risk for G-10 countries.

In July 1996, ISMA issued a report on the CAD that stated, "it would, perhaps, not be too unfair to compare the CAD to the castle built by the mad King Ludwig of Bavaria – newly built but to an antique design."[16] By April 1997, Germany, Spain and Luxembourg had still not implemented the CAD or the ISD and were being threatened with fines for their failure. An amended version of the CAD, CAD-2, which paralleled the Basle Committee's 1995 market risk proposal, was widely discussed. An interim amendment to the CAD, referred to as the Amsterdam Accord, was adopted in 1997. It permitted EU banks to use VaR models for the calculation of capital adequacy and limited a laborious required capital calculation to twice a year, but did not create significant capital savings for EU banks.

Despite the Basle Committee's endorsement of market risk management tools, the Basle Accord was itself considered overly rigid and out of date by market practitioners. It was accused of encouraging banks to take on higher levels of risk without commensurately increasing capital.[17] In June 1999 the Basle Committee released for comment a proposed new capital adequacy framework. The proposal was modified and substantially expanded in a second version released in January 2001. The proposal,

[16] "Getting closer," *The Economist*, May 25, 1996.

[17] Remarks by William J. McDonough, President of the FRBNY, before the 11th International Conference of Banking Supervisors (Basle, September 20, 2000), p. 8. Quoted in Eugene M. Katz, "The New Basle Capital Accord," *Bank Accounting & Finance*, (3/22/2001).

which is still under consideration, combines a minimum capital level, with both supervisory and market-based regulation.

Observations

The failure of even 50 percent of EU member-states to implement national legislation adopting the CAD by its January 1, 1996 deadline (or for several years afterward) underlines the difficulties in developing fixed harmonised regulatory standards. There were many reasons for the ISD's and the CAD's unpopularity. The directives, based on the 1988 Basle Accord, inflexibly preserved standards that were rapidly outstripped by market practices, new technology and other regulatory regimes. Additionally, the compromises negotiated into the directives allowed member-states to develop unique national implementation schemes that preserved national distinctiveness and encouraged regulatory arbitrage. For example, ISD Article 15.5 gave EU states the right to prohibit the creation of "new markets" within their territories. The Dutch used this provision to demand Dutch licensing of foreign screen-based trading systems providing remote access to the Amsterdam Stock Exchange. The demand was ultimately abandoned[18] but demonstrated the ambiguity of the article and that it could be used to inhibit other developments. Derogations to the directives' implementation targets created an uneven regulatory playing field even before the directives were ratified. Additionally, challenges to member-states over their failure to implement directives led to protracted legal battles that further impaired the directives' potential effectiveness.[19] The CAD's building block and trading book approach has also come under criticism for being unreflective of business risks. Despite functionally segregating trading and other assets for capital purposes, the risks to which corporations are exposed are not segregated. This makes the trading book concept "inappropriate" in accurately reflecting institutional financial risk.[20]

The ISD and CAD's drawbacks are functions of both their rigidity and their flexibility. Flexible compromises engineered to ensure adoption of the CAD and ISD undercut the directives' effectiveness by permitting delays and the preservation of distinctive national implementation regimes that encourage regulatory arbitrage. The

[18] In 1995.
[19] Steil, "Regional Financial Market Integration: Learning from the European Experience."
[20] Ibid.

directives' rigidity is reflected in the EU's difficulty in amending the directives despite their being made obsolete and inconsistent by Basle Committee actions. The directives' difficulties reflect the political process that led to their development. The EU's goal of regulatory harmonisation was substantially weakened by decisions to enshrine national preferences and to adhere to the objective of establishing fixed directives in an area that was rapidly evolving.

IOSCO's international regulatory influence has improved significantly as a consequence of its decision to work jointly with the Basle Committee – despite IOSCO remaining encumbered with governance mechanisms that inhibit the development of flexible, responsive market guidelines. The slow evolution of international financial services to a universal banking model will eventually confront international regulators with the decision of whether IOSCO should continue as a distinct intergovernmental regulator, should be folded into the Basle Committee, or should assume a different, perhaps strictly technical, role. The Basle Committee has indicated its willingness to enter regulatory discussions and make recommendations that affect IOSCO's constituencies. IOSCO's rigid governance procedures and wide membership make it difficult to develop international regulation on highly sensitive topics such as capital adequacy absent the imprimatur of the Basle Committee. The Basle deliberative procedures and senior stature have been more effective at producing harmonised international regulatory guidelines. It is also clear that on topics such as capital adequacy, the powerful Basle Committee is prepared to use its considerable prestige to advance its regulatory preferences, even at the cost of publicly disagreeing with the EU or IOSCO. Nevertheless, on a wide range of "lesser" topics, including disclosure, operational and technical issues, managerial issues and market manipulation, IOSCO continues to lead standards development for securities firms.

Appendix C

Decision-making in the European Community: The Single European Act and Qualified Majority Voting

A primary objective behind the adoption of the Single European Act (SEA") in 1986 was the completion of the Single Market by the deadline of December 31, 1992. The SEA[21] recognises the inertia that had characterised EU rule making prior to the Act's adoption. That inertia had been caused in large part by the requirement of unanimous approval by the EU Council of Ministers for the majority of EU legislation.[22] The SEA established that only qualified majority vote[23] was required for most issues associated with the development of the internal market.

The path to achievement of the Single Market was defined by the 1985 White Paper,[24] which detailed 300 discrete legislative steps necessary to achieve the internal market by the end of 1992. The EU functions as a supranational institution, capable of adopting legislation that binds its member states and their citizens by less that unanimous vote. The Council of European Communities (Council), the Commission of the European Communities (the Commission) and the European Parliament (the Parliament) develop EU legislation.

The Commission is responsible for representing the interests of the EU, as a discrete entity. As a result, the Commission's members are expected to consider the interests of the EU over their own national interests. The Council is comprised of

[21] *Single European Act*, O.J. (L 169), (July 1, 1987).
[22] A. Campbell, "The Single European Act and the Implications," *International & Comparative Law Quarterly* 35 (1986).
[23] A qualified majority vote in the SEA was defined as a minimum of 54 out of a possible 76 votes (71%) in the Council to approve a Commission proposal. The votes of member-states were accorded differing numerical weights, ensuring the interests of larger member states did not consistently dominate those of smaller states in voting on legislation. In the EC, the twelve member-states' votes were weighted as follows: Belgium (5), Denmark (3), France (10), Germany (10), Greece (5), the Republic of Ireland (3), Italy (10), Luxembourg (2), the Netherlands (5), Portugal (5), Spain (8), and the United Kingdom (10).
[24] See: *Completing the Internal Market*: White Paper from the Commission to the European Market, COM (85).

member state representatives who reflect the interests of their home jurisdictions. This sets up a tension between these institutions. This is reflected in debates over legislative proposals that promote EU regional interests at the expense of national interests or sovereignty.[25] The third party to EU legislation, the Parliament, has the smallest role in the formulation of EU rules. The role of the Parliament is advisory and consultative rather than legislative.

The SEA amended Article 100 of the EEC Treaty, which required unanimous voting in the Council. The amendment is broadly applicable, covering any "measures" adopted by the Council, not just directives. The EEC Treaty had provided for five different types of measures to be adopted by the Council and Commission: regulations, directives, decisions, recommendations and opinions. Regulations were binding on member-states and did not require national implementation. The other categories were increasing less binding. Directives were binding as to their objective but subject to national implementation. Interestingly, as of 1997 several member states had not yet implemented the ISD, which was originally adopted in 1992.

The Council and Commission more frequently adopted directives than regulations as they complemented the EU principle of mutual recognition, which was more flexible than the strict harmonisation implied by regulations. There are several mechanisms available to member-states in the event they do not want to adopt legislation but don't have sufficient votes to counter a qualified majority. These include citing the "Luxembourg Accord[26]" understanding that permits a member-state to veto legislation contrary to its vital national interests.

Legislation is developed through the interaction of the three legislative bodies, the Council, the Commission and the Parliament. The Commission can initiate and implement legislation. The Council, however, has the authority to make decisions. The Parliament advises and consults. The cooperation procedure mandated by the SEA is as follows:[27]

---

[25] Potter, "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward."

[26] Peter Sutherland, "The Dawn of a United Europe: An Introduction to 1992 and Beyond," *St. Louis University Public Law Review* 9 (1990). Cited in Potter.

[27] Adapted from Potter, "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward."

1. The Commission proposes legislation to the Council.
2. The Council forwards the proposal to Parliament, which adopts an opinion with regard to the proposed legislation.
3. The Parliament sends the proposal back to the Council, which may, by qualified majority vote, adopt a "common position" on the legislation. The Council explains the "common position" to Parliament.
4. If Parliament approves the common position within three months (or does nothing at all signifying disapproval), the Council will adopt the legislation as its common position. Alternatively, the Parliament may, by absolute majority, either reject or propose amendments to the Council's common position.
5. If Parliament rejects the legislation, the Council must vote unanimously to override and adopt the legislation. If, however, Parliament suggests amendments, the Commission must examine them in the context of the Council's common position. Following deliberations, the Commission will again forward the proposed measure to the Council. The Commission is given one month to review and indicate which of the proposed amendments are unacceptable.
6. The Council is then given an additional three months to take one of four available steps:

    a) Adopt the Commission's reviewed proposal by qualified majority vote,
    b) Adopt, by unanimous vote, Parliament's amendments previously rejected by the Commission,
    c) By unanimous vote, otherwise amend the Commission's reviewed proposal, or
    d) Do nothing and allow the proposed measure to lapse.

Parliament's review of Commission proposals (steps 3 and 4) is referred to as a "first reading." Time limitations are not imposed on Parliament's review. Neither is a time limit imposed on Council's issuance of a common position.

The largest change, aside from the adoption of qualified majority voting, in new review procedures stemming from the SEA was the development of a "second reading," following step 4. Under earlier procedures Parliament would have adopted a definitive text of proposed legislation. Under the new procedures, the Council requests a second reading by the Parliament by transmitting its common position. All three legislative bodies now negotiate over final terms subject to strict time limits.

The SEA and amended legislation review procedures had several implications for the adoption of EU directives. First, they provided a more active role to Parliament in the consideration of legislation. However, limitations on Parliament's powers circumscribed substantive alteration of its largely consultative role. Second, the amendments increased the level of interaction between the Council and Commission. More fundamentally, the adoption of qualified majority voting was significant because it undermined the ability of a single member state to derail legislation with which it objected. This meant that even controversial issues were more closely scrutinised and subject to greater give and take between the Council and Commission. As is evident in the resolution of disagreements over the CAD and ISD, qualified majority voting acted as a powerful incentive to member-states to initiate compromises in order to resolve contentious issues and finalise legislation. It also acted as a robust incentive for the Commission and the Council to hear out each other's views and develop consensus resolutions to issues arising particularly out of national preferences.

Negatively, the SEA and qualified majority voting promoted compromise as the path to resolve disagreements. Compromise may not produce effective legislation or problem-solving especially if, as was the case with the CAD and ISD, certain issues were simply swept under the rug through derogations or ambiguous language in order to achieve agreement in the Council. This reflects a politicisation of the directive development process that was the consequence of legislatively imposing compromise.[28]

[28] Ibid.

Finally, the SEA increased the influence of the Council in developing legislation. While only the Commission could propose legislation, the Council carried final voting approval. This arrangement forces the Commission to be responsive to the concerns of the Council, particularly to possible member state protectionist interests. This was case in the development of the compromises that facilitated agreement by the Council to the ISD and CAD. In particular, neither of the voting blocs on ISD issues, the Club-Med[29] and Northern European[30] groups, represented a qualified majority. As a result, they were forced to compromise in order to develop a consensus view on the ISD. However, rather than construct a compromise that struck a defined middle ground (or reflected concessions by affected states), the Council and Commission elected to permit derogations by member-states and the inclusion of ambiguous language in the final directives. Both "compromises" were consequences of the SEA and the political pressure to which it subjected EU directive debates. In particular, both the ISD and CAD were subject to intense political pressure associated with the deadline to complete the Single Market. As a result, the SEA and qualified majority voting both had a material impact on the final form of the CAD and ISD.

[29] France, Belgium, Italy, Portugal, Spain and Greece represented 43 votes in the Council.
[30] Germany, the UK, Denmark, the Netherlands, Luxembourg and Ireland represented 33 votes in the Council.

Appendix D

Memoranda of Understanding

A factor competing with multilateral co-ordination of international regulatory harmonisation was the rapid proliferation of bilateral regulatory agreements. Bilateral agreements frequently took the form of Memoranda of Understanding. In his 1991 annual report, SIB Chairman Walker noted that progress in establishing cooperation agreements with foreign regulators had been made. Walker noted that the SIB had entered into eight new bilateral regulatory agreements in the past year. This brought to 40[31] the regulatory agreements the SIB had signed. Discussions had begun with the SEC and US Commodity Futures Trading Commission (CFTC) to extend existing agreements. Walker predicted these agreements would "gain momentum."[32] During the four years Richard Breeden was Chairman of the SEC, the US entered into 18 bilateral agreements.[33]

MOU growth was tied to the expansion of cross-border capital market activity. As cross-border trading increased, bankers and borrowers increasingly accessed markets in differing jurisdictions. Regulators saw a need to enhance the scope of information and assistance they could expect from their foreign counterparts. MOUs were initially used to formalise understandings related to exchange of information and assistance.[34] The scope of MOUs varied but they generally shared a common goal: the encouragement of mutual cooperation between national securities regulators regarding the administration and enforcement of securities laws. These general objectives differed from those of the EU and IOSCO negotiations. The execution of bilateral MOUs and the development of

[31] Representing 29 countries and offshore financial centres.
[32] ISRR, "Progress Being Made on Foreign Talks with Regulators, SIB Says", 1 July 1991.
[33] Jurisdictions with which the SEC executed MOUS included: Italy (1993), Australia (1993), Spain (1992), Norway, (1991), UK (1986 and 1991), Sweden (1991), Luxembourg (1990), Canadian Provinces of Ontario, Quebec and British Columbia (1998), Japan, (1986), and Switzerland (1982). See: Alan L. Jakimo, "Capital Market Globalization and the SEC's Use of Memoranda of Understanding," (New York: Brown & Wood, 1995).
[34] Ibid.. See article for a fuller discussion of MOUs.

multilateral capital adequacy standards were considered unlikely to generate jurisdictional or regulatory conflicts. However, the scope of bilateral cooperation expanded beyond information sharing and the potential for MOUs to complicate the objectives of multilateral negotiations grew. The multi-jurisdictional disclosure system between the US and Canada was one example. The US in particular entered into bilateral education and consulting contracts, sponsored by the SEC and State Department, with the objective of extending US' securities regulatory experience to other securities markets. A by-product of these arrangements was the dissemination of US regulatory practices and values. More generally, MOUs established precedents and benchmarks for other states and markets. In the same way, a 1987 bilateral agreement between the United States and the UK on capital adequacy standards for commercial banks had established a precedent and impetus for the 1988 Basle Capital Accord;[35] the expansion of bilateral agreements carried the potential to influence the direction, speed and scope of international negotiations over regulatory standards. If nothing else, these agreements encouraged the EU to develop its own standards or risk potential conflicts with separate bilateral precedents.

[35] Kapstein, *Governing the Global Economy: International Finance and the State.*

Bibliography

Official Source Materials:

Association, The Securities. "Investment Services Directive - a Commentary and Analysis," London: The Securities Association, 1989.

Basle Committee on Banking Supervision, "The Supervisory Treatment of Market Risks, Consultative Proposal." p. 2-3. Basle, April 1993.

Basle Committee on Banking Supervision, and Technical Committee of IOSCO. "Joint Report, Framework for Supervisory Information About Derivatives Activities." Basle, May 1994.

Basle Committee on Banking Supervision, BIS: Basle Committee on Banking. "Basle Concordat." Basle, 1975.

Capital Adequacy Directive, 93/6/EEU, "Council Directive of 15 March 1993 on the capital adequacy of investment firms and credit institutions", O.J.N*. L141, 11.06.93, pp. 1-26.

"Completing the Internal Market: White Paper from the Commission to the European Council" (COM No. 85) 310 (June 14, 1985).

Cranford, John R. "Drexel Case Seen Spurring Support: House Votes 410-0 to Stiffen Penalties for Insider Trading." *Congressional Quarterly Weekly Report*, 9/17/88, p. 2580-81.

EC Directive 77/780, "First Banking Co-ordination Directive," 12 December 1977.

EC Directive 80/390, "Council Directive Co-ordinating the Requirements for the Drawing Up, Scrutiny and Distribution of Listing Particulars to be Published for the Admission of Securities to Official Stock Exchange Listing", 23 O.J. European Commission (No. L 100) 1 (1980).

EC Directive 87/345, "First Amendment to the Listing Particulars Directive", 30 O.J. European Commission (No. L 185) 81 (1987).

EC Directive 77/780, "Second Banking Co-ordination Directive" ("SBD").

EC Directive 89/646, "On the Co-ordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending , O.J. (No. L 386) 1 (1989).

EC Directives (additional): the Solvency Ratio Directive, the Own Funds Directive, the Second Consolidated Supervision Directive, the Large Exposures Directive and the Deposit Guarantee Directive. Respectively; 89/646/EEU, 89/647/EEU, 89/229/EEU, 92/30/EEU, 92/121/EEU, and 94/19/EU.

European Commission, "Single European Act", O.J. (L 169). July 1, 1987. Also: Single European Act of 17 February 1986, 30 O.J.

European Court Reports 649, 1979 Common Market Law Reports 494, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein, Cassis de Dijon*, Case 120/78.

GAO. "European Community: U.S. Financial Services' Competitiveness under the Single Market Program." 1-72. Washington, D.C.: United States General Accounting Office, 1990.

———. "Financial Derivatives: Actions Needed to Protect the Financial System." 196. Washington D.C.: United States General Accounting Office, 1994.

———. "Financial Services Industry Issues." 1-22. Washington, D.C.: United States General Accounting Office, 1988.
———. "International Banking: Strengthening the Framework for Supervising International Banks." Washington, D.C.: The United States General Accounting Office, 1994.
———. "Securities Markets: Challenges to Harmonising International Capital Standards Remain." Washington, D.C.: United States General Accounting Office, 1992.

Investment Services Directive, 93/22/EEU, "Council Directive of 10 May 1993 on investment services in the securities field". O.J. N*. L141, 11.06.93, pp. 27-46.

IOSCO, By-Laws of the International Organization of Securities Commissions.

IOSCO, Technical Committee. "Capital Adequacy Standards for Securities Firms." Montreal: International Organization of Securities Commissions, 1989.

IOSCO, Technical Committee. "The Implications for Securities Regulators of the Increased Use of Value at Risk Models by Securities Firms.". Montreal: International Organization for Securities Commissions, July 13, 1995.

IOSCO, "Capital Requirements for Multinational Securities Firms." Montreal: International Organization of Securities Commissions, 1990.

———."1992 Annual Report." Montreal: International Organization of Securities Commissions, 1993.
———. "1995 Annual Report." Montreal: International Organization of Securities Commissions, 1996.

SEC, *Self-Funding Study*, 1988, II-1.

SEC. "Fifth Report to Congress on the Effect of the Absence of Fixed Rates of Commissions." Washington, D.C.: US Securities and Exchange Commission, 1977.

———. "Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce: Internationalization of Securities Markets II-36." Washington, D.C.: U.S. Securities and Exchange Commission, 1987.
———. Chuppe, Terry M., Hugh R. Haworth, and Marvin G Watkins. "The Securities Markets in the 1980s: A Global Perspective" Washington, D.C., U.S. Securities and Exchange Commission, 1989.

United Kingdom, HM Government, "Invisible Earnings: The UK's Hidden Strength.". London: HM Treasury, 1996.

Books and Journal Articles:

Armstrong, K. and S. Bulmer, *The Governance of the Single European Market*, Manchester: Manchester University Press, 1998, 340pp.

Axelrod, Robert, and Robert O. Keohane. "Achieving Cooperation under Anarchy." In *Neorealism and Neoliberalism: The Contemporary Debate*, edited by David A. Baldwin, p. 91-94, 1993.

Beck, Robert J. "Institutionalist Approaches." *International Rules* 3 (1996): p. 165 - 66.

Benston, George J. "Competition Versus Competitive Equality in International Financial Markets." in *Regulating International Financial Markets: Issues and Policies*, edited by Franklin R. Edwards and Hugh T. Patrick, 277-90. Boston: Kluwer, 1992.

Benz, A. "Politikverflechtung ohne Politikverflechtungsfalle. Koordination und Structurdynamik in Europäischen Mehrebenensystem." *Politische Viertlejahrschrift* 39 (1998): p. 558-89.

Blackburn, Simon. *Dictionary of Philosophy*. Oxford: Oxford University Press, 1996.

Börzel, T. "Organizing Babylon. On the Different Conceptions of Policy Networks." *Public Administration* 76 (1998): p. 253-73.

Börzel, Tanja A. "What's So Special About Policy Networks? An Exploration of the Concept and Its Usefulness in Studying European Governance." *European Integration online Papers (EIoP)* 1, no. 16 (1997).

Bronfman, Corinne, Kenneth Lehn, and Robert A. Schwartz. "US Securities Markets Regulation: Regulatory Structure." In *International Financial Market Regulation*, edited by Benn Steil. Chichester: John Wiley and Sons, 1994.

Brown, Philip. "The Politics of the EU Single Market for Investment Services: Negotiating the Investment Services and Capital Adequacy Directives." In *The New World Order in International Finance*, edited by Geoffrey R.D. Underhill, p. 124-44. London: Macmillan Press, 1997.

Bulmer, S.J. "New Institutionalism and the Governance of the Single European Market." *Journal of European Public Policy* 5, no. 3 (1998): p. 365-86.

Buzan, Barry, David Held, and Anthony McGrew. "Realism vs. Cosmopolitanism: A Debate." *Review of International Studies* 24, no. 3 (1998): pp. 387-99.

Campbell, A. "The Single European Act and the Implications." *International & Comparative Law Quarterly* 35 (1986): p. 932, 35.

Caporaso, J., and J. Keeler. "The European Community and Regional Integration Theory." Paper presented at the Third Biennial Conference of the European Community Studies Association, Washington, D.C., 27-29 May 1993.

Carr, E.H. *The Twenty Years Crisis 1919 - 1939, an Introduction to the Study of International Relations*. 2nd ed. New York: Harper and Row, 1946.

Cecchini, Paolo, Michel Catinat, and Alexis Jacquemin. *The European Challenge 1992: The Benefits of the Single Market*. Aldershot: Wildwood House, 1988.

Cerny, P. "International Finance and the Erosion of Capitalist Diversity." In *Political Economy of Modern Capitalism*, edited by C. Crouch and W. Streeck. London: Sage, 1997.

———. "Plurilateralism: Structural Differentiation and Functional Conflict in the Post-Cold War World Order." *Millennium: Journal of International Studies* 22, Spring (1993): p. 21-51.
———. "Globalization and the Changing Logic of Collective Action." *International Organization* 49, no. 4 (1995): p. 595-625.

Coffee, Jr., John C. "Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation." *The Business Lawyer* 50, no. 2 (1995): p. 447-84.

Cohen, Benjamin J. "Phoenix Risen; the Resurrection of Global Finance." *World Politics* 48, January (1996): p. 268-96.

Coleman, William D., and Geoffrey R.D. Underhill. "Globalization, Regionalism and the Regulation of Securities Markets." In *Regionalism & Global Economic Integration: Europe, Asia and the Americas*, edited by William D. Coleman and Geoffrey R.D. Underhill. London: Routledge, 1998.

Cooper, Richard. *The Economics of Interdependence*. New York: McGraw-Hill, 1968.

Connolly, W.E. "Legitimacy." In *Political Thought*, edited by D.W Miller, J. Coleman, W. Connolly and A. Ryan. Oxford: Blackwell, 1991.

Cooke, Peter. "Bank Capital Adequacy and Capital Convergence." 1-138. London: Price Waterhouse, 1991.

Cox, Robert. *Approaches to World Order*. Cambridge: Cambridge University Press, 1996.

Crouch, Colin, and Wolfgang Streeck, eds. *Political Economy of Modern Capitalism: Mapping Diversity and Convergence*. London: Sage Publications Ltd, 1997.

Cutler, A. Claire, Virginia Haufler, and Tony Porter, eds. *Private Authority and International Affairs*., Albany: State University of New York Press, 1999.

Dale, Richard, and Simon Wolfe. "Capital Standards." In *The European Equity Markets: The State of the Union and an Agenda for the Millennium*, edited by Benn Steil, p. 409. London: Royal Institute of International Affairs, 1996.

de la Gueriviere, J. *Voyage a L'interieure De L'eurocratie*. Paris: Le Monde Editions, 1992.

Dehousse, R. "Integration v. Regulation? On the Dynamics of Regulation in the European Community." *Journal of Common Market Studies* 30, no. 4 (1992): 383ff.

Deutsch, Karl, et. al. *Political Community and the North Atlantic Area*. Princeton: Princeton University Press, 1957.

Dilworth, Robert J. "Germany." *University of Pennsylvania Journal of International Business Law* 13, no. 4 (1993): 529-46.

Dimson, E., and P. Marsh. "City Research Project: The Debate on International Capital Requirements – Evidence on Equity Position Risk for UK Securities Firms, Subject Report VIII." London: London Business School, 1994.

Dombrowski, Peter. "Haute Finance and High Theory: Recent Scholarship on Global Financial Relations." *Mershon International Studies Review* 42, May (1998): p. 1-28.

Donnelly, Jack. "Realism: Roots and Renewal." *Review of International Studies* 24, no. 3 (1998): 399-407

Donnelley, M. "The Structure of the European Commission and the Policy Formation Process." In *Lobbying in the European Community*, edited by S. Mazey and J. Richardson. Oxford: Oxford University Press, 1993.

Duric, John. "Regulation Easy as SEC." *Australian Financial Review*, 11/16/88, p. 8.

Durieux, Gilbert, Michel Serieyssol, and Patrick Stephan. *French Financial Markets*. Cambridge: Woodhead Publishing, 1995.

Edwards, Franklin R., and Frederic S. Mishkin. "The Decline of Traditional Banking: Implications for Financial Stability and Regulatory Policy." *Economic Policy Review* (July 1995): p. 27 - 47.

Evans, Peter B, Harold K. Jacobson, and Robert D. Putnam, eds. *Double-Edged Diplomacy: International Bargaining and Domestic Politics*. Berkeley: University of California Press, 1993.

Evans, Peter B. "Building an Integrative Approach to International and Domestic Politics." In *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, edited by Peter B. Evans, Harold K. Jacobson and Robert D. Putnam. Berkeley: University of California Press, 1993.

Familet, Cara. "Improving Securities Regulations in the EC: The French Example." *North Carolina Journal of International Law and Commercial Regulation* 17 (1992): 519-29.

Filipovic, Miroslava. *Governments, Banks and Global Capital: Securities Markets in Global Politics*. Aldershot: Ashgate Publishing Limited, 1997.

Fioretos, Orfeo. "Sources of Multilateral Preferences." In *Varieties of Capitalism*, edited by Peter A. Hall and David Soskice. Oxford: Oxford University Press, 2001.

Frieden, Jeffry A., and David A. Lake. "Introduction: International Politics and International Economics."

In *International Political Economy*, edited by Jeffry A. Frieden and David A. Lake. Boston: Bedford/St. Martin's, 2000.

Geiger, Uri. "The Case for the Harmonization of Securities Disclosure Rules in the Global Market." *Columbia Business Law Review* 1997, nos. 2&3 (1997): p. 243-317.

George, Alexander L. "Case Studies and Theory Development: The Method of Structured, Focused Comparison." In *Diplomacy: New Approaches in History, Theory, and Policy*, edited by Paul Gordon Lauren, p. 286. New York: The Free Press, 1979.

Germain, Randall D., and Michael Kenny. "Engaging Gramsci: International Theory and the New Gramscians." *Review of International Studies* 24, no. 1 (1998): 3-21.

Gilpin, Robert. *The Political Economy of International Relations*. Princeton: Princeton University Press, 1987.

Glaser, Charles. "Realists as Optimists: Co-Operation as Self Help." *International Security* 19 (1994/1995): p. 50, n.1.

Goodhart, Charles, Philipp Hartmann, David Llewellyn, Liliana Rojas-Suarez, and Steven Weisbrod. *Financial Regulation: Why, How and Where Now?* London: Routledge, 1998.

Gourevitch, P. *Politics in Hard Times*. Ithaca: Cornell University Press, 1986.

Gourevitch, Peter. "The Second Image Reversed: The International Sources of Domestic Politics." *International Organization* 32, no. 4 (1978): p. 881 - 911.

Granirer, D.M., "A modern great power concert: New York, Tokyo, London and the political economy of transnational financial regulatory cooperation," Princeton University, unpublished Ph.D. thesis, 1991.

Grant, C. *Delors: Inside the House That Jacques Built*. London: Nicholas Brealey, 1994.

Green Cowles, M., J. Caporaso, and T. Risse. *Transforming Europe, Europeanization and Domestic Change*. Ithaca: Cornell University Press, 2001.

Green Cowles, Maria. "Setting the Agenda for a New Europe: The ERT and EC 1992." *Journal of Common Market Studies* 33, no. 4 (1995).

Grieco, Joseph M. "Anarchy and the Limits of Co-Operation: A Realist Critique of the Newest Liberal Institutionalism." *International Organization* 42 (1988): 485.

Grundfest, Joseph A. "Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences." *Journal of Financial Services Research* December, no. 4 (1990): 349-78.

Guy, Paul. "Regulatory Harmonisation to Achieve Effective International Competition." In *Regulating International Financial Markets: Issues and Policies*, edited by Franklin R. Edwards and Hugh T. Patrick. Norwell, Massachusetts: Kluwer Academic Publishers, 1992.

Gyohten, Toyoo. "Global Financial Markets: The Past, the Future, and Public Policy Questions." In *Regulating International Financial Markets: Issues and Policies*, edited by Franklin R. Edwards and Hugh T. Patrick. Boston: Wolters Kluwer, 1992.

Haaland-Matlary, J. "What Is Integration Theory, and Do We Need It?" 1994.

Haas, Ernst B. *The Uniting of Europe: Political, Social, and Economical Forces, 1950-1957, Library of World Affairs, No. 42*. London: Stevens, 1958.

———. *Beyond the Nation-State: Functionalism and International Organization*. Stanford: Stanford University Press, 1964.

———. "Turbulent Fields and the Theory of Regional Integration." *International Organization* 30, no. 2 (1976).

Haas, E., and P. Schmitter. "Economics and Differential Patterns of Political Integration: Projections About Unity in Latin America." In *International Political Communities: An Anthology*. New York: Doubleday, 1966.

Haas, Peter. "Introduction: Epistemic Communities and International Policy Coordination." *International Organization* 46, no. 1 (1992): 1-35.

Habermas, J. *Legitimation Crisis*. Translated by T. McCarthy. Boston: Beacon, 1973.

Hall, Peter A. "The Role of Interests, Institutions, and Ideas in the Comparative Political Economy of the Industrialized Nations." In *Comparative Politics: Rationality, Culture, and Structure*, edited by Mark Irving Lichbach and Alan S. Zuckerman, 174 - 207. Cambridge: Cambridge University Press, 1997.

Hall, Peter A., and David Soskice, eds. *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. Oxford: Oxford University Press, 2001.

Halliday, Fred, and Justin Rosenberg. "Interview with Ken Waltz." *Review of International Studies* 24, no. 3 (1998): 371-87.

Haufler, Virginia. "Crossing the Boundary between Public and Private: International Regimes and Non-State Actors." In *Regime Theory and International Relations*, edited by Volker Rittberger, 94-112. Oxford: Clarendon Press, 1995.

Helleiner, Eric. *States and the Re-emergence of Global Finance: From Bretton Woods to the 1990s*. Ithaca, New York: Cornell University Press, 1994.

Heritier, A., "The Accommodation of Diversity in European Policy-Making and Its Outcomes: Regulatory Policy-Making as a Patchwork," *Journal of European Public Policy* 3, no. 2 (1996).

Heritier, A., C. Knill, and S. Mingers, *Ringing the Changes in Europe. Regulatory Competition and the Transformation of the State. Britain, France, Germany* (Berlin/New York: de Gruyter, 1996).

Hirst, Paul, and Grahame Thompson. *Globalization in Question: The International Economy and the Possibilities of Governance*. Cambridge: Polity Press, 1996.

Hix, S. *The Political System of the European Union*. New York: St. Martin's Press, 1999.

Hix, Simon. "The Study of the European Community: The Challenge to Comparative Politics." *West European Politics* 17, no. 1 (1994): p. 1-30.

Hoffmann, S. "Obstinate or Obsolete? The Fate of the Nation-State and the Case of Western Europe." *Daedalus* 95, no. 3 (1966): p. 862-915.

Hollingsworth, J.R., and R. Boyer, eds. *Contemporary Capitalism: The Embeddedness of Institutions*. Cambridge: Cambridge University Press, 1997.

Hood, Christopher. *Explaining Economic Policy Reversals*. Buckingham: Open University Press, 1994.

Hooghe, Liesbet, "Building a Europe with the Regions. The Changing Role of the European Commission in Cohesion Policy and European Integration: Building Multi-Level Governance," ed. By L. Hooghe, Oxford, Oxford University Press, 1996.

Hume, David. *An Enquiry Concerning Human Understanding*, 1748.

Hurrell, A., and A. Menon. "Politics Like Any Other? Comparative Politics, International Relations and the Study of the EU." *West European Politics* 19, no. 2 (1996): p. 386-402.

Jachtenfuchs, M. "The Governance Approach to European Integration." *Journal of Common Market Studies* 39, no. 2 (2001): p. 245-64.

Jakimo, Alan L. "Capital Market Globalization and the SEC's Use of Memoranda of Understanding.". New York: Brown & Wood, 1995.

Jayasuriya, Kanishka. "Globalization and the Changing Architecture of the State: The Regulatory State and the Politics of Negative Coordination." *Journal of European Public Policy* 8, no. 1 (2001): p. 101-23.

Jimenez, Pamela. "International Securities Enforcement Cooperation Act and Memoranda of Understanding." *Harvard International Law Journal* 31, no. 1 (Winter 1990).

Johnson, Philip M. "Reflections on the CFTC/SEC Jurisdictional Dispute." In *Regulating International Financial Markets: Issues and Policies*, edited by Franklin R. Edwards and Hugh T. Patrick. Norwell, Massachusetts: Kluwer Academic Publishers, 1992.

Jones, Robert A. *The Politics and Economics of the European Union*. 2nd ed. Cheltenham: Edward Elgar, 2001.

Jonsson, Christer. *Superpower: Comparing American and Soviet Foreign Policy*. London: Frances Pinter, 1984.

Jordan, Cathy. "Regulation of Canadian Capital Markets in the 1990s: The United States in the Driver's Seat." *Pacific Rim Law and Policy Journal* 4, no. 3 (1995): p. 577-603.

Kane, Edward J. "Tension between Competition and Coordination in International Financial Regulation." In *Governing Banking's Future: Markets vs. Regulation*, edited by Catherine England, p. 33-48. Boston: Kluwer, 1991.

Kapstein, Ethan B. *Governing the Global Economy: International Finance and the State*. Cambridge: Harvard University Press, 1994.

Karmel, Roberta S. "National Treatment, Harmonization, and Mutual Recognition: The Search for Principles for the Regulation of Global Equity Markets." Paper presented at the Capital Market Forum, London 1993.

Kassim, H., and A. Menon, eds. *The European Community and National Industrial Policy*. London: Routledge, 1996.

Katz, Eugene M. "The New Basle Capital Accord." *Bank Accounting & Finance* (3/22/2001): p. 28.

Katzenstein, Peter. *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*. Ithaca: Cornell University Press, 1978.

Katzenstein, Peter J., Robert O. Keohane, and Stephen D. Krasner. "International Organization and the Study of World Politics." *International Organization* 52, no. 4 (1998): p. 645-85.

Keohane, Robert O. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton: Princeton University Press, 1984.

———. *International Institutions and State Power: Essays in International Relations Theory 3*, 1989.
———. "International Institutions: Two Approaches." *International Studies Quarterly* 32 (1988): 379.
———. "The World Political Economy and the Crisis of Embedded Liberalism." In *Order and Conflict in Contemporary Capitalism*, edited by John Goldthorpe, 16. Oxford: Clarendon Press, 1984.

Keohane, Robert O., and S. Hoffmann. "Institutional Change in Europe in the 1980s." In *The New European Community. Decision-making and Institutional Change*, edited by R. O. Keohane and S. Hoffmann, p. 1-39. Boulder: Westview, 1991.

Keohane, Robert O., and Helen V. Milner, eds. *Internationalization and Domestic Politics*. Cambridge: Cambridge University Press, 1996.

Keohane, Robert O., and Joseph S. Nye, Jr. "Introduction." In *Governance in a Globalizing World*, edited by Joseph S. Nye, Jr. and John D. Donahue. Washington, D.C.: Brookings Institution, 2000.

———. *Power and Interdependence: World Politics in Transition.* Boston: Little, Brown, 1977.
———. eds. *Transnational Relations and World Politics.* Cambridge: Harvard University Press, 1970.

Key, Sydney J. "Mutual Recognition: Integration of the Financial Sector in the European Community." *Federal Reserve Bulletin*, September 9, 1989: p. 591ff.

Khademian, Anne M. *The SEC and Capital Market Regulation: The Politics of Expertise.* Pittsburgh: University of Pittsburgh Press, 1992.

Kindleberger, Charles. *The World in Depression: 1929-1939.* Berkeley: University of California Press, 1973.

King, Gary, Robert O. Keohane, and Sidney Verba. *Designing Social Inquiry: Scientific Inference in Qualitative Research.* Princeton: Princeton University Press, 1994.

Knopf, Jeffrey W. *Domestic Society and International Co-Operation: The Impact of Protest on US Arms Control Policy.* Edited by Smith. Steve, *Cambridge Studies in International Relations.* Cambridge: Cambridge University Press, 1998.

Kohler-Koch, B. "European Networks and Ideas: Changing National Policies?" *European Integration online Papers (EIoP)* 6, no. 6 (2002).

Krasner, Stephen D. "Global Communications and National Power: Life on the Pareto Frontier." *World Politics* 43, no. 3 (1991): p. 336–66.

———. "State Power and the Structure of International Trade." *World Politics* 28, April (1976): p. 317–47.
———. "Structural Causes and Regime Consequences: Regimes as Intervening Variables." *International Organization* 36, no. 2 (1982): p. 185.
———, ed. *International Regimes.* Ithaca: Cornell University Press, 1983.

Lake, David. *Power, Protection and Free Trade.* Ithaca: Cornell University Press, 1988.

Large, Andrew. "The Future of Global Regulation." 34. Washington, D.C.: Group of Thirty, 1998.

Lawton, Thomas C., James A. Rosenau, and Amy Verdun, eds. *Strange Power: Shaping the Parameters of International Relations and International Political Economy.* Burlington, VT: Aldershot, 2000.

Lequesne, C. *Paris-Bruxelles: Comment Se Fait La Politique Europeenne De La France.* Paris: Presses de la Fondation Politique Nationale des Sciences Politiques, 1993.

Lew, Darrel S. "The EEC Legislative Process: An Evolving Balance." *Columbia Journal of Transnational Law* 27 (1989): p. 688.

Leydon, Denise M. "International Securities - London's Dominance in the Emerging Integrated International Market." *Suffolk Transnational Law Journal* 11 (1987): p. 421-36.

Licht, Amir. "Games Commissions Play: 2x2 Games of International Securities Regulation." *Unpublished Paper* (1998): p. 1-44.

Lindberg, L. "Decision-Making and Integration in the European Community." *International Organization* 19, Winter (1965).

———. *The Political Dynamics of European Economic Integration.* Stanford: Stanford University Press, 1963.

Majone, G. "Cross-National Sources of Regulatory Policymaking in Europe and the United States." *Journal of Public Policy* 11, no. 1 (1991): p. 76 - 106.

———. "The European Community between Social Policy and Social Regulation." *Journal of Common Market Studies* 32, no. 2 (1993): p. 153-70.

Mann, M. "Nation-States in Europe and Other Continents: Diversifying, Developing, Not Dying." *Daedalus* 13 (1993): p. 115-40.

Marks, G. "Structural Policy after Maastricht." In *The State of the European Community*, edited by A.W. Cafruny and G Rosenthal. New York: Lynne Rienner, 1993.

———. "Structural Policy and 1992." In *Euro-Politics: Institutions and Policymaking in the 'New' European Community*, edited by A. Sbragia. Washington, D.C.: Brookings Institution, 1992.
———. "Structural Policy and Multi-Level Governance in the European Community." In *The State of the European Community*, edited by A.W. Cafruny and G Rosenthal. Boulder: Lynne Rienner, 1993.

Marks, Gary, Liesbet Hooghe, and Kermit Blank. "European Integration from the 1980s: State-Centric v. Multi-Level Governance." *Journal of Common Market Studies* 34, no. 3 (1996): p. 341-78.

Martin, Lisa. "Theories and Empirical Studies of International Institutions." *International Organization* 52, no. 4 (1998).

Matlary, J. "The EC Policy-Making Process in the Field of Energy: An Analysis with a View to Norwegian Interests." In *Norwegian Gas in the New Europe*, edited by O. Austvik. Oslo: Vett og Viten, 1991.

McCahery, Joseph. "Market Regulation and Particularistic Interests: The Dynamics of Insider Trading Regulation in the Us and Europe." In *The New World Order in International Finance*, edited by Geoffrey R. D. Underhill, p. 50 - 75. London: Macmillan Press Ltd., 1997.

McCathie, Andrew. "Germany Moves to Bring Financial Markets into Line." *Australian Financial Review*, 2/19/92, p. 14.

———. "US, UK Move on Joint Regulation of Banks, Securities." *Australian Financial Review*, 2/12/88, p. 79.

Mearsheimer, John. "The False Promise of International Institutions." *International Security* Winter, no. 19 (1994).

Mill, John Stuart. *Principles of Political Economy*, 1848.

Miller, David. "Authority." and "Power" In *The Blackwell Encyclopaedia of Political Thought*, edited by David Miller, et. al. Oxford: Blackwell, 1991.

Milner, Helen V. "International Theories of Cooperation among Nations: Strengths and Weaknesses." *World Politics* 44, no. 3 (1992): pp. 466-96.

———. "Rationalizing Politics: The Emerging Synthesis of International, American, and Comparative Politics." *International Organization* 52, no. 4 (1998).
———. *Resisting Protectionism*. Princeton: Princeton University Press, 1988.
———. *Interests, Institutions, and Information: Domestic Politics and International Relations*. Princeton: Princeton University Press, 1997.

Mitrany, David. *A Working Peace System: An argument for the functional development of international organization*, The Royal Institute of International Affairs, London, 1943.

Moran, Michael. *The Politics of the Financial Services Revolution: The USA, UK and Japan*, London, MacMillan, 1990.

———. "Regulatory Change in German Financial Markets." In *The Politics of German Regulation*, edited by Kenneth Dyson. Aldershot: Dartmouth, 1992.

Moravcsik, Andrew. *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht*.

Ithaca: Cornell University Press, 1998.

———. "Preferences and Power in the European Community: A Liberal Intergovernmental Approach." *Journal of Common Market Studies* 33, no. 4 (1993): p. 473-524.
———. "Introduction: Integrating International and Domestic Theories of International Bargaining." In *Double-Edged Diplomacy: International Bargaining and Domestic Politics*, edited by Peter B. Evans, Harold K. Jacobson and Robert D. Putnam. Berkeley, Ca.: University of California Press, 1993.
———. "Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community." *International Organization* 45, Winter (1991): p. 19-56.

Morgenthau, Hans J. *In Defense of the National Interest*, New York, Knopf, 1951.

———. *Politics among Nations: The Struggle for Power and Peace,* rev. by K.W. Thompson, New York, McGraw-Hill, 1993.

Morton, Christina. "Michael Mann: Making a Mission of International Enforcement." *International Financial Law Review* (1990): p. 7-8.

Muegge, Daniel. "The Governance of the European Securities Industry: From the Investment Services Directive to Lamfalussy." University of Amsterdam, unpublished M.Phil. thesis, 2002.

Murphy, Craig N. "Understanding IR: Understanding Gramsci." *Review of International Studies* 24, no. 3 (1998): pp. 417-27.

Nayar, Baldev Raj. "Regimes, Power, and International Aviation." *International Organization* 49, no. 1 (1995): p. 139 - 70.

Niebuhr, Reinhold. *The Irony of American History*, London, Nisbet, 1952.

Norton, Joseph J., and Christopher D. Olive. "The Ongoing Process of Bank and Regulatory Supervisory Convergence: A New Regulatory-Market "Partnership"." *Annual Review of Banking Law* 16 (1997).

Nunes, Keith Dill, et. al. "French & SEC Securities Regulation: The Search for Transparency and Openness in Decision-making." *Vanderbilt Journal of Transnational Law* 26, no. 2 (May 1993): p. 217-48.

Nye, Joseph S., Jr. "Comparative Regional Integration: Concepts and Measurement." *International Organization* 22 (1968).

Oatley, Thomas, "The Dilemmas of International Financial Regulation," *Regulation* 34, no.4 (2000), pp. 36-39.

Oatley, Thomas, and Robert Nabors. "Redistributive Co-Operation: Market Failure, Wealth Transfers, and the Basle Accord." *International Organization* 52, no. 1 (1998): p. 35-55.

Odell, John S. "Bounded Rationality and the World Political Economy: The Nature of Decision Making." In *Governing the World's Money*, edited by David M. Andrews, C. Randall Henning and Louis W. Pauly. Ithaca: Cornell University Press, 2002.

———. *Negotiating the World Economy*. Ithaca: Cornell University Press, 2000.
———. *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change*. Princeton: Princeton University Press, 1982.

Pauly, Louis W. *Who Elected the Bankers? Cornell Studies in Political Economy*. Ithaca: Cornell University Press, 1997.

Pimlott, J. "The Reform of Investor Protection in the UK - an Examination of the Proposals of the Gower Report and the UK Government's White Paper of January, 1985." *Journal of Comparative Business and Capital Market Law* 7 (1985): p. 141.

Pinder, J. "The Single Market: A Step Towards European Union." In *The EC and the Challenge of the Future*, edited by J. Lodge. London: Pinter, 1989.

Polanyi, K. *The Great Transformation*. Boston: Beacon Press, 1944.

Pollack, M.A. "International Relations Theory and European Integration." *Journal of Common Market Studies* 39, no. 2 (2001): p. 221-44.

Porter, Tony. *States, Markets and Regimes in Global Finance*. London: The Macmillan Press, 1993.

Potter, Barbara Campbell. "Implications of the Single European Act on European Community Law-Making: A Modest Step Forward." *Vanderbilt Journal of Transnational Law* 26 (1993): p. 249-69.

Puchala, D. "Institutionalism, Intergovernmentalism and European Integration." *Journal of Common Market Studies* 37, no. 2 (1999): p. 317-31.

———. "Of Blind Men, Elephants, and International Integration." *Journal of Common Market Studies* 10, no. 3 (1972).

Puchala, D., and R.F. Hopkins. "International Regimes: Lessons from Inductive Analysis." In *International Regimes*, edited by Stephen D. Krasner. Ithaca: Cornell University Press, 1983.

Putnam, Robert D. "Diplomacy and Domestic Politics: The Logic of Two-Level Games." *International Organization* 42. Summer (1988): p. 427-60.

Reinicke, Wolfgang H. *Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980 - 1990*. Brookfield, Vermont: Edward Elgar, 1995.

Richards, John E. "Toward a Positive Theory of International Institutions: Regulating International Aviation Markets." *International Organization* 53, no. 1 (1999): p. 1-37.

Risse, T. "Exploring the Nature of the Beast: International Relations Theory and Comparative Policy Analysis Meet the European Union." *Journal of Common Market Studies* 34, no. 1 (1996): p. 53-80.

Rittberger, Volker, ed. *Regime Theory and International Relations*. Oxford: Clarendon Press, 1995.

Romer, Thomas, and Howard Rosenthal. "Modern Political Economy and the Study of Regulation." In *Public Regulation: New Perspectives on Institutions and Policies*, edited by Elizabeth E. Bailey, p. 73-116. Cambridge: MIT Press, 1987.

Rosenau, James A., ed. *Linkage Politics: Essays on the Convergence of National and International Systems*. New York: Free Press, 1969.

Ruggie, John Gerard. *Constructing the World Polity: Essays on International Institutionalization*. New York: Routledge, 1998.

———. "International Responses to Technology. Concepts and Trends." *International Organization* 29, no. 4 (1975): p. 557-83.

Sandholtz, Wayne. "Choosing Union: Monetary Politics and Maastricht." *International Organization* 47, no. 1 (1993): p. 1-39.

———. "Membership Matters: Limits of the Functional Approach to European Institutions." *Journal of Common Market Studies* 34, no. 3 (1996): p. 403-29.

Sandholtz, Wayne, and John Zysman. "1992: Recasting the European Bargain." *World Politics* 42 October (1989): p. 95-128.

Sbragia, A. "Thinking About The European Future: The Uses of Comparison." In *Europolitics: Institutions and Policymaking in the 'New' European Community*, edited by A. Sbragia. Washington, D.C.: Brookings Institution, 1992.

Scharpf, S. "Die Problemlösungsfähigkeit der Mehrebenenpolitik in Europa." In *Regieren in Entgrenzen Raumen, Pvs Sonderhft 29/1998*, edited by B. Kohler-Koch, p. 121-44. Opladen: Westdeutscher Verlag, 1998.

———. "Introduction: The Problem Solving Capacity of Multi-Level Governance." *Journal of European Public Policy* 4, no. 4 (1997): p. 520-38.

Scheppele, Kim, and Karol Soltan. "The Authority of Alternatives." In *Authority Revisited: Nomos XXIX*, edited by J. Roland Pennock and John W. Chapman. New York: New York University Press, 1987.

Schmidt, Vivien A. "Loosening the Ties That Bind: The Impact of European Integration on French Government and Its Relationship to Business." *Journal of Common Market Studies* 34, no. 2 (1996).

Schmitter, P. "The Emerging Europolity and Its Impact Upon National Systems of Production." In *Contemporary Capitalism: The Embeddedness of Institutions*, edited by J.R. Hollingsworth and R. Boyer. Cambridge: Cambridge University Press, 1997.

———. "Still the Century of Corporatism?" *Review of Politics,* 36, no. 1 (1974): p. 85-131.

Schneider, Volker, Godefroy Dang-Nguyen, and Raymund Werle. "Corporate Actor Networks in European Policy-Making: Harmonising Telecommunications Policy." *Journal of Common Market Studies* 32, no. 4 (December 1994).

Schuster, Gunnar. "Extraterritoriality of Securities Laws: An Economic Analysis of Jurisdictional Conflicts." *Law & Policy in International Business* 26 (1994): p. 165-202.

Scott-Quinn, Brian. "EC Securities Markets Regulations." In *International Financial Market Regulation,* edited by Benn Steil. Chichester: John Wiley and Sons, 1994.

"SEC and Congress Again Seek Foreign Co-Operation." *Australian Financial Review,* 3/10/89, p. 38.

Seidman, L. William. *Full Faith & Credit: The Great S&L Debacle and Other Washington Sagas.* New York: Beard Books, 2000.

Sharp, M. "The Community and New Technologies." In *The EC and the Challenge of the Future,* edited by J. Lodge. London: Pinter, 1989.

Sinclair, Timothy J. "Between State and Market: Hegemony and Institutions of Collective Action under Conditions of International Capital Mobility." *Policy Sciences* 27, no. 4 (1994): p. 447-66.

Snidal, Duncan. "The Game Theory of International Politics." In *Cooperation under Anarchy,* edited by Kenneth A. Oye. Princeton: Princeton University Press, 1986.

Sobel, Andrew C. *Domestic Choices, International Markets: Dismantling National Barriers and Liberalizing Securities Markets.* Ann Arbor: University of Michigan Press, 1994.

Sommer, A.A. "IOSCO: Its Mission and Achievement." *Northwestern Journal of Law and Business* 17, no. 1 (1996): p. 15-29.

Steil, Benn. *Competition, Integration and Regulation in EC Capital Markets.* London: Royal Institute of International Affairs, 1993.

———. "Equity Trading IV: The ISD and the Regulation of European Market Structure." In *The European Equity Markets,* edited by Benn Steil, *et. al.* London: European Capital Markets Institute, 1996.

———. *Illusions of Liberalisation: Securities Regulation in Japan and the EC.* London: Royal Institute of International Affairs, 1995.

———. "Regional Financial Market Integration: Learning from the European Experience." London: Royal Institute of International Affairs, 1998.

———. "Regulatory Foundations for Global Capital Markets." In *Finance and the International Economy,* edited by Robert O'Brien, pp. 62-76. Oxford: Oxford University Press, 1992.

———, ed. *International Financial Market Regulation*. Chichester: John Wiley & Sons Ltd., 1994.

Steinherr, Alfred, and Christian Huveneers. "Universal Banking in the Integrated European Marketplace." In *The New European Financial Marketplace*, edited by Alfred Steinherr, p. 49-65. London: Longman Group, 1992.

Story, Jonathan, and Ingo Walter. *Political Economy of Financial Integration in Europe: The Battle of the Systems*. Cambridge, MA: The MIT Press, 1997.

Strange, Susan. "Cave! Hic Dragones: A Critique of Regime Analysis." *International Organization* 36, no. 2 (1982).

———. "The Defective State." *Daedalus* 24 (1995): p. 56.
———. "The Future of Global Capitalism; or, Will Divergence Persist Forever?" In *Political Economy of Modern Capitalism*, edited by C. Crouch and W. Streeck. London: Sage, 1997.
———. "International Economics and International Politics: A Case of Mutual Neglect." *International Affairs* 46 (1970): p. 304-15.
———. "Rethinking Structural Change in the International Political Economy: States, Firms and Diplomacy." In *Political Economy and the Changing Global Order*, edited by Richard Stubbs and G.R.D. Underhill. London: Macmillan, 1994.
———. *States and Markets*. Second ed. London: Pinter Publishers, 1988.
———. "Wake up, Krasner! The World Has Changed." *Review of International Political Economy* 1, no. 2 (1994): p. 210-19.

Streeck, W., and P.C. Schmitter. "Neo-Voluntarism: A New European Social Policy Regime?" In *Governance in the Emerging Euro-Polity*, edited by G. Marks, S. Scharpf, P.C. Schmitter and W. Streeck. London: Sage, 1996.

Stubbs, Richard, and Geoffrey R.D. Underhill, eds. *Political Economy and the Changing Global Order*. London: The Macmillan Press Ltd., 1994.

Sutherland, Peter. "The Dawn of a United Europe: An Introduction to 1992 and Beyond." *St. Louis University Public Law Review* 9 (1990): p. 1,5.

Symposium. "The Internationalization of Securities Markets." *Maryland Journal of International Law and Trade* 11 (1987): p. 157.

Taylor, P. "Intergovernmentalism in the EC in the 70s: Patterns and Perspectives." *International Organization* 36, no. 4 (1982).

———. *The Limits of European Integration*. London: Croom Helms, 1983.
———. "The New Dynamics of EC Integration in the 1980s." In *The EC and the Challenge of the Future*, edited by J. Lodge. London: Pinter, 1989.

Thieffry, Van Doorn & Lowe. "The Single European Market: A Practitioner's Guide to 1992." *B.C. International and Comparative Law Review* 12 (1989): p. 357, 59.

Tobin, Glenn. "Global Money Rules: The Political Economy of International Regulatory Cooperation." Harvard University, unpublished Ph.D. thesis, 1991.

Underhill, G.R.D. "Conceptualizing the Changing Global Order." In *Political Economy and the Changing Global Order, 2nd Ed.*, edited by Richard Stubbs and G.R.D. Underhill, p. 4-5. Oxford: Oxford University Press, 2000.

———. "The State-Market Relationship: Prospects for Change in World Order," *International Affairs* 76, no. 4 (2000): p. 805-24.
———. "States, Markets and Governance. Private Interests, the Public Good, and the Democratic Process," p. 5-33. Amsterdam: Vossiuspers Universiteit van Amsterdam, 2001.
———. "Keeping Governments out of Politics: Transnational Securities Markets, Regulatory Cooperation, and Political Legitimacy." *Review of International Studies* 21 (1995): p. 251-78.

———. "Private Markets and Public Responsibility in a Global System: Conflict and Cooperation in Transnational Banking and Securities Regulation," In *The New World Order in International Finance*, edited by G.R.D. Underhill. London: MacMillan Press Ltd., 1997.

Van Zandt, David E. "The Regulatory and Institutional Conditions for an International Securities Market." *Virginia Journal of International Law* 32 (1991): p. 49-51.

Vogel, Steven K. *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*. Ithaca: Cornell University Press, 1996.

Wallace, Helen. "The Institutional Setting." In *Policy-Making in the European Union*, edited by Helen Wallace and William Wallace. Oxford: Oxford University Press, 2000.

Wallace, Helen, and William Wallace, eds. *Policy-Making in the European Union*. 4th ed. Oxford: Oxford University Press, 2000.

Wallace, William, ed. *The Dynamics of European Integration*. London: Pinter, 1990.

Walter, Andrew. "NGOs, Business , and International Investment: The Multilateral Agreement on Investment, Seattle, and Beyond." *Global Governance* (January 2001).

———. *World Power and World Money*. Revised ed. Hemel Hempstead: Harvester Wheatsheaf, 1993.

Waltz, Kenneth N. *Theory of International Politics*: Addison-Wesley, 1979.

———. *Man, the State and War: A Theoretical Analysis*. New York: Columbia University Press, 1959.

Warren III, Manning Gilbert. "Global Harmonisation of Securities Laws: The Achievements of the European Communities." *Harvard International Law Journal* 31, no. 1 (1990): p. 185-232.

———. "Regulatory Harmony in the European Communities: The Common Market Prospectus." *Brooklyn Journal of International Law* 16 (1990): p. 19-53.

Webb, C. "Introduction: Variations on a Theoretical Theme." In *Policy-Making in the EC*, edited by C. Webb, *et. al.*, London: Wiley and Sons, 1977.

Weber, H. *Le Parti Des Patrons: Le CNPF, 1946-1990*. Paris: Seuil, 1986.

Weber, M, *Economy and Society*, vol. I., eds., G. Roth and C. Wittich, New York, Bedminster, 1968.

Webster's Seventh New Collegiate Dictionary. Springfield, MA: G &C. Merriam Co., 1963.

Wendt, A. *Social Theory of International Politics*. New York: Cambridge University Press, 1999.

———. "Collective Identity Formation and the International State." *American Political Science Review* 88, June (1994): p. 384-96.

White, Lawrence J. "International Regulation of Securities Markets: Competition or Harmonization." In *The Industrial Organization and Regulation of the Securities Industry*, edited by Andrew W. Lo, p. 207-42. Chicago: The University of Chicago Press, 1996.

White, William R. "International Agreements in the Area of Banking and Finance: Accomplishments and Outstanding Issues." Basle: Bank for International Settlements, 1996.

Wolff, Samuel. "Securities Regulation in the European Community." *Denver Journal of International Law and Policy* 20, no. 1 (1991): p. 99-144.

Woolcock, Stephen. "Competition among Rules in the Single European Market." In *International Regulatory Competition and Coordination*, edited by William Bratton, Joseph McCahery, Sol Picciotto and Colin Scott, p. 289-321. Oxford: Clarendon Press, 1996.

Woolcock, Stephen, Michael Hodges, and Kristin Schreiber. *Britain, Germany, and 1992.* New York: Council on Foreign Relations, 1991.

Worth, Nancy. "Harmonizing Capital Adequacy Rules for International Banks and Securities Firms." *North Carolina Journal of International Law and Commercial Regulation* 18, no. 1 (Fall 1992): p. 133 -71.

Young, Oran. *International Governance: Protecting the Environment in a Stateless Society.* Ithaca: Cornell University Press, 1994.

———."Regime Dynamics: The Rise and Fall of International Regimes." In *International Regimes*, edited by Stephen D. Krasner. Ithaca: Cornell University Press, 1983.

Zaring, David. "International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations." *Texas International Law Journal* 33 (1998): p. 281-330.

Zürn, M. *Regieren Jenseits des Nationalstaates. Globalisierung und Denationalisierung als Chance.* Frankfurt a. M.: Suhrkamp, 1998.

Zysman, John. *Governments, Markets and Growth.* Ithaca: Cornell University Press, 1983

Newspapers, News Services, Magazines, Trade Publications:

"Adequacies Inadequate (Capital Reserve Regulations for Securities Firms)." *The Economist*, 30 September 1989, p. 80.

"Alas, Poor Europe." *The Economist*, 1982.

Andrews, Edmund L., "Greenspan Argues Against Strict Rules for Fed," *The New York Times*, p. C1, August 30, 2003.

Atkins, Ralph, and Andrew Hill. "UK Plans to Put the Brake on the Single Market: British Presidency under the Conservatives May Put New Legislation in Jeopardy." *Financial Times*, 10 February 1992 1992, p.14.

Bacon, Richard. "EC Finance Rules Face Fresh Obstacles." *Euromoney*, May 1993, p. 50-55

Barber, Lionel. "Survey of Financial Futures and Options: Brady Sets Framework for Debate - the Regulatory Impact." *Financial Times*, 3/10/88 1988, p. 3.

Barchard, David, Richard Waters, and Lucy Kellaway. "Bank Opposes Brussels Capital Directive." *Financial Times*, 5 February 1990, p. 16.

"Basle Brush," *The Economist*, 3/27/03.

"Basle's Model for Success." *International Financial Review* 15/4/95.

Bray, Nicholas. "Capital Norms Have a Way to Go." *The Wall Street Journal*, 3 February 1992, p. 9.

Buchan, David, and Tim Dickson. "The European Market: EC Gears up for Financial Services Christmas Rush." *Financial Times*, 28 November 1988, p. 8.

Bush, Janet. "Smoke Starts to Rise over the Battle for Regulation of US Markets." *Financial Times*, 2/4/88, p. 4.

Campbell, Katharine, and Deborah Hargreaves. "Frankfurt Fights to Regain Bunds: A Liffe Contract under Fire." *Financial Times*, 26 November 1990, p. 17.

Campbell, Katherine. "Regulators Discuss Financial Giants." *Financial Times*, 10 October 1990, p. 34.

———. "Roles Are Reversed for City of Bankers." *Financial Times*, 28 October 1991, p. XI

"Campeau Debacle May Fuel Debate over Market Reform Bill." *Dow Jones News Service - Ticker*, 1/18/90

"Capital Market Globalization and the SEC's Use of Memoranda of Understanding." *Brown & Wood - Corporate Newsletter* (1995-96): p. 4-6.

"City Faces up to Europe." *Financial Times*, 17 August 1989, p. 16.

"County Nat West: Anatomy of Cover-Up." *The Economist*, 28 January 1989, p. 78ff.

Day, Kathleen. "Tough Cop at the SEC; Chairman Richard Breeden, in Office a Year, Aggressively Seeks to Expand Agency's Authority." *The Washington Post*, 10/14/90, p.1.

Dickson, Tim. "Anglo-German Boost for Single Insurance Market." *Financial Times*, 31 March 1990, p. 2.

———. "Capital Adequacy Directive: Compromise with More Changes Likely." *Financial Times*, 26 April 1990, p. 2.

———. "EC Unveils Capital Adequacy Plans." *Financial Times*, 26 April 1990, p. 28.

"Dingell, Markey Intent on Stock Market Reform Legislation." *Dow Jones News Service - Ticker*, 4/4/89.

Donkin, Richard. "Europe Losing Sight of Single Market Goal, Says Lord Young - Challenge of 1992." *Financial Times*, 4 May 1989.

Doyle, John M. "GAO Criticizes 2 Agencies for Conflicting Views of Crash." *The Associated Press - Los Angeles Daily News*, 7/24/1990, p. B3.

———. "SEC Chief Rebuts Critics of Bill to Shift Power on Stock Index Futures." *The Associated Press*, 6/7/90.

———. "SEC Chief to Congress: Banking, Securities Regulation Must Change." *The Associated Press*, 7/11/1990.

du Bois, Martin. "EC Considers Plan to Revamp Securities Rules." *The Wall Street Journal*, 16 March 1990, p. B4.

"EC's Capital Adequacy Directive Toned Down for Securities Industry." *The American Banker*, 24 February 1992.

Egan, Jack. "A Bond Scandal That Won't Stop." *US News & World Report*, 9/16/91 1991, p. 48-49.

Evans, Garry. "Bundesbank Clings to Power." *Euromoney*, April 1992, p. 55ff.

Fairlamb, David. "High-Tech Capital Adequacy." *Institutional Investor* August 1994, p. 42.

"France Presses Ahead with Liberalisation." *Financial Times*, September 26, 1991.

French, Martin. "Doing the Continental." *Euromoney*, July 1987, p. 24-35.

"Futures Commission Wins Crucial Ruling, Battle with SEC Now Shifts to Congress." *The San Francisco Chronicle*, 6/19/1990, p. 4.

"Getting closer," *The Economist*, May 25, 1996.

Graham, George. "Regulators Lay Basis for Fraud Fight." *Financial Times*, 18 July 1991. p. 33.

"Greenspan Backs Move for New Regulatory Body." *Australian Financial Review*, 12/3/87, 70.

Hargreaves, Deborah. "Futures Industry Chief Fights Off Regulation." *Financial Times*, March 11,1988, p. 28.

Hill, Andrew. "Capital Adequacy Rules Delayed." *Financial Times*, 19 December 1991, p. 29.

———. "Compromise Proposed on EC Investment Services." *Financial Times*, 25 June 1992, p. 27.
———. "EC Closer to Accord on Capital Adequacy." *Financial Times*, 3 February 1992, p. 17.

Holberton, Simon. "City's Foreign Earnings Fall Sharply." *Financial Times*, 2 August 1989, p. 8.

Holman, Richard L. "The Decline of French Industry." *The Wall Street Journal*, August 23, 1991, p. A4.

Ingersoll, Bruce. "SEC Will Seek Authority from Congress to Regulate Bank Brokerage Activities." *The Wall Street Journal*, April 30, 1987.

———. "The SEC Case against Drexel: Charges Likely to Add Pressure for Tougher Insider-Trading Law." *The Wall Street Journal*, September 8, 1988.

ISRR. "1992 Spurs Us Agencies to Regulatory Cooperation." October 25, 1989, p. 4-5.

———. "Accounting Reconciliation Key to U.S.-Canada Pact." March 26, 1990, p. 3-4.
———. "Another Delay Hits Taurus; Launch Set for Spring 1993." 5 November 1991.
———. "Bank of England Chief Urges Liberal Regulatory Regime." 5 November 1991.
———. "Commission Approves Single License for Providers of Investment Services." 4 January 1989, p. 1, 8.
———. "Commission Spokesman Tries to Calm Reciprocity Concerns." 12 April 1989.
———. "Compromises Sought to Move Capital Adequacy Rules Ahead." 24 March 1992.
———. "Constitution Issues Posed by Extraterritorial Enforcement." June 21, 1989, p. 6.
———. "'Convergence,' More Than Harmonisation, Is Key Word in Cautious Working Group Sessions.", September 27, 1989, p. 8-10.
———. "Differences on Equity, Technical Details Suggest Long Wait for Global Capital Rules." 11 February 1992.
———. "Disagreement Plagues Committee Discussions on Harmonised International Capital Standards." July 28, 1992, p. 1,7-8.
———. "EC Appears to Have Backed Off from "Mirror Image' Proposal." 12 April 1989.
———. "EC Commissioner Seeks Compromises from UK, France on Investment Services Directive." 22 April 1991.
———. "EC Commissioner Upbeat on Talks with US Officials.", 10 May 1989.
———. "EC Sets up High Level Working Group to Boost Investment Services Directive." 11 March 1991.
———. "EC-Adopted Capital Adequacy Rule Gets Low-Key UK Approval." 7 May 1990.
———. "European Exchanges Look to 1992, Some Question Commission's Role." January 18, 1989, p. 1-2.
———. "FSVC, SEC Resolve Differences; Hungary Mission to Depart." September 10, 1990, p. 3.
———. "Germany: Businesses Urge Retaliation against SEC's Listing Policy." October 20, 1992, p. 3-4.
———. "House Panel Passes Bill to Expand SEC Authority." November 22, 1989, p. 7.
———. "Implementation of Rule 144a and Reg. S Expected Soon." March 26, 1990, p. 2-3.
———. "IMRO Take a 'Thumping' over Maxwell Scandal." 21 April 1992.
———. "Interview: SEC's Michael Mann Sets Active Pace and New Initiatives for the Recently Formed Office of International Affairs." April 23, 1990, p. 9-10.
———. "Investment Service Directive Remains Stalled among Ministers." July 15, 1991, p. 2.
———. "Investment Services Directive Remains Stalled among Ministers." 15 July 1991.
———. "IOSCO and EC Officials Meet to Map out Harmonization Effort." December 6, 1989, p. 1,8.
———. "IOSCO: EC Moves Could Doom Global Accounting Harmony." January 17, 1990, p. 6-7.
———. "IOSCO Sees Major Effort on Futures and Ethics in Chile." July 16, 1990, p. 2-3.
———. "ISE's Douglas-Mann Gives IOSCO's Strategic Report a Cautious Welcome," December 3, 1990, p. 5.
———. "Latest EC Draft Capital Rule Wins Qualified U.K. Approval." 26 March 1990.
———. "Lawmakers Set Agenda Amid Growing Worry That US Has Lost Edge in Global Capital Markets." June 21, 1989, p. 9-10.

———. "London School Warns EC Regulation Threatens London Financial Center." 7 April 1992.
———. "London to Remain Competitive, Brittan Tells Stock Exchange." 7 June 1989.
———. "LSE Chairman Makes New Bid for European Wholesale Market." 19 November 1991.
———. "MPs Urge Speedier Adoption of Investment Services Rules." 16 August 1989.
———. "New Directive Underway on Capital, Market Risk." 7 June 1989.
———. "New Rules Will Tighten Capital Adequacy Requirements." 2 August 1989.
———. "Off-Exchange Trade Compromise Unlikely to Succeed Quickly." 14 January 1991.
——— "Progress Being Made on Foreign Talks with Regulators, SIB Says", 1 July 1991.
———. "Progress on West German-IOSCO Accord to Resolve Capital Adequacy Row." October 25, 1989, p. 1, 8.
———. "Reciprocity Should Extend to Bank Branches, MPs Say." 29 March 1989.
———. "Re-Regulation Trend Emerging in the Financial Markets." January 31, 1990, p. 6-7.
———. "Revised Draft Capital Rules Reflect Technical Changes." February 25, 1992, p. 2-3.
———. "Rule 144A Will Shift Some Euromarket Business to U.S.", May 7, 1990, p. 1,8.
———. "SEC and MoF Expand Enforcement Coordination; Multijurisdictional Disclosure Pact Expected Soon." January 14, 1991, p. 1,8.
———. "SEC Asks for More Authority in International Investigations." March 15, 1989, p. 1, 10.
———. "SEC Asks Major Capital Hike for Us Securities Firms." September 13, 1989, p. 1-2.
———. "SEC Chairman Urges Capital Rules That Cover All Types of Securities." June 16, 1992, p. 6-7.
———. "SEC, EC in Co-operation Agreement." 23 September 1991.
———. "SEC Funding, Data-Sharing Bill Receives Senate Panel's Ok.", September 27, 1989, p. 5.
———. "SEC Official Sees No Near-Term Change to Reconciliation Rules.", January 28, 1992, p. 4-5.
———. "SEC Plans to Encourage Foreign Rights Offerings." March 25, 1991, p. 5-6.
———. "SEC Questions Role of FSVC Emerging Markets Effort." July 2, 1990, p. 3-4.
———. "SEC Signs Assistance Pacts with France, the Netherlands." January 3, 1990, p. 1-2.
———. "SEC Stands Firm on Requiring Foreign Reconciliation to GAAP." July 14, 1992, p. 5.
———. "SEC's Michael Mann Sets Active Pace and New Initiatives for the Recently Formed Office of International Affairs." April 23, 1990, p. 1.
———. "SIB Joining BIS Group on Equity-Position Risk Study." 2 July 1990.
———. "SIB Undergoes Major Reshuffle; New Executive Committee Set Up." 28 January 1991.
———. "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved." October 7, 1991, p. 8-10.
———. "Technical Committee Meeting Sets Stage for Standards Reports." March 25, 1991, p. 3.
———. "Technical Committee Sends Capital Memorandum to Banking Supervisors; MOU Principles Approved." 7 October 1991.
———. "Three Harmonisation Reports Are to Be Released in Venice." August 16, 1989, p. 6-7.
— — —. "Transparency May Not Come with 1992, Attorney Warns." 10 May 1989.
———. "Trilateral Meeting of Securities Regulators Focuses on Multi-Jurisdictional Disclosure Issues." 24 September 1990.
———. "Trilateral Meeting of Securities Regulators Focuses on Multi-Jurisdictional Disclosure Issues." September 24, 1990, p. 1,7-8.
———. "TSA Warns Member Firms on Latest EC Draft Capital Adequacy Directive." 31 January 1990.
———. "U.K. Financial Services Legislation May Conflict with EC Banking Directive." 1 March 1989.
———. "U.K. Place Strong Political Support on Achieving U.S. Multi-Jurisdictional Pact." March 12, 1990, p. 1,8.
———. "US, Europe Split on Capital Adequacy Standards; Breeden Firmly Rejects UK Approach as 'Unsafe'." November 3, 1992, p. 1, 8-9.
———. "US'. SEC Forges New Global Role within IOSCO; Breeden Chairs Strengthened Technical Committee." November 19, 1990, p. 1,9.

"Issue of Capital Adequacy May Improve Outlook for Glass-Steagall Repeal." *Securities Week*, 11/30/87, p. 1.

Johnson, Ian. "Frankfurt Fights to Be Europe's Wall St." *The Baltimore Sun*, 5/31 1992, p. 1C.

Kane, Frank. "Shaky Foundations May Leave the Cad Tottering with a Single European Securities Market on the Horizon." *The Sunday Telegraph*, 14 June 1992, p. 39.

Kellaway, Lucy. "Bankers Cautious over EC Capital Backing Proposal." *Financial Times*, 10 January 1991, p. 14.

———. "International Equity Issues: Many Rows on the Way to Market." *Financial Times*, 21 November 1990, p. 35.
———. "Single Market Deadline Threatened." *Financial Times*, 19 December 1990, p. 25.

Kellaway, Lucy, and Tim Dickson. "Painful Birth of Single Market: The Deregulation of Financial Services in the European Community." *Financial Times*, 19 December 1990, p. 16.

Kellaway, Lucy, and Richard Waters. "Brittan Pledges Flexibility in EC Financial Services Rules." *Financial Times*, 6 February 1990, p. 33.

Koenig, Peter. "Has the US Got the Bottle for a Fight?" *Euromoney*, January 1, 1990, p. 45.

———. "Into the Maelstrom." *Euromoney*, June 1987, p. 67-79.

Lambert, Richard. "The City Finds Its Head Start under Attack: A Far-Reaching Study of London's Prospects as a World Centre." *Financial Times*, 1 June 1989.

———. "FT Conference: World Leadership in Financial Services 'within Grasp of EC'." *Financial Times*, 17 October 1989, p. 2.

Lamont, Norman. "Interview with the Chancellor." *Financial Times*, 31 December 1991, 4.

Lascelles, David. "Calls to Bring Watchdogs into Line: Moves to Harmonise Securities Rules Worldwide." *Financial Times*, 14 August 1989, p. 17.

———. "Capital Adequacy Directive: EC Battles to Create a Level Playing Field for Banks and Securities Houses." *Financial Times*, 26 April 1990, p. 2.
———. "Flaw in the Argument: The Governor of the Bank of England's Views on Banking Supervision." *Financial Times*, 7 November 1990, p. 24.
———. "Order in the Marketplace - the Blue Arrow Affair Brought Credit to the Bank of England." *Financial Times*, 25 September 1989, p. 35.
———. "Reforms Fail to Keep Pace with Changes in the Markets." *Financial Times*, 24 May 1991, p. III.
———. "Securities Rules Closer to Global Harmonisation." *Financial Times*, 14 August 1989, p. 1.
———. "US Groups Seek Air Treatment from EC." *Financial Times*, 21 February 1990, p. 2.

Lee, Peter. "Daimler Listing Opens the Door." *Euromoney*, May 1993, p. 10-12.

———. "Securities Houses Face Capital Clampdown." *Euromoney*, April 1992, p. 32-43.
———. "Who's Afraid of a Labour Government?" *Euromoney*, December 1991, p. 45-48.

"The Lex Column: Capital Adequacy." *Financial Times*, 9 June 1992, p. 20.

London, Simon. "Banks Face Hope and Frustration - Moves on the Stony Road to Capital Adequacy." *Financial Times*, 27 March 1991, p. 33.

———. "Banks Struggle to Achieve Capital Adequacy." *Financial Times*, 30 November 1990, p. 37.
———. "Fresh Try on Securities Directive." *Financial Times*, 16 July 1991, p. 27.
———. "IPMA Urges EC to Revise Proposals for New Rules." *Financial Times*, 13 May 1992, p. 31.

London, Simon, Alice Rawsthorn, and Andrew Hill. "Muted Cheers for the Single Market: Attempts to Unify European Securities." *Financial Times*, 11 June 1992, p. 23.

Lynch, Tom. "EC Bank Plans Threaten City's Role, Says Minister." *Financial Times*, 10 February 1989, p. 7.

Manasian, David, and Craig Forman. "Confusion, Duplication Hamper British Market-Regulation Effort." *The Wall Street Journal*, 5 January 1989.

Miller, D.W. "Storming the Palace in Political Science." *The Chronicle of Higher Education*, September 21, 2001, p. A16.

Moerman, Filip. "Ruffles on the Level Playing Field." *Euromoney* November 1993.

Murray, William. "Polly Peck's Fall Signals Banking Shift." *The Wall Street Journal*, 2 November 1990 1990, p. B4A.

Norman, Peter. "Economics Notebook: UK Prefers a Bank in the Hand." *Financial Times*, 30 April 1990, p. 25.

Osborn, Neil. "TSA Chief Admits Big Will Benefit." *Euromoney*, September 1987, p. 462-63.

Owen, David. "UK Plays Down Capital Adequacy Hopes." *Financial Times*, 4 June 1992, p. 34.

Owen, David, and Richard Waters. "EC Poised to Rule on Capital." *Financial Times*, 18 May 1992, p. 19.

"A Passport to Strife." *The Economist*, 28 April 1990, p. 84.

Peston, Robert. "The Challenge to the City from Continental Centres Is Intensifying." *Financial Times*, 1 November 1991, p. 23.

Peston, Robert, and Tracy Corrigan. "Breeden Opposes IOSCO Capital Standard: SEC Chairman Condemns Proposal as 'Imprudent' - Chance of Agreement Recedes." *Financial Times*, 28 October 1992, p. 23.

———. "International Capital Markets: Hopes Dwindle for New Agreement on Capital Requirements." *Financial Times*, 28 October 1992, p. 30.

———. "International Capital Markets: Sir Leon Brittan Joins Row over Capital Standards - IOSCO Conference." *Financial Times*, 29 October 1992, p. 28.

Power, William. "Securities Industry Accepts Bank Role, but on its Terms." *The Wall Street Journal*, December 4, 1989.

Pretzlik, Charles, "Basle II 'could damage banks' capital market liquidity, *Financial Times*, August 10, 2003.

Press, Associated. "SEC Chief as Congress to Broaden His Powers." *The Atlanta Journal Constitution*, 2/2/90, p. 4.

Reports, International. "Banking & Finance - the Securities Summit: Consensus with Basle?" IBC USA Licensing Inc., 1992.

———. "United Kingdom Second Thoughts on Maastricht?" New York: IBC USA (Publications) Inc., 1992.

Review, International Financial. "International Capital Markets.". London: IFR, 1992.

Ricks, Thomas E., and Tim Carrington. "Challenging Job: In Aftermath of Crash, Many Ask If SEC Chief Is up to His New Post." *The Wall Street Journal*, 11/3/87.

Riddell, Peter. "Ruder Explains SEC's Stance on Drexel." *Financial Times*, 4/19/89, p. 41.

"Riegel Promises Prompt Action on Securities Legislation." *Dow Jones News Service - Ticker*, 4/18/89.

Robb, Gregory. "SEC, CFTC Chiefs Fight in Congress." *The New York Times*, 5/25/90 1990, p. 3.

"Ruder - Rules to Be Re-Proposed." *Dow Jones News Service - Ticker*, 6/15/89.

Salwen, Kevin G. "Breeden Turns Plunge in Stock Market to Advantage in Pushing SEC Agenda." *The Wall Street Journal*, 10/26/89.

———. "SEC, Seeking Hostile Takeover of CFTC's Power to Regulate Financial Markets, Is Favored to Win." *The Wall Street Journal*, 4/20/90 1990, p. 16.

"SEC Chief Urges Congress to Expand Agency's Power." *Houston Chronicle*, 2/4/88, p. 3.

"SEC Creates Overseas Office to Work with Foreign Regulators." *Star-Tribune Newspaper of the Twin Cities*, December 19, 1989, p. 8D.

Seelye, Katherine Q. "A Spectrum of Color-Coded Choices for the White House's E.P.A. Nominee." *The New York Times*, 26 May 2003, p. A11.

Service, Dow Jones News. "SEC's Breeden Calls Brittan Remarks 'Ill Informed'." *Dow Jones News Service - Ticker*, 10/29/92.

Sherwell, Chris. "SEC Chief Draws up Global Blueprint." *Financial Times*, 11/16/88, p. 40.

Shirreff, David. "Regulatory Overload." *Euromoney* June 1995, p. 115.

"Status of City Preserved." *The Daily Telegraph*, 8 June 1992, p. 25.

Stephens, Philip. "Parliament and Politics: Thatcher Denies Isolation over Europe - Prime Minister's Guildhall Address." *Financial Times*, 13 November 1990, p. 15.

Supplement. "The City Revolution." *Financial Times*, 27 October 1986, at I.

"Trojan Horses." *The Economist*, February 13, 2003.

Vise, David A. "Battling for Market Control; SEC, Led by Ruder, Votes to Ask Congress for Index Futures Role." *The Washington Post*, 5/27/88, p. 1.

———. "SEC Chairman Warns Congress on Futures." *The Washington Post*, 2/2/90 1990, p. 5.

von Ribbentrop, B. "Frankfurt Throws Down the Gauntlet." *Euromoney*, October 1990, p. 42-43.

Waller, David. "Frankfurt Considers Electronic Trading." *Financial Times*, 18 January 1992, p. 22.

Waters, Richard. "Capital Questions for EC Investment." *Financial Times*, 22 May 1992, p. 27.

———. "EC Amends Proposals for Capital Adequacy." *Financial Times*, 16 November 1989, 45.

———. "EC Directive on Capital Rules Could Hit UK Firms." *Financial Times*, 22 December 1989, p.22.

———. "An Emotive Topic for International Regulators - the Development of Capital Rules for Securities Traders." *Financial Times*, 31 January 1992, p. 29.

———. "The European Market: Securities Firms Look across Borders - How Bankers and Brokers Are Preparing for Battle." *Financial Times*, 7 January 1991, p. 4.

———. "German Action Threatens Capital Adequacy Accord." *Financial Times*, 21 September 1989, p. 28.

———. "International Capital Markets: Brokers Face 70% Capital Rise under EC Plan." *Financial Times*, 27 September 1990, p. 33.

———. "International Capital Markets: International Draft Rules on Capital Delayed." *Financial Times*, 12 August 1992, p. 24.

———. "International Capital Markets: Regulators to Discuss Co-operation Moves." *Financial Times*, 14 September 1990, p. 32.

———. "IOSCO Conference - Germans Back Down on Capital Plans." *Financial Times*, 22 September 1989, p. 37.

———. "IOSCO Conference: French and Italians Turn Down DTI Membership." *Financial Times*, September 21, 1989, p. 37.

———. "The Quest for a Capital Adequacy Directive." *Financial Times*, 5 April 1991, p. 27.

———. "Regulators Seek to Give IOSCO Greater Influence." *Financial Times*, 12 November 1990, p. 19.

———. "Regulators to Discuss Cooperation Moves." *Financial Times*, 14 September 1990, p. 32.

———. "Search for Security: Last-Ditch Efforts to Reach an Agreement on Capital Adequacy in the Securities Markets." *Financial Times*, 23 October 1992, p. 20.

———. "Securities Regulators Close to Capital Rules." *Financial Times*, 27 January 1992, p. 15.
———. "Survey of International Capital Markets: Drexel's Fall May Spur Talking-Shop - Regulation." *Financial Times*, 2 July 1990, p. IV.
———. "US Houses Condemn EC Directive." *Financial Times*, 6 March 1990, p. 33.

Waters, Richard, and Lucy Kellaway. "Europe's Investors Seek a CAD with Sense of Fair Play: EC Plans for Capital Adequacy." *Financial Times*, 9 February 1990, p. 31.

Week, Securities. "US Regulators Need Forum for International Issues, Glauber Says." In *Securities Week*, 3. New York: McGraw-Hill, Inc., 1989.

"Well-Mannered Watchdogs." *Financial Times*, 6 March 1989, p. 16.

Wolman, Clive. "TSA Opposes the Reciprocity Provisions of EC Directive." *Financial Times*, 5 April 1989, p. 8.

Acknowledgements

This thesis represents the completion of a longstanding aspiration. It also represents part of a personal journey that would not have been possible without the guidance, encouragement and patience of many individuals.

Professor Richard N. Ottaway and Elaine Davis Ottaway urged me to begin my journey and encouraged and counselled me along the way. Dr. Michael R. Hodges was my first Research Supervisor. He provided direction, enthusiasm, and a role model in the early stages of my research. Tragically, he passed away before my thesis was completed. Dr. Andrew R. Walter guided me through the completion of my thesis and provided support and advice on navigating the thickets of thesis structure and defence.

Professor Geoffrey R.D. Underhill and Dr. Thomas C. Lawton, my thesis examiners, went beyond the normal duties of examiners in providing guidance on ways to improve my thesis' structure and arguments. I am very grateful for their counsel, their patience and their thoughtfulness. My interview subjects provided invaluable research information. I thank them for their willingness to share their experiences freely and frankly.

Two colleagues, Dr. Michael R. King and Dr. Charles W. Parker, provided fellowship and commiseration as we laboured to complete our theses. The International Relations Department of the London School of Economics was a regular source of ideas, advice, and encouragement. Professor John S. Micgiel facilitated my being named a Visiting Scholar at Columbia University, which enabled me to complete my research in New York. Columbia's School of International and Public Affairs, in particular its Office of Career Services, provided me with work and, more importantly, a welcome break from the solitude of writing.

Throughout my work, my family and friends have been unstinting in their support for what seemed a never-ending and quixotic project. I am permanently indebted to them. My thesis has benefited tremendously from the thoughtful and expert critiques of

Rachel Abram and Dr. Elizabeth M. Kurz. The advice of Dr. Marilyn Puder-York and Pamela Pagliochini reinvigorated my research and writing.

More than anything else, however, I have been sustained throughout this journey by the love and support of my wife, Barbara. Without her unflagging encouragement, her unwavering patience, and her personal grace in the face of many hurdles, my dream would never have been realised.

Amor magnus doctor est.[1]

[1] St. Augustine.