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Financial Legal System in Response to the Financial Crisis: Opportunities and Challenges.

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Lessons from Other Society-sensitive Sectors for a Financial Regulatory Regime

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I. Introduction

Since the outbreak of the financial crisis, international financial regulation has been a hotly debated topic. Substantive rules are questioned, supervisory authorities tackled and new architectural rules asked for. Expert reports made available could already fill libraries, and legislators are under considerable pressure to present reform proposals as soon as possible.

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

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

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

[*] University of Zurich and University of Hong Kong.Discussion paper – please do not quote without the author's permission .The author wishes to thank Prof. Christine Kaufmann and MLaw Seraina Gruenewald for their valuable comments as regards an earlier version of this article.

[1] See ROLF H. WEBER, Mapping and Structuring International Financial Regulation – A Theoretical Approach, European Banking Law Review 2009, 651.

[2] JAN H. DALHUISEN, Dalhuisen on International Commercial, Financial and Trade Law, Oxford 2004, 908.

[3] For this topic see below III.2.

[4] WEBER (Fn 1), 653.

meaning the safety and soundness of the financial system.[5] A further concern in financial services regulation is consumer protection: The relationship between financial intermediaries and their customers has become an important element of financial regulation.[6] Not only is an integrated, however, not excessive financial regulation system essential for the functioning of the financial markets, but also will it enhance market players' acceptance of regulatory interventions.[7] Many voices call now (again)[8] for a new international financial architecture. Experts all over the world try to develop a framework which would be designed to prevent further crises. However, a certain weakness of this approach consists in the fact that financial experts do not necessarily take into account the experiences which have been made with regulatory structures in other fields. Subsequently, Internet regulation will be looked at as a comparative example for the development of a sound financial regulatory framework. Similar to the Internet, financial markets have gained a global dimension over the past decades, affecting and involving an increasing number of "participants".

II. Lessons from Internet Regulation

1. Spontaneous Regulation

In the early days of the emergence of cyberspace, Internet scholars have assigned attributes of independence to this new "province" of the world.[9] It has been argued that the participants in cyberspace would create a "net nation" without any regulatory body policing the Internet.[10] In the meantime the euphoric approach of independence has vanished. Nevertheless, it can still be said that the Internet developed beyond a regulatory legal framework and was mainly based on self-regulation by its users since the assumption prevailed that the Internet would not be governed by laws in the legal sense, but rather by "codes" defining the relevant parameters resulting from technical protocols, standards and procedures.[11]

Without any doubt, the establishment of an adequate legal framework for the Internet needs to take into account available regulatory models. Apart from the possibility of no regulation at all, which does not seem to be a viable solution, the choice is principally between traditional national regulation, international

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[5] For further details see ROLF H. WEBER/DOUGLAS ARNER, Toward a New Design for International Financial Regulation, 29 University of Pennsylvania Journal of International Law 2007, 391, 416/17 with references.

[6] See ROY C. SMITH/INGO WALTER, Global Banking, Oxford 2003, 337.

[7] WEBER (Fn 1), 654.

[8] See already ROLF H. WEBER, Challenges for the New Financial Architecture, 31 Hong Kong Law Journal, 2001, 241 ss; MARIO GIOVANOLI, A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting, in: Giovanoli (ed.), International Monetary Law, Issues for the New Millennium, Oxford 2000, 3 ss.

[9] See DAVID R. JOHNSON/DAVID G. POST, Law and Borders – The Rise of Law in Cyberspace, 48 Stanford Law Review 1996, 1367 ss.

[10] See NICHOLAS NEGROPONTE, Being Digital, London 1996, 237.

[11] ROLF H. WEBER, Regulatory Models for the Online World, Zurich 2002, 25 ss and 89 ss; for the importance of codes for Internet regulation see LAWRENCE LESSIG, Code and Other Laws of Cyberspace, New York 1979, and LAWRENCE LESSIG, Code Version 2.0, New York 2006.

agreements and self-regulation.[12] The latter scheme has indeed played an important role in the online world. However, instead of an established form of self-regulation, the virtual world is rather designed by "spontaneous" regulation, encompassing regulatory autonomy and independence from any structured regime of rule-making.[13]

Generally speaking, spontaneous self-regulation is justified if it is more efficient than state law and if compliance with legislative rules is less likely than compliance with self-regulation. Seen from a broader perspective, self-regulation is "law" which is responsive to changes in the "environment" and which develops and establishes rules, quite often derived from industry or business standards and shaped by occurring events, independent of the principle of territoriality.[14] Milhaupt/Pistor describe this development as a "rolling relationship between law and markets".[15]

Since provisions of a self-regulating nature are not enforceable through public action, such rules do not have the legal quality of law. However, self-regulation can result in moral pressure and be understood as a social control model. Such a system of control may consist of rules of normatively appropriate human behavior, similar to the notion of a "social contract".[16]

During the last few years, the legal doctrine has developed the notion of "soft law" for commitments in international relations expressing more than just policy statements, but less than law in its strict sense, also possessing a certain proximity to law and a certain legal relevance.[17] Therefore, it can be said that soft law is a social notion close to law and that it usually covers certain forms of expected and acceptable codes of conduct.[18] Furthermore, the role of soft law for the development of good faith and customary rules as well as the need to establish rules to govern international relations should not be underestimated; moreover, soft law may contribute essentially with respect to the interpretation of international law.[19] Nevertheless, certain weaknesses of self-regulatory mechanisms cannot be overlooked. These mainly concern the legitimacy aspects of processes of implementation of "private norms" as well as the procedural aspects for their enforcement (for example, lack of direct sanctions).[20]

The experiences in the Internet context show that soft law can indeed function as a regulatory scheme, for example, in the domain name allocation process. Even if some scepticism is justified in view of the Internet Corporation for Assigned Names and Numbers (ICANN), it should be kept in mind that the whole technical system has been implemented and is running without major

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[12] See ROLF H. WEBER, Shaping Internet Governance: Regulatory Challenges, Zurich 2009, 11 ss.

[13] See JOHNSON/POST (Fn 9), 1370 ss.

[14] See WEBER (Fn 1), 657; from a sociological point of view see ANTHONY GIDDENS, The Consequences of Modernity, Stanford 1990, 63 ss.

[15] CURTIS J. MILHAUPT/KATHARINA PISTOR, Law and Capitalism, Chicago/London 2008, 6.

[16] WEBER (Fn 12), 20, 73 ss.

[17] The term „soft law" was introduced by RENÉ JEAN DUPUY, Declaratory Law and Programmatory Law: From Revolutionary Custom to "Soft Law", in: Akkerman/Krieken/Pannenborg (eds), Declaration on Principles, Leyden 1977, 247 ss.

[18] WEBER (Fn 11), 82/83.

[19] WEBER (Fn 12), 20/21.

[20] WEBER (Fn 12), 21/22.

(legal) frictions.[21]

2. Multi-Stakeholderism

The discussion related to the establishment of an adequate regulatory framework for the Internet has more and more crystallized in the appreciation that shared power amongst several social participants of the online world would be unavoidable, i.e., multi-stakeholderism would have to become the underlying concept for the development of the Internet regulatory environment.[22] Legal scholars have realized that a fitting of the regulatory framework needs to consider the principles of the subject it addresses and hence pay special attention to the technological environment of the Internet.[23] The bottom-up approach in self-regulation also calls for the inclusion of all interested groups of the online world in the regulatory process, in which diversity and pluralism should be considered as common objectives.[24] Nevertheless, architectural principles must be implemented which take due account of a minimum of predictability required for an adequate legal framework in order to establish reliable relations between natural or legal persons.[25]

As mentioned, the Internet was implemented mainly by the private sector which mostly followed a bottom-up approach in self-regulation, taking special account of the technical issues raised by this new network system. Since civil society is concerned with the establishment of communication channels, in practice every individual is potentially a "netizen". Therefore, as an issue of legitimacy[26] participation in decision-making processes needs to encompass every member of civil society. In order to reflect this appreciation, Lessig has introduced the notion of the "commons" ("Allmende" in the sense of the old German farmers' system), allowing the inclusion of the whole of civil society in societal processes.[27]

Interactions between science or politics and collective responses from citizens lead to transgovernmental networks which, however, may cause a disaggregation of states in favor of the established networks, i.e., a "disaggregated sovereignty"; thereby, actual cooperation and solution achievement could be improved, but concerns about legitimacy remain.[28] The respective networks having their own powers, incentives, motivations, abilities etc. would need to take due account of already existing international organizations, corporations, non-governmental organizations and other actors in the transnational society.[29]

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[21] For the discussion about the role and legitimacy of ICANN see in detail WEBER (Fn 12), 60 ss with further references.

[22] See WEBER (Fn 12), 88 ss.

[23] See JEREMY MALCOLM, Multi-Stakeholder Governance and the Internet Governance Forum, Perth 2008.

[24] See SLAVKA ANTONOVA, Powerscape of Internet Governance, Saarbrücken 2008.

[25] WEBER (Fn 12), 89 ss.

[26] For further details to the legitimacy aspect see WEBER (Fn 12), 105 ss with references.

[27] LAWRENCE LESSIG, The Future of Ideas, New York 2001, 19 ss.

[28] See MYRIAM SENN, Decentralisation of Economic Law – An Oxymoron?, Journal of Corporate Law Studies 2005, 427, 442 ss.

[29] Otherwise, the risk of fragmentation becomes critical (below II.3); for further details see THOMAS SCHULTZ, Carving up the Internet: Jurisdiction, Legal Orders, and the Private/Public International Law Interface, 19 The European Journal of International Law Interface 2008, 799, 800 ss.

The specialized field of Internet regulation requires a high level of competence and expertise. Joint involvement of all stakeholders having the necessary know-how in one way or the other is desirable as it generally ensures a form of representation at the international level. This is an important aspect in view of the legitimacy of the regulatory framework; the stakeholders, enhancing communication, coordination and cooperation in a kind of forum, frame a central governance point for Internet issues, allowing for participation and dialogue.[30]

The envisaged realization of a concept of "multi-stakeholderism in governance", perceived as the new way forward in favor of the inclusion and participation of the whole of society,[31] goes beyond the scope of traditional governance theories, which generally pursue an approach strictly distinguishing the state (public law) from society (civil law). Such a development challenges the traditional international legal and political understanding of legitimacy and makes it necessary to tackle the general question of who could be a legitimate stakeholder and which aspects are to be encompassed by such concept of "transnationalism".[32]

3. Fragmentation

The implementation of the multi-stakeholderism principle and the inclusion of all members of civil society in the (autonomous and spontaneous) rule-making process inevitably lead to a certain fragmentation of regulation since societal processes and contradictions are to be reflected.[33] Based on a fragmentation of knowledge, power or control,[34] increased specialization and diversification occur and design multiple variations of regulatory types or regimes of relationships and arrangements.[35] If epistemic communities and networks are involved in the rule-making process, private actors start to play a role not only as decision-makers, but also as intermediaries and brokers.[36]

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

- Ruggie analyzed the functions of the manifold epistemic communities and their role in the rule-making processes, arguing that collective awareness and attention may be mutually beneficial.[37]

- Koskenniemi highlighted structural conflicts between various regimes and addressed possible approaches for a harmonization of rule-making processes.[38]

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[30] See WEBER (Fn 12), 148 ss with further references.
[31] See-WEBER (Fn 12), 148/149,172/173.
[32] See WEBER (Fn 12), 268.
[33] MARTTI KOSKENNIEMI, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission, United Nations, A-CN.4/L.682, April 13, 2006, 11/12.
[34] SENN (Fn 28), 444 ss.
[35] KOSKENNIEMI (Fn 33), 30-34.
[36] See PETER N. GRABOSKY, Using Non-Governmental Resources to Foster Regulatory Compliance, 8 Governance: An International Journal of Policy and Administration 1995, 545.
[37] JOHN GERARD RUGGIE, International Responses to Technology: Concepts and Trends, 29 International Organization 1975, 557 ss.

- Slaughter developed principles for government networks, permitting coordination on a global level and creating a new authority responsible and accountable for the development of rules.[39]

The regulation of the online world clearly shows that fragmentation can create the risk of incompatible or conflicting rules and standards. Therefore, the harmonization approach should be considered an appropriate response ("assembling mixed orders"),[40] and the diversification of global legal activities through rapid expansion of cross-border rules needs to take into account the requirement of the implementation of coherent minimum standards. In other words, legal predictability requires increased attention to "equalize" the inherent risks of fragmentation.[41]

Certain mechanisms can work as a means of overcoming fragmentation: (a) Transparency and accountability need to be further developed. Transparency is a recognized significant principle for regulatory systems; its importance stems from its relevance in the achievement of other necessary tenets of regulation, such as providing sufficient information to enable informed decisions.[42] Further aspects are accessibility, clarity, logic and rationality, truthfulness and accuracy as well as openness. Since a transparent methodology for rule-making processes based on revisable procedures reduces mistrust and can have a legitimizing effect, transparency and accountability should be persistent objectives of any governance mechanism.[43] (b) Another important aspect concerns conflicts of laws. Contradictory or intersecting objectives of rules and mandates of international financial institutions may cause regulatory redundancies or loopholes, thus weakening the financial markets as a whole. For these cases, special conflict rules are necessary in order to determine which regulation or institution takes priority over the other rules or institutions.

III. Implications for Financial Regulation

Based on the described findings, the following elements of financial regulation merit further elaboration.

1. Actors: Widening the Scope of Participants

In all regulatory segments, the institutional actors play a key role in the rule-making processes. As North points out, institutions structure incentives in human exchange whether political, social or economic;[44] furthermore, institutional change shapes the way societies evolve through time and hence is important to understand historical change. Actors also institute processes by producing and disseminating rules that determine the behavioral patterns of the

[38] KOSKENNIEMI (Fn 33), 65-67 and 99-101.
[39] ANNE-MARIE SLAUGHTER, A New World Order, Princeton/Oxford 2004, 12/13 and 262/63.
[40] See SASKIA SASSEN, Territory, Authority, Rights. From Medieval to Global Assemblages, Princeton/Oxford 2006, 378 ss.
[41] WEBER (Fn 1), 658/59.
[42] WEBER (Fn 12), 98.
[43] WEBER (Fn 12), 99.
[44] See DOUGLASS C. NORTH, Institutions, Institutional Change and Economic Performance, Cambridge 1991, 3.

"participants".[45] Black refers to the term of polycentric regulations occurring in multiple sites, shaped by practical issues and events.[46]

In the financial markets, the actors such as organizations and institutions adopting regulatory rules are quite numerous. The main drivers are the international financial institutions, incorporating a considerable amount of regulatory authorities and powers. Over the years, some powerful institutions and organizations have further expanded their activities up to a level that is far beyond their original mandates. In particular the mandates of the Bretton Woods Institutions, namely the International Monetary Fund and the World Bank Group, do not fully reflect the actual scope of regulatory activity of these regulatory bodies anymore.[47] The multi-stakeholderism approach, however, invites to adopt a more cooperative attitude towards the inclusion of non-governmental organizations and interests groups in the rule-making process. While it is clear that the multiplicity of regulatory actors bears the substantial risk of incoherent rule-making in the field of financial regulation[48], such approach would not necessarily entail a (additional) fragmentation of regulatory powers. The aim of a more balanced allocation of powers could be achieved, amongst others, by mandating the regulatory actors to cooperate and consult with the various stakeholders. In doing so, it should be taken into account that private actors do not only encompass financial intermediaries and their associations, but also investors, consumers and the "traditional" industry being dependent on the proper functioning of financial markets.

Furthermore, it can also not be overlooked that the Bretton Woods Institutions coincide with the historically main actors at the end of the Second World War, namely the United States and its European allies. At the some token, Asian countries are substantially underrepresented in these institutions;[49] not surprisingly, the Asian stakeholders are therefore in the process of establishing their own "Asian Monetary Fund". The need to come to a more equalized representation of countries is also reflected in the fact that the G7/G8 are loosing "moral" competences in favor of the G20 having initiated and driven the recent regulatory reforms and endeavors at the Summits in November 2008 and April 2009[50] as well as in September 2009.[51]

In sum, the implementation of a multi-stakeholder approach makes it desirable to better include the voices of all participants of financial markets in the future. The realization of this goal would also necessitate certain reforms at the institutional level, including the expansion of membership and enhancement of status towards those countries that are currently underrepresented in the regulatory process. A step into the right direction has been made by the Fourth Amendment to the IMF Articles of Agreement, which finally (it had been proposed in 1997 already) came into effect in August 2009. The Amendment provides for a special one-time allocation of Special Drawing Rights (SDR),

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[45] WEBER (Fn 1), 682.

[46] See JULIA BLACK, Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes, 2 Regulation & Governance 2008, 139–141.

[47] See WEBER/ARNER (Fn 5), 393 ss.

[48] WEBER (Fn 1), 682.

[49] See EDWIN M. TRUMAN, Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform, in: Truman (ed.), Reforming the IMF for the 21st Century, Washington 2006, 201 ss.

[50] WEBER (Fn 1), 684/85.

[51] Forthcoming.

enabling all Members of the IMF to participate in the SDR system on a more equitable basis. The re-establishment of the Financial Stability Board (FSB) by the G20 in April 2009, entrusting it with further functions and competences, as well intents to install a more diversified and pluralistic system. The FSB could thus take a leading part in the translation of a multi-stakeholder approach into the international financial regulatory agenda.

2. Sources of Law: Making Soft Law Somehow Hard

Self-regulation appears to be a vital source in the field of financial regulation, at least in an international context. It generally pursues the regulatory objective of standardization. Private stakeholders, not being directly accountable to the general public, increasingly introduce industry standards designed to be observed by the relevant market participants.[52] Standards often relate to the usual behavior of the "reasonable man", understood as expression of common sense.[53] The ongoing transformation implies to take into account the evolution of self-regulatory regimes.[54] A high degree of "organization" of the market participants facilitates the implementation of international standards, which is the case in the financial markets. Since standards efficiently remove market access barriers, they are open to harmonization procedures; with the increasing globalization of markets, standards can ensure that important financial services meet globally recognized levels of performance and safety.[55]

Standards as such do not have a status as actual legal source as they are often non-binding. Yet most standards qualify as soft law, still lacking a legitimate authority of adoption and enforcement, but providing a concrete benchmark for the behavior of market participants.[56] However, experience in the financial markets over the last years has shown that the implementation of autonomous regulation and non-state standards can lead to a gradual process of institutionalization;[57] even if established by epistemic communities and decentralized networks, soft law can be of public benefit.[58]

Representatives of states and international organizations increasingly recognize that soft law released by private stakeholders is usually modern und dynamic and allows the implementation of adequate decision-making structures.[59] Consequently, Koskenniemi points out that neither regimes nor states have a fixed nature or self-evident objectives; therefore, the task for international lawyers would not be to learn new managerial vocabularies but the user language of international law to articulate the politics of critical universalism.[60] Hart has described the process of formalization and institutionalization or

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[52] WEBER (Fn 1), 660.

[53] ALAN D. MILLER, The „Reasonable Man" and Other Legal Standards, California Institute of Technology, Social Science Working Paper no. 1277, September 2007.

[54] See SASSEN (Fn 40), 330 ss, 378 ss; ANTHONY GIDDENS, The Constitution of Society, Outline of the Theory of Structuration, Cambridge 1984, 228 ss.

[55] WEBER (Fn 1), 683.

[56] See above II.2.

[57] WEBER (Fn 1), 660/61.

[58] See also TOMMASO PADOA-SCHIOPPA, Regulatory Finance: Balancing Freedom and Risk, Oxford 2004, 41/42.

[59] See also above II.2.

[60] MARTTI KOSKENNIEMI, The Fate of Public International Law: Between Technique and Politics, 70 The Modern Law Review 2007, 1.

codification of general standards as secondary norms; civil society actors can monitor the form of rules by applying different instruments depending on their grade of specification.[61] Consequently, various forms of private and hybrid regulatory regimes emerge which, however, need to be included in a general framework allowing to comply with objectives such as homogeneity and coherence.[62] Linked to the increasing influence of civil society (concept of governmentality), Foucault calls for an "art of government" in order to mirror the epistemic networks and autonomous regulation against the public interests.[63] Teubner expresses the idea that the unity of the regulatory regimes is significant for the perception of phenomena at supra-, infra- and transstate levels, forecasting a new evolutionally stage in which law will become a system for the coordination of action within and between semi-autonomous societal subsystems.[64]

The expanded inclusion of all stakeholders in the financial markets is not only politically reaffirmed in the international discussions, but also a part of the Declaration of the Summit on Financial Markets and the World Economy of the G20 Leaders of 15 November 2008 referring to the enhanced cooperation between the stakeholders in order to restore global growth and achieve the needed reforms in the world financial systems.[65] Furthermore, the promotion of existing policy networks responsible for setting international regulatory standards has been at the core of most (national) reports containing recommendations for a redesigning of the international financial architecture.[66] If based on cooperation and supported by broad consensus, a soft law regime may, at least in part, be a substitute for a hard law regime with explicit enforcement powers.[67] A balanced and diversified regulatory process, pursuing the multi-stakeholderism approach, may put participants under "moral" and political pressure to support and obey soft law due to its enhanced legitimacy. The experiences in the international financial markets have demonstrated – similar to the Internet context – that soft law can function as a regulatory scheme. However, recent developments veer towards a more comprehensive and stringent framework and thus a somewhat "harder" approach.

3. Regulatory Targets: Achieving a Comprehensive Mapping Structure

In financial markets – even more than in other legal fields – laws and regulations have to be able to flexibly adapt and respond to market change in

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[61] HARALD L.A. HART, The Concept of Law, 2nd ed. Oxford 1997, 79-81.

[62] See also PAUL SCHIFF BERMAN, The Globalization of Jurisdiction, 151 University of Pennsylvania Law Review 2002, 329 ss and 366 ss.

[63] MICHEL FOUCAULT, Naissance de la biopolitique, Cours au Collège de-France 1978/79, Gallimard/Seuil 2004.

[64] GUNTHER TEUBNER, Recht als autopoietisches System, Frankfurt 1989, 81 ss and 118 ss.

[65] See Declaration of the Summit on Financial Markets and the World Economy of November 15, 2008, http://www.g20.org/Documents/g20_su-mit_declaration.pdf.

[66] See, e.g., Financia, Services Authority, The Turner Review, A Regulatory Response to the Global Banking Crisis, March 2009; European Commission, Report of the High-Level Group on Financial Supervision within the EU, February 2009.

[67] See also DOUGLAS ARNER/MICHAEL W. TAYLOR, The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?, AIIFL Working Paper no. 6, June 2009, 3.

order to mitigate uncertainty and restore market equilibrium.[68] Given the increasing integration of financial markets, international financial regulation is confronted with the difficult task of mitigating differences within the organization of national legal systems and various regulatory frameworks[69] while upholding flexibility and effectiveness. By pursuing various regulatory targets, namely standardization, harmonization, reciprocity, mutual recognition and coordination, regulators have sought to achieve this goal.

As already outlined, standardization is the most common target in international financial regulation. Standards are often a first step to coordinate the transactional activities and can also establish a basis for future harmonization. Standardization takes up the idea of general principles of international law.[70] Even if implemented in a non-binding, mostly recommendatory nature, standards may have a considerable influence on the behavior of financial markets participants as they provide a benchmark for proper business conduct.[71] The signalling effect of standards should not be underestimated; the mere announcement to adopt certain standards implies a more proactive stance toward the particular regulatory area and may already trigger behavioural change by the signal's recipients.[72] In a nutshell, standardization plays a central role as regards every source of law, be it soft or hard.

Yet in recent years, the principle of harmonization has gained importance. On the one hand, this fact can be explained with the increasing relevance of the IMF, trying to implement a harmonizing approach in various areas of financial regulation. On the other hand, the target of harmonization is promoted by growing integration processes all over the world, especially within the European and Asian regions, and the acknowledgement of the concerned stakeholders that a certain degree of coherence is inevitable in order to allow for the smooth execution of international transactions.[73] Harmonization should not be qualified as a contrast to standardization, but rather as a further step in the direction of legal convergence. However, from a multi-stakeholderism perspective, the regulatory unification that necessarily accompanies the harmonization process and consolidates the existing regulatory frameworks may be critical. In practice, the drafting of harmonized rules is mostly geared to the regulation and regulatory practices of dominant stakeholders, whereas less powerful groups, such as developing countries, have to stand aside.[74]

Contrary to standardization and harmonization, the principles of reciprocity and mutual recognition do not have a major importance in the field of financial regulation.[75] More astonishing is the fact that cooperation – in the sense of a regulatory target – has also not yet found a substantial role to play in financial regulation.[76] Until the outbreak of the current financial crisis, the coordination approach has often been pursued rather spontaneous, based on the circumstances of the individual case. However, permanent and institutionalized coordination is

[68] MILHAUPT/PISTOR (Fn 15), 5, 27/28.
[69] See MILHAUPT/PISTOR (Fn 15), 28 ss.
[70] WEBER (Fn 1), 658 and 683; see also above II.2 and III.2.
[71] WEBER (Fn 1), 661.
[72] MILHAUPT/PISTOR (Fn 15), 34/35.
[73] WEBER (Fn 1), 658/59 and 683/84.
[74] See WEBER (Fn 1), 659.
[75] WEBER (Fn 1), 662/63 and 684.
[76] WEBER (Fn 1), 684.

a prerequisite for transparent, sound and properly supervised financial markets. The political tenor thus goes towards the strengthening of institutional collaboration, especially between the FSB, the IMF and the World Bank, and the establishment of new multilateral institutional structures such as the FSB as well as the so-called supervisory colleges.[77]

In sum, the coordination approach seems to have gained in importance as a result of financial turmoil that has hit global financial markets in unprecedented intensity and complexity in the past months. Compared to other regulatory targets, especially harmonization and standardization, coordination has the advantage that it is non-exclusive. It rather naturally fosters dialog and collaboration among the various stakeholders, yet without necessarily initiating a regulatory race to the bottom.

4. Areas of Regulation: Structuring the Relevant Issues

Which areas financial regulation covers also depends on the dynamic relationship between law and markets. The identification of the actors and rights that find protection in the regulatory systems necessarily involves a balancing of conflicting interests.[78] Over the past decades, the variety of issues being covered by financial regulation has constantly increased. In addition, regulatory frameworks often contain rules with implications in several areas; hence, regulators do not stick to a specific single area, but cover several issues within a set of adopted rules.[79] This way of processing, however, bears the risk of overlapping regulations and of causing interferences between the various areas of regulation, of which the most important are transparency and accountability, prudential regulation, surveillance and market integrity.

As already mentioned in the context of Internet regulation,[80] transparency and accountability are regulatory areas which have been attracting the regulators' attention to a very far extent. These two topics are fundamental both as a feature of the regulatory system and an aim of regulation. By abolishing information asymmetries, transparency and accountability enable market participants to judge and compare financial services, thereby also constituting an instrument of consumer protection.[81] Furthermore, disclosure rules and information audits are crucial factors for the functioning of financial markets. Clear, comprehensive and effective accounting standards can also provide for an early warning with regard to financial turmoil.[82] By promoting transparency, financial regulation also helps to ensure that the financial sector takes full responsibility for its own decisions and actions in order to reduce moral hazard[83] – a feature of eye-catching topicality given the extensive public support measures that have become necessary in the course of the current financial crisis.

By establishing appropriate requirements for financial intermediaries, prudential

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[77] See, e.g., United Nations General Assembly, Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development, 13 July 2009; G-20, Declaration on Strengthening the Financial System, London Summit, 2 April 2009.

[78] See MILHAUPT/PISTOR (Fn 15), 5, 32.

[79] WEBER (Fn 1), 684.

[80] See above II.3.

[81] WEBER (Fn 1), 665.

[82] WEBER (Fn 1), 665.

[83] See WEBER (Fn 1), 666 with further references.

regulation aims at implementing safety and soundness related to the financial systems as a whole. The notion of prudential regulation is very broad and not always consistent.[84] A reasonable distinction can be drawn between preventive and protective regulation: Whereas preventive regulation is concerned with controlling the risks taken by financial intermediaries, thereby reducing the probability of failures of market participants to an acceptable level, protective regulation refers to measures which provide support to financial intermediaries once a crisis threatens, such a deposit insurance systems and the lender of last resort function.[85] Generally, the objective of prudential regulation is to be seen in the intention to prevent the development of systemic risks in order to maintain the stability of the financial sector.[86] Thereby, prudential regulation helps to promote public confidence, which obviously is a vital pre-condition for smooth financial intermediation.[87] By ensuring that market players conduct their business in a sound and prudent manner and that they hold enough capital and liquidity in order to meet the various challenges related to their business, prudential regulation complements effective management and market discipline.[88] International efforts to ensure adequate prudential regulation have led to the formulation of various minimum standards and best practices, namely those adopted by the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors.

Another important issue in financial regulation is surveillance, constituting both an enforcement technique and an objective for financial stability. Surveillance is only efficient if the supervisors – not necessarily being identical with the regulators – are at least equally well informed as the market participants.[89] The IMF plays a leading part in the surveillance of the financial markets, which is also a fundamental aspect of the WTO's duties and responsibilities being realized through the Trade Policy Review Mechanism.

The integrity of financial markets is a basic premise for their smooth functioning. If there is a risk of manipulation or exploitation for criminal purposes, investors and consumers are deterred from participating in a financial market; public confidence will be impaired by the abuse of entrusted power for private gain.[90] Financial intermediaries, becoming increasingly active in cross-border businesses, also are affected by practical costs and problems of corruption; therefore, combating corruption and upholding market integrity is vital aspect of financial regulation.

Accompanying the development towards an increasing multiplicity of regulatory actors and sources, the advancing integration and globalization of financial markets has led to a fragmentation of the areas of regulation. Against the

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[84] LAZAROS PANOURGIAS, Banking Regulation and World Trade Law – GATS and EU and „Prudential" Institution Building, Oxford 2006, 11 ss.

[85] WEBER (Fn 1), 669; GUIDO FERRARINI, Introduction, in: Ferrarini (ed.), Prudential Regulation of Banks and Securities Firms, European and International Aspects, London/The Hague/Boston 1995, 3, 4.

[86] See ROLF H. WEBER, Financial Stability – Structural Framework and Development Issues, International and Comparative Law Journal 2008, 1 ss.

[87] WEBER (Fn 1), 669.

[88] DOUGLAS ARNER, Financial Stability, Economic Growth, and the Role of Law, Cambridge 2007, 196.

[89] WEBER (Fn 1), 669/70.

[90] ARNER (Fn 88), 181/82.

background of the improved position which the Financial Stability Board has gained since its re-establishment on the occasion of the 2nd G-20 Summit of early April 2009 in London, further efforts should be taken to give the FSB a stronger coordinating role in the implementation and surveillance of the manifold rules. Due to its broad membership and mandate, the FSB is a particularly suitable actor for the coordination of the rule-making processes in the financial markets, thereby providing for the necessary legal predictability.

IV. Conclusion

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

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

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

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

Since the outbreak of the current financial crisis, the need for certain reforms at the institutional level, aiming to better consider the voices of all participants of financial markets, has become even more apparent. The recent adoption of the Fourth Amendment to the IMF Articles of Agreement (finally) provides for a more equitable allocation of powers among the Members of the IMF. At the core of the development towards a more pluralistic and diversified financial

regulatory framework is the FSB, having been entrusted with further functions and a broader membership by the G20 in April 2009. The FSB seems to be a suitable actor to incorporate the multi-shareholderism approach into the financial regulatory agenda, simultaneously alleviating fragmentation by coordinating its efforts with other international financial institutions and stakeholders and by promoting transparency.