

**The Quest for Accountability in Transnational Regulatory Networks: The Case of
the Basel Committee on Banking Supervision**



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To God

To my parents Andres and Cristina

To my wife Lourdes and my son Pablo

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The Quest for Accountability in Transnational Regulatory Networks: The Case of the Basel Committee on Banking Supervision

Abstract

This thesis focuses on the search for accountability processes related to the standard setting powers of a transnational regulatory network that operates in the highly complex and uncertain environment of global finance: the Basel Committee on Banking Supervision (BCBS).

The thesis draws upon and builds on two main resources: the academic literature from international law, political science, international relations and public administration about the concept of accountability and— as a theoretical framework — Niklas Luhmann’s idea of communication which suggests that communication is a selection process rather than a process of transmission. In this selection process the idea of meaning in the sense of a common understanding is paramount. The analysis focuses on the key milestones of the Basel Committee’s work: the Concordat, as well as the Basel I, Basel II and Basel III accords.

The thesis also draws on a qualitative original data set compiled by the author, made up of extracts of discussions of the Basel Committee’s work in the international financial journalistic press. Additionally, official documents and press releases from the BCBS were coded by classifying them into common themes (such as minimum capital standards or the delay on the implementation timetable of Basel III) and the thesis’ analysis assessed whether they formed part of an accountability process (i.e., whether they asked for an account, responded to an accountability claim, judged an accountability claim and referred to which consequences should follow the judgement).

On the basis of this thematic analysis the thesis identifies five accountability processes in relation to the work of the Basel Committee based on communication. These revolve around the standards for minimum capital requirements in Basel II, the standards for debt exposures of banks lending to small and medium size enterprises, the over complexity of the Basel III accord, the alleged detrimental effects of the Basel accord for US banks, and the delay in the schedule to implement Basel III.

Drawing on Luhmann's ideas about communicative events, the thesis develops a novel account of communicative accountability that explains accountability as the decentred and flexible communicative interaction between an accountant and an accountee whose communications have to resonate with an epistemic community. This epistemic community plays the role of a social system in which expectations about the exercise of regulatory powers of the Basel Committee are managed. The thesis argues that this process of communicative accountability can be empirically traced and that it is significantly facilitated by reliance on a shared language and expertise of a common professional community to which both the Basel Committee and a wider professional community belong to.

The thesis argues that while the concept of communicative accountability developed through the research can be used to identify processes which seek to render TRNs like the BCBS accountable, these processes may also lack sufficient legitimacy, in the sense of formal power from a recognized source such as a state or an international organization underpinning these accountability processes. Increased legitimacy matters because it would enhance certainty in an accountability process and therefore, help to identify more clearly the legitimate accountant and to uphold his or her authority to ask for the account. Hence, as a whole, this thesis contributes towards the quest for alternative ways of understanding and improving accountability mechanisms in relation

to the exercise of regulatory powers by globalized regulatory institutions in a transnational sphere such as the BCBS.

Chapter 1. Introduction. The need to hold transnational regulatory networks accountable: the possibility of communicative accountability

The rise of non-state actors such as the Basel Committee on Banking Supervision (the BCBS or the Committee) in transnational governance and regulation coupled with the absence of formal mechanisms for holding them accountable, has led me to explore the possibility of accountability processes ‘on the margins of the state’¹. These processes would typically not be the product of domestic mechanisms such as statutes, courts, legislatures, or parliaments. Neither are they based on principal-agent relationships (i.e., a legitimate delegation from democratically elected authorities²). Additionally, because the BCBS and other financial networks also lack a public mandate based on international law, it is hard to hold them accountable on the basis of treaties, covenants, or international courts. This lack of ‘formal’ processes of accountability in transnational financial regulation creates the necessity to find alternative, informal ways for holding the powerful to account.

In this vein, the context of the 2008 financial crisis is eloquent. By 2007 it was clear that the global economy was navigating dangerous waters. What came as a surprise for many was the size and depth of the crisis as it unravelled, one of the worst global crisis since the Great Depression of 1929³. The collapse of Bear Stearns and Lehman Brothers was the harbinger of bad news for the US’ financial system, and with it, for the global financial system and the world’s economy. Britain was next, and by 2008, HBOS had failed and, with it, the trust in the banking and financial system. We

¹ Graff-Peter Calliess and Peer Zumbansen, *Rough Consensus and Running Code: A Theory of Transnational Private Law* (Hart 2010).

² Pierre Hugues Verdier, ‘Transnational Regulatory Networks and Their Limits’ (2009) 34 *Yale Journal of International Law* 113.

³ Joseph Stiglitz, *Freefall: Free Markets and the Sinking of the Global Economy* (Penguin 2010).

know now the consequences: credit crunches, a confidence crisis in the grading firms, and bankruptcies of companies (Woolworth's), cities (Detroit), and even countries (Finland). The movement *Occupy Wall Street* was a popular reaction to the crisis and demanded punishment for those they believed were responsible for the backlash: banks, bankers, and banking regulators.

The campaign spread to London (*Occupy the City*), Basle (*Occupy Basle*), Madrid (*Los Okupas*), and Frankfurt (*Occupy Frankfurt*), among many other cities in the world⁴. What was common to all these movements was the shared impression that banks and bankers were not accountable to anybody and that they seemed to have got away with the consequences of the disaster they caused. In a successful experiment, the magazine *n+1*⁵ opened an on-line site called 'Occupy the boardroom.' The site offered a space to publish claims against the banks and bankers in light of the financial crisis of 2008. They received more than 8000 letters complaining about the financial industry. At the end they decided to print them as a book⁶. The book is full of claims against the financial system.

In one of them, one person claims that, although people say that the demands of "Occupy Wall Street" are too vague, the problem is that there are so many things that are broken that it is difficult to create a "catch phrase" or a billboard to synthesise all of them. The claimant continues arguing that the crisis has been felt by ordinary people and that the democratic institutions of the United States (US) (e.g., the Congress, the President or the Supreme Court) are dominated by corporations. But ordinary people

⁴ *The Guardian* put on a chronology of all the events and demonstrations since 2011. See: <www.theguardian.com/world/occupy> Accessed 15 April 2015.

⁵ See: <<https://nplusonemag.com/about>> Accessed 15 April 2015.

⁶ N+1, *The Problem are The Banks: Letters to Wallstreet*, (n+1 2012), the texts were taken from the Spanish translation (N+1, *El Problema son los Bancos: Cartas a Wallstreet* (Sexto Piso, 2013)). The texts reproduced here were translated from Spanish.

know what those demands are. If they do not know, this person concluded, they are “deaf, blind, greedy, cold, selfish, cruel, or everything at once”.⁷

In another passage a shareholder of Goldman Sachs complains about the lack of morals in the firm, arguing that that investment bank’s corporate policy damages a great majority of the population (99% he says), only benefiting people like himself – a shareholder. He complains that the firm is spending his and other investors’ money to influence national politics and he closes his argument threatening the bank to withhold his shares in a corporation which behaves immorally.⁸

The pages of the book are filled with poignant stories, desperate situations, and sometimes angry demands to banks and bankers. They show the real drama that the 2008 crisis caused in many households. They are, however, somewhat vague either because their writers did not frame the comments in specialised financial and banking language or because their demands were not specific enough to attach responsibility to the addressees.

The demands for justice include documentaries⁹, books¹⁰, and numerous articles from newspapers from the time of the 2008 financial crisis. The critiques to the financial sector, however, preceded that moment. For instance a 2002 piece in the *Evening Standard* reads:

Hundreds of people in this country and thousands around the world are dedicating every moment of their working day to an arcane document whose proposals could have significant repercussions on the share prices and takeover potential of British financial institutions.

(...)

⁷ *ibid* 52.

⁸ *ibid*, 97.

⁹ Charles Ferguson, *Inside Job* (2010); Sington, David, *The Flaw* (2011).

¹⁰ Andrew Ross-Sorkin, *Too Big to Fail: Inside the Battle to Save Wall Street* (Penguin 2010).

Calculations are fiendishly complicated and many in the industry question whether the benefits of the new regime will justify the enormous expense. Criticism has been rife but experts know the accord will emerge in some shape or form and are working out its effect on the financial industry¹¹.

Unlike the comments I quoted above, other critiques were more precise.

Compare, for example, the following quotation from Adamati and Hellwig:

In the aftermath of the crisis, regulators set out to strengthen capital regulation. Although the resulting accord, 'Basel III,' eliminates some abuses, it fails to address the basic problem that banks can easily game the regulation. Bank's equity can still be as low as 3 percent of their total assets. It is not clear that anything would have been substantially different in the 2007-2009 crisis had Basel II already been in place. (...)

According to bankers, higher equity requirements for banks will restrict bank lending and reduce economic growth. They argue that, to have safer banks, we must sacrifice growth. (...)

The weakness of Basel III was the result of an intense lobbying campaign mounted by bankers against any major change in regulation. This campaign has continued since (...).

In the debate on bank capital regulation, there are many flawed and muddled arguments (...). [T]he pervasive confusion of capital with reserves is particularly insidious. Consider the statements 'Capital is the stable money banks sit on' and 'Think of it as an expanded rainy day fund.' These statements would make sense if they referred to banks' cash reserves, but they are false if applied to bank equity. Capital and reserves are on different sides of the banks' balance sheets. Capital requirements refer to the banks' funding, whereas reserve requirements restrict how banks use their funds¹².

The difference between both types of criticisms is that in the first type they raise general concerns about the fairness of the system or the democratic qualities of global standard setting institutions such as the BCBS. On the contrary, the second type of criticism uses the specialised language of the banking regulatory community and focuses on very specific aspects of the regulatory regime (e.g., minimum capital and

¹¹ Joanne Hart, 'Basel 2 Set to change Bank Shares and Deals Scene' *The Evening Standard*, (London 11 January 2002).

¹² Anat Adamati and Martin Hellwig, *The Bankers New Clothes: What's Wrong with Banking and What to Do about It* (Princeton University Press 2013) Loc 2018

acceptable liquidity ratios for banks). While both types criticise the banking industry or the BCBS, the sharpness and precision of a critique could increase the probability that a claim gets the attention of its addressee (in this case, the financial community). More interestingly, that claim might start an accountability-like process with consequences for the person or the organisation to which the critique is directed. Furthermore, the media and public opinion might create quasi accountability processes¹³, where certain criticisms directed towards an organisation produce justifications from those entities (or people) that later, as a result of the interactions between accountors and accountees shape the public image of an organisation or group in a positive or negative manner.

Part of the literature on sociology and political science has helped to sharpen accountability's meaning¹⁴, however, reports of different international organizations and statements by politicians mention the word increasingly¹⁵. As I later discuss in chapter 3, each of these references to accountability often imply different meanings. The situation is problematic because many parties in the national and transnational arena call for 'an increase in accountability' as a solution to the problem of the exercise of potentially uncontrolled quasi-public networks in the international sphere.

¹³ Sina Odugbemi, Timothy Lee, *Accountability through Public Opinion: From Inertia to Public Action*, (World Bank 2011) 5; Mark H Moore, 'Accountability, Legitimacy, and the Court of Public Opinion' in Mark Bovens, Richard E Gooding and Thomas Schillemans (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

¹⁴ Barbara S Romzek, Melvin J Dubnick, 'Accountability in the Public Sector: Lessons from the Challenger Tragedy' (1987) *Public Administration Review* 47, 227-238; Richard Mulgan, 'The processes of public accountability' (2000) 56 *Australian Journal of Public Administration* 1, 25-37; Patricia Day and Rudolf Klein, *Accountabilities: Five Public Services* (Tavistock 1987); Roderick A W Rhodes, 'The New Governance: Governing without Government' (1996) *Political Studies* XLIV, 652-667; Melvin M Dubnick, George J Frederickson *Accountable Governance: Problems and Promises* (M.E. Sharpe 2011).

¹⁵ The IMF has information regarding its own accountability in its webpage, see <www.imf.org/external/about/govaccount.htm> (Accessed 15 April 2015). The World Bank also fosters accountability in those countries where its programs are exercised, see: <web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEVCOMMENG/EXTGOVACC/0,,menuPK:3252017~pagePK:64168427~piPK:64168435~theSitePK:3252001,00.html> (Accessed 15 April 2015). Finally, USAID has an interest to improve accountability too, see: <www.usaid.gov/what-we-do/democracy-human-rights-and-governance/promoting-accountability-transparency> (Accessed 15 April 2015).

The thesis, therefore, seeks to explore the communicative dimension for holding financial Transnational Regulatory Networks (TRNs) like the BCBS accountable. To do this, it analyses the discussions around the work of the Basel Committee on Banking Supervision (BCBS) drawing on some concepts in relation to communication from Niklas Luhmann.

This chapter introduces the reader to the thesis and is divided into four sections. The first one explains the features of the mechanisms for holding the powerful accountable at the domestic level (i.e. the state level). The second section explains transnational regulatory networks (TRNs) and depict them as mechanisms for reining in the complexity of global governance and regulation, and thus outline some features of the diminishing importance of the domestic level for transnational regulation. Then, section three will explain the diminishing role of domestic accountability mechanisms for holding TRNs accountable, thereby creating an accountability gap. Finally, section four provides an overview of the structure of the thesis.

1. Traditional domestic mechanisms for holding the powerful to account in nation states

The Westphalian system that started in 1648 has been the dominant framework for international relations for three hundred years. It is still valid for most of the world's population, however, due to many circumstances that I explain in section 2, it is no longer possible that one state unilaterally provides a centralized and unique exercise of power and therefore a single accountability regime in its sovereign territory. In the same vein, the level of complexity and uncertainty that coordination possesses have makes it

very costly for states to create an International Organization (IO) with a wide mandate, so that it can tackle complexity¹⁶.

This section highlights the most important features of the Westphalian system, in which nation-states are sovereign in their own territory and can coordinate efforts at the international level with the mechanisms of public international law. As I said, this system is still valid, but not for all the challenges that countries must face, especially not for those of a transnational character. I explain the most relevant features of liberal democracies because the discussion about the accountability gap of quasi public networks of governance stems from the categories and concepts bequeathed by the constitutional framework embedded in the states. I will argue in the conclusion of the thesis that, while those concepts are valid and necessary up to a point to guide the discussion about the accountability of the informal networks of governance, they can no longer enhance and structure that discussion because their usefulness has diminished.

The most common form of organisation in nation-states has been liberal democracy, which is a political governance system that - to varying extent:

provides citizens with political liberties and establishes democratic rule... Political liberties exist to the extent that the people of a country have the freedom to express a variety of political opinions in any media and have the freedom to form or to participate in any political group. Democratic rule, in association with political rights, exists to the extent that the national government is accountable to the general population, and each individual is entitled to participate in the government directly or through representatives.¹⁷

First, liberal democracies are based on the assumption that it is possible to identify the source of their legitimacy in a mandate from 'the people' or 'the parliament.' The modern 'people' is a group of individuals living in a certain territory

¹⁶ Pierre-Hugues Verdier, 'The Political Economy of International Financial Regulation' (2013) 88 *Indiana Law Journal* 4, 1405-1474.

¹⁷ Kenneth Bollen, 'Liberal Democracy: Validity and Method Factors in Cross-National Measures' (1993) 37 *American Journal of Political Science* 4, 1207.

who think of themselves as political equals¹⁸. In general terms, any individual in liberal democracies has the ability to participate in the political process, regardless of her or his social condition, wealth, education, etc. This participation normally takes the form of voting to elect her or his representatives, and the freedom to intervene in the debate of politically contested issues. Those countries which are liberal democracies have therefore taken measures to assure that any individual has the effective right to participate in some form in the exercise of public powers.

Second, the physical space of political participation for the individual tends to be the geographical territory of the state. I will not delve here into the history and structure of the modern state¹⁹. It is necessary, however, to highlight that states have jurisdiction over a territory and within the borders of that territory²⁰ which can be geographically located (physical) or extended (i.e., to vessels, embassies, or aircraft). The general idea is that the territory constitutes a limit to the state jurisdiction and action. This main tenet of liberal democracies is being challenged by transnational problems, as I later explain.

Third, liberal democracy implies, among other things, a centralized power delegated by a ‘demos’ (or the ‘people’²¹) to political representatives. It also enables the delegation of powers to other public officials, bodies, or agencies²². Liberal democracies

¹⁸ Robert Dahl *Poliarchy: Participation and Opposition*, (Yale University 1981).

¹⁹ Ernst Cassirer *The Myth of The State*, (OUP 1946); Salvador Cárdenas Gutiérrez ‘La Razón de Estado en la Nueva España: Siglos XVII y XVIII’ (Phd Thesis, Universidad de Navarra 1994); Martin Loughlin, *The Idea of Public Law* (OUP 2003).

²⁰ The application of the law of one state extraterritorially is possible, however this feature belongs more – I think – to a global context where migration of nationals of one country to another has enabled some sort of extraterritorial application of the law. The ‘Universal Jurisdiction’ hypothesis for human rights is also a feature of globalization. See Darren Hawkins, ‘Universal Jurisdiction for Human Rights: From Legal Principle to Limited Reality’ (2003) 9 *Global Governance* 3, 347-365.

²¹ Different countries have different sources of legitimacy. The most conspicuous exception to the French and American principle of ‘popular sovereignty’ is Britain (and some other countries of the Commonwealth: Australia, Canada, New Zealand, etc.). In Britain the source of sovereignty is the Crown. However, the power of the Crown is exercised by the Parliament, and not any more by the Monarch. See: Martin Loughlin *The Idea of Public Law* (n 19); Paul Craig ‘The Struggle to Delimit Executive Power in Britain’, in Paul Craig, Adam Tomkins (eds.) *The Executive and Public Law: Power and Accountability in Comparative Perspective* (OUP 2006); and Timothy Endicott *Administrative Law* (OUP 2009).

²² Nigel Dodd, ‘Money and the Nation-State: Contested Boundaries of Monetary Sovereignty in Geopolitics’ (1995) 10 *International Sociology* 2, 139-154.

are based on the assumption that individuals agree on vesting power to some elected representatives that govern in their name. The representatives not only receive the delegation of authority from all the people, but they are also accountable to the public for the decisions they take. In this vein, agents are accountable to their principals. In turn, there is also a principal-agent relationship between the politician (the principal) and each civil servant (the agent).

The concept of representation refers also to the principal-agent relationship between elected public officials and their constituencies. As I said before, the whole idea of accountability in liberal democracies implies a form of representation and a principal-agent relationship. In this vein, Pitkin enumerates four different meanings of representation: formalistic, symbolic, descriptive, and substantive representation²³. Formalistic representation has two features. First it encompasses the ways in which a representative gains its status (election, nomination, etc.); second, it assumes accountability, or the way in which the representative is punished or is responsive to her or his constituents.

While Pitkin explains symbolic representation as the meaning that the representative has for those represented, descriptive representation is ‘the extent to which the representative resembles those represented’²⁴. Finally, substantive representation means the real ways which the representative uses to represent the interest of her or his constituents.

All the four meanings of representation that Pitkin puts forward assume a delegation from ‘the people’ or the constituents to a representative²⁵. This delegation is a typical tenet of liberal democracies. It is also very important for the representatives’

²³ Hanna F Pitkin, *The Concept of Representation* (University of California Press 1967).

²⁴ *ibid.* 151.

²⁵ *ibid.*

accountability in that in liberal democracies representation establishes an accountability relationship between the representative and its constituents.

Another feature of liberal democracies is the preoccupation that no part of government should dominate any other part. This concern is present in *The Papers of the Federalist* written by Hamilton, Madison, and Jay. In paper number 51 they say:

The only answer that can be given is, that as all these exterior provisions are found to be inadequate, the defect must be supplied, by so contriving the interior structure of the government as that its several constituent parts may, by their mutual relations, be the means of keeping each other in their proper places... In order to lay a due foundation for that separate and distinct exercise of the different powers of government, which to a certain extent is admitted on all hands to be essential to the preservation of liberty, it is evident that each department should have a will of its own; and consequently should be so constituted that the members of each should have as little agency as possible in the appointment of the members of the others. Were this principle rigorously adhered to, it would require that all the appointments for the supreme executive, legislative, and judiciary magistracies should be drawn from the same fountain of authority, the people, through channels having no communication whatever with one another²⁶

This description is classic and has been phrased in the concept of ‘checks and balances’. The concept implies that the authority of the state is distributed among several bodies with a more or less clear mandate. This means that the polities that form the state must be legitimised by a (legitimate) delegation of power. In turn, each one of these organisations limits the power of each other.

Because there is more clarity about the responsibilities and scope of each public officer and public organization, liberal democracies might provide more certainty for curtailing the exercise of public powers. Nevertheless, in the following section I argue that liberal democratic tenets – at least in the classical model described above – do not apply to transnational governance.

In reading the points made above the following qualification should be borne in mind. Although the objective of this thesis is to explore alternative ways of thinking

²⁶ James Maddison, Alexander Hamilton, John Jay, *The Federalist Papers* (First published 1788, Penguin 1987) No. 51.

about accountability and thus alternative mechanisms of accountability for transnational regulation, it is also true that, in recent years, not all accountability structures in the context of the state reflect the principal-agent model. Alternative models such as those encompassed by New Public Management (NPM)²⁷ and the delegation of power to quasi-independent agencies – which has recently become more common in liberal democracies – also reflect a departure from the principal-agent model creating an accountability gap in domestic regulation.

In the academic literature such developments have been captured through Black's notion of decentring regulation²⁸, and Levi-Faur's description of regulatory capitalism in which the boundaries between society and the state are redrawn by the growth in importance of experts' opinions²⁹. There is also Braithwaite's proposal which puts forward formal and informal mechanisms of restorative justice as an alternative to fill the accountability gap in liberal democracies³⁰, and Scott's proposals for identifying 'extended mechanisms for accountability'³¹ in the form of interdependence and redundancy. All of these proposals try to address the challenge of accountability gaps in domestic regulation. Yet, unlike transnational regulation, the domestic context can rely on institutions such as parliaments and courts that correspond to the principal-agent model, and which in turn complement alternative accountability mechanisms that have been examined in the proposals mentioned above.

²⁷ Michael Barzelay *The New Public Management: Improving Research and Policy Dialogue* (University of California Press 2001); David Osborne and Ted Gaebler *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* (Addison-Wesley 1992); Christopher Hood 'A Public Management for All Seasons?' (1991) 69 *Public Administration* 1, 3-19.

²⁸ Julia Black 'Decentring Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World' (2001) 54 *Current Legal Problems* 1, 103-146.

²⁹ David Levi-Faur, 'The Global Diffusion of Regulatory Capitalism' (2005) 598 *The Annals of The American Academy of Political and Social Science*, 12-32.

³⁰ John Braithwaite, *Restorative Justice and Responsive Regulation* (OUP 2002); John Braithwaite, *Crime, Shame and Reintegration* (1989 Cambridge University Press).

³¹ Colin Scott, 'Accountability in the Regulatory State' (2000) 27 *Journal of Law and Society* 1, 38-60.

2. Transnational governance through networks

TRNs specialised on cross-border banking and financial regulation have proved to be a preferred approach among policy makers to tackle transnational financial problems³². The increased volume of financial transactions is one of the phenomena that globalisation comprises. Nayyar synthesises some of the challenges that financial globalisation brings along:

In their endeavour to attract direct foreign investment, developing countries compete with each other in a 'race to the bottom', by offering tax holidays, diluting labour laws, repressing trade unions, or turning a blind eye to environmental concerns. The rapid integration of, and into international financial markets, combined with the explosive growth in portfolio investment flows and short-term capital movements, has led to a volatility in capital flows and an instability in exchange rates so that the danger of capital flight is ever present.³³

The intensification of cross-border transaction has also affected geography, especially urban geography³⁴. 'Global cities' have new functions: 'first, as highly concentrated command points in the organization of the world economy; second, as key locations for finance and for specialized service firms (...); third, as sites of production, including the production of innovations, in these leading industries; and fourth, as markets for the products and innovations produced.'³⁵ The four functions that Sassen lists are closely linked to transnational finance. Cities like New York, London, Frankfurt, or Hong Kong have become the centres of finance, banking, and finance and banking regulation. Other cities stand in a second, third or fourth place in importance. A vibrant, diverse, and innovative professional community migrates to these geographical centres of banking and finance.

³² Pierre Huges Verdier, 'The Political Economy of International Financial Regulation' (n 16).

³³ Deepak Nayyar, 'Towards Global Governance' in Deepak Nayyar (ed.) *Governing Globalization* (OUP 2002), 5-6.

³⁴ Manuel Castells, *The Internet Galaxy, Reflections on the Internet, Business and Society* (OUP 2001), 548.

³⁵ Saskia Sassen, *Global Cities: New York, London, Tokio* (Princeton University Press 2001), 3-4.

Aside of the growing importance of ‘global cities’, as I will explain in chapter 2, international transactions in foreign exchange markets are closely connected to the internationalization of the financial industry. This internationalisation began in the 1970s when some parts of the system designed in Breton Woods collapsed. Later on, in the 1980s, the governments of Reagan in the United States and Thatcher in the UK sought to reduce the regulatory burden to the financial system. This process is known as the ‘big bang’³⁶. From that point in time onwards, financial innovation grew significantly, and so did the flux of funds across different countries. Eventually, the ‘big bang’ of deregulation caused high levels of uncertainty:

This profound transformation could not escape its own consequences. The level of risk had grown to historic highs and had already begun to create concern among analysts before the October 1987 crash. The level of speculation built into this growth was extremely high; perhaps the only way this massive increase could have occurred was through speculation, epitomized by the futures market and corporate takeovers at exorbitant prices. (...) The emergence of growing integration at the global scale meant that the October 1987 collapse in prices in New York, the 1994-95 Mexican crisis, the 1997 East Asian crisis, and the 1998 Russian crisis, had worldwide repercussions. The October 1987 crisis was perhaps the first global crisis of the new financial era.³⁷

The amount of money and financial transactions moving from one country to others was greater than before. There was ‘no comprehensive measure of gross international financial flows’³⁸ which increased faster than trade³⁹. While central banks in most countries were the ‘lenders of last resort’⁴⁰, the transnational dimension of financial flows lacked an international body with the same function as a central bank⁴¹.

The combination of mounting levels of transnational flows, increasing innovation, and a growing degree of complexity created a ‘perfect storm’ to which none

³⁶ Philip Coggan, *How the City Works* (Penguin 2008).

³⁷ Sassen, Saskia (2001) *Global Cities: New York, London, Tokio* (n 35), 67-68.

³⁸ Richard J Herring, Robert E Litan, *Financial Regulation in the Global Economy*, (Brookings Institution 1994), 23.

³⁹ *ibid.*

⁴⁰ Meaning that they would guarantee the stability of the economy in case of a financial crash.

⁴¹ *ibid.*, 66.

of the countries had the needed institutional power to provide an effective solution. Three points for concern were salient: contagion from one country to others⁴²; the growing involvement of financial institutions in the derivatives markets⁴³; and the risk of the international payment systems breaking down because of insolvency or illiquidity of one of the financial institutions⁴⁴.

In addition to financial transnational problems, globalisation has unveiled other challenges that call for a transnational approach. Some of these are international migration⁴⁵, money laundering⁴⁶, cross-border environmental problems⁴⁷, climate change, and managing and avoiding natural disasters.

While these problems involve the work of countries and international organisations such as the United Nations, the International Monetary Fund, the World Bank, and the World Trade Organization, the amount of novelty and uncertainty arising from transnational challenges calls for a different approach. This is based on networks or ‘clubs’ or regulators that come together on a regular basis to discuss the most salient transnational issues of their expertise and provide a consensual solution. The literature calls them polycentric regulatory networks⁴⁸ or transnational regulatory networks (TRNs)⁴⁹. In this thesis I follow the relevant literature and call them TRNs.

TRNs differ from other governance mechanisms in globalisation in that they lack a public mandate – i.e., a treaty or covenant that structures their organisation and

⁴² ‘Thus, for example, the stock market crash of 1987 displayed clear evidence of herd like behaviour by actors throughout the world: the crash first occurred in the Japanese equities markets and then spread to New York and eventually to London’, *ibid*, 68.

⁴³ Derivatives are very complex financial products. Their price is ‘dependent on or derived from one or more underlying assets’, see: <www.investopedia.com/terms/d/derivative.asp> Accessed 14 April 2016.

⁴⁴ Richard J Herring, Robert E Litan, *Financial Regulation in the Global Economy* (n 38), 68-70.

⁴⁵ Deepak Nayyar, ‘Towards Global Governance’ (n 33).

⁴⁶ Rainer Hülse, ‘Even Clubs can’t do without Legitimacy: Why the Anti-Money Laundering Blacklist was suspended’ (2008) 2 *Regulation & Governance* 4, 459-479.

⁴⁷ Bettina Lange, ‘The EU Directive on Industrial Emissions: Squaring the Circle of Integrated, Harmonised and Ambitious Technology Standards?’ (2011) 13 *Environmental Law Review*, 199-204.

⁴⁸ Julia Black, ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (2008) *Regulation & Governance* 2, 154-155.

⁴⁹ Anne-Marie Slaughter, *A New World Order* (Princeton University Press 2004); Pierre Hugues Verdier, ‘The Political Economy of International Financial Regulation’ (n16).

confers their powers. They also differ from international organizations (IOs) and countries in the way they conduct their work, usually through soft law mechanisms like consensus and prestige⁵⁰.

As I explained above, transnational problems like climate change, financial regulation, drug trafficking, money laundering, and terrorism need a wider approach to their regulation⁵¹. No single country – even if it is a Great Power – is capable to provide effective solutions to transnational problems. The focus on the domestic level must be complemented by a wider analysis of transnational or global processes that usually overlap with national jurisdictions⁵².

While the problems to be addressed by regulation are global and complex, the consequences from those problems are often felt domestically. Politicians and public servants have a harder task ahead when convincing their constituencies that they are trying their best to solve transnational problems⁵³, leaving club-like structures like TRNs as the eminent mechanisms for transnational governance and regulation. As Mayntz puts it, '[n]etworks typically emerge where power is dispersed among the agents in a policy field, but where cooperation is necessary for the sake of effectiveness.'⁵⁴

TRNs are 'informal multilateral forums that bring together representatives from national regulatory agencies or departments to facilitate multilateral co-operation on issues of mutual interest within the authority of their participants'⁵⁵. Additionally, TRNs have developed in response to a 'need for and capacity of different domestic

⁵⁰ *ibid.*

⁵¹ Rainer Hülse, 'Even Clubs can't do without Legitimacy: Why the Anti-Money Laundering Blacklist was suspended' (n 46).

⁵² Ulrich Beck, 'The Terrorist Threat: World Risk Society Revisited' (2002) 19 *Theory, Culture & Society* 4.

⁵³ Robert Keohane, 'Global Governance and Democratic Accountability' in David Held, Mathias Koenig-Archibugi (eds.) *Taming Globalisation: Frontiers of Governance* (Polity 2003).

⁵⁴ Renate Mayntz, 'New Challenges to Governance Theory' (European University Institute, *Jean Monet Chair Paper RSC No. 98/50* 1998), 6.

⁵⁵ Pierre Hugues Verdier, 'Transnational Regulatory Networks and Their Limits' (n 2), 118.

government institutions to engage in activities beyond their borders, often with their foreign counterparts. It is regulators pursuing the subjects of their regulations across borders.⁵⁶ These networks can share information, harmonize standards or coordinate enforcement processes.

Slaughter classifies TRNs into three types⁵⁷. The first category is formed by those networks which lay under the umbrella of an international organization and that are the result of an international treaty which structures their organization. The second type is not a product of an international treaty but rather an executive agreement. Nevertheless, the executive agreement provides a public mandate and organises these networks. Finally, the third type comprises TRNs that are neither the result of an international treaty nor an executive agreement among heads of State. This last type is the result of the domestic regulators' interaction, in which national regulators come together to coordinate transnational policy. Members of these TRNs are civil servants appointed by their own countries who also possess a recognised level of expertise in a relevant field.

The International Monetary and Financial Committee and the European Council of Ministers are examples of the first type of network⁵⁸. The series of executive agreements between the government of the United States and the European Union on transatlantic cooperation are examples of the second TRN that Slaughter highlights⁵⁹. Finally, the International Organization for Security Commissions (IOSCO) is an example of the third type of TRN. The IOSCO is an international network formed by regulators of securities which can belong to the network as ordinary, associate, and

⁵⁶ Anne-Marie Slaughter, *A New World Order* (n 49), 12.

⁵⁷ *ibid.*

⁵⁸ See: <www.imf.org/external/np/exr/facts/groups.htm> Accessed 15 April 2015

⁵⁹ Anne-Marie Slaughter, *A New World Order* (n 49).

affiliate members⁶⁰. The IOSCO works by memoranda of understanding (MoU) signed between the institution and its members⁶¹. The BCBS is another very relevant example of the third type of TRN that Slaughter explains. It lacks a public mandate and its members are public officials from the member countries' central banks and financial supervisory agencies. Chapters 2 and 3 will explain the history and the work of the BCBS more deeply. The BCBS takes its decisions by consensus and enforces them with tools from 'soft law'⁶².

As I will explain in chapter 2 and 3 the BCBS was created by the G-10 central banks' governors and since 2009, countries from the G-20 participate in it. As such, its governance and organisation depends upon the G-20 governors who form the Committee's governing body (called the Governors and Heads of Supervision or GHOS). The Committee's secretariat is hosted by the Bank of International Settlements (BIS) in Basle, Switzerland. The BIS does not oversee the work of the BCBS, although both organisations share the same building⁶³. The BCBS' employees are only a handful of people and work on a *secondment* basis. This means that the officials working at the Committee's secretariat are employees of their domestic banking regulatory agencies and work at Basle on a temporary basis. The Committee has also nine working groups and 19 sub-groups that tackle specific issues (e.g. quantitative impact studies, audits, definition of capital, etc.)⁶⁴.

⁶⁰ The difference between the three terms is that ordinary members are national regulators, associate are regulators of a sub-national unit and affiliate are other types of organizations.

⁶¹ See: <www.iosco.org> Accessed 16 April 2015.

⁶² Abbott and Snidal say that three variables exist in every kind of regulation. These are: Binding level, Precision and Delegation. Soft law happens when one or more of them is absent or weakened, see chapter 5. Kenneth W Abbott, Duncan Snidal, 'Hard and Soft Law in International Governance' (2000) 54 *International Organization*.

⁶³ This fact was confirmed in two different interviews with former employees of the Committee, and one other interview with another official working for the BIS on November 2011.

⁶⁴ The organization chart of the BCBS can be found at: <www.bis.org/bcbs/organigram.pdf> Accessed 15 April 2015.

With Goodhart I argue that the BCBS has become a truly transnational regulatory body. At the same time, however, it is apparently accountable to no one⁶⁵. Contrary to Goodhart's opinion, people at the Committee state that they are only a technical body for coordination between banking supervisory authorities from the countries where the most important financial centres are. They perceive themselves as a 'think-tank' for banking regulators⁶⁶. But I argue in chapter 4 that the Committee has indeed regulatory power, which only underlines again the issue of its lack of accountability. The next section explains the accountability gap of financial TRNs in general and the BCBS in particular.

3. The challenges for accountability that financial TRNs like the BCBS pose

TRNs are designed to tackle transnational problems in a more effective way than IOs, however, because they lack a public mandate and because they are represented by only a handful of countries. This in turn seems to create a trade-off between the effectiveness of TRNs' standards and their apparent lack of accountability⁶⁷.

Most of the criticism directed to the BCBS is based on the Committee's lack of a public mandate, lack of wider representation, and lack of transparency⁶⁸. In this vein, and as I explain in chapters 2 and 3, the BCBS has introduced some measures to make its decision making processes more transparent and enhance participation (e.g.,

⁶⁵ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (Cambridge University Press 2011).

⁶⁶ Interview with a member of the BCBS, (Basle Switzerland, November 2011).

⁶⁷ Rainer Hülse, 'Even Clubs can't do without Legitimacy: Why the Anti-Money Laundering Blacklist was suspended' (n 46); David Zaring 'Informal Procedure, Hard and Soft, in International Administration' (2005) 5 *Chicago Journal of International Law*, 547-601; Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (2006) 17 *European Journal of International Law* 1, 15-46.

⁶⁸ Krisch argues that the BCBS does not deserve respect because its work is 'based on exclusion, leaving out substantial parts of those affected by its decisions, without providing a compelling justification.' Niko Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (OUP 2012), Loc 2217.

consultation processes). From another point of view, however, BCBS' members are public servants of their countries but none of the standards that it publishes go through the legislative process at the domestic level⁶⁹. Additionally, formal membership, as I will explain in chapter 2 and 3, leaves out most of the countries of the world.

The European Union is an exception to the notion that the absence of a process of transposing Basel standards into domestic law through formal law-making processes contributes to an accountability gap. The Basel II and Basel III accords were transposed into Directives through the approval of the European Parliament and Council⁷⁰. In 2006 Basel II was transposed into the Capital Requirement Directive (the CRD⁷¹) and the fourth version of the Capital Requirement Directive (the CRD IV⁷²) reproduced Basel III in 2013.

While the European Council and Parliament intervened when transposing Basel II and Basel III into European legislation, the key elements and key content of the CRD and CRD IV were not discussed by the European institutions. The locus of their negotiations was the BCBS. European national governments, the European Council and the ECB took part in the negotiating process of Basel II, prior to the issuing of the accord⁷³. Additionally and in a similar way to the US case where, due to the Dodd-Frank Act of July 21, 2010, standards of capital adequacy were stricter than those of

⁶⁹ Domestic institutions did participate at some stage on the Basel II negotiating process. In the USA, Congress nominated the Accord's negotiators and granted their mandate. In the European context both the European Council and the European Central Bank were observers at the BCBS. In both cases early drafts of the accord were subject to consultation processes, summaries of which were in turn submitted by the relevant regulators (e.g., the Board of Governors of the Federal Reserve System in the US or the Financial Services Authority in the UK) at the consultation processes of the BCBS. Michael S Barr and Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67).

⁷⁰ Lucia Quaglia, 'The Politics of Financial Services Regulation and Supervision Reform in the European Union' (2007) 46 *European Journal of Political Research* 2, 269-290.

⁷¹ Council Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions [2006] OJ L 177/201.

⁷² Parliament and Council Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 176/338; See also the complementary regulation: Parliament and Council Regulation 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 321/6.

⁷³ Michael S. Barr and Geoffrey P. Miller 'Global Administrative Law: The View from Basel' (n 67).

Basel III, the European CRD IV left the accord's key elements intact⁷⁴, leaving the national governments at liberty to enact higher standards at their own discretion. Furthermore, the CRD IV clearly stated that the BCBS, through its Standards Implementation Group⁷⁵ would monitor the implementation of Basel III by EU member states. Moreover, the Commission should provide update reports on domestic implementation to 'identify differences that could raise level playing field concerns'⁷⁶.

Thus, this thesis argues that the Basel Committee is a regulatory agency that possesses power to shape conducts of financial services actors. Even if the EU constitutes an example of the intervention of the Parliament and the Council to enact the BCBS' accords, as previous paragraphs have explained, the essential contents of the EU law on minimum capital standards for banks are those of the Basel Committee's accords although they may be stricter in domestic legislation. This suggests that the locus of the negotiation and discussion of the BCBS' accords has been so far the Committee and not the EU and its institutions.

At the same time, European financial regulators – at the domestic level and at the European one – are subject to accountability mechanisms both at the national and the European level. Likewise, more informal structures⁷⁷ such as the Banking Advisory Committee (BAC), the Banking Supervision Committee (BSC) of the European System of Central Banks (ESCB), and the *Groupe de Contact*, focus on technical standards and

⁷⁴ Alexander Lehmann, Micol Levi, Peter Tabak, *Basel III and regional financial integration in emerging Europe* (European Bank for Reconstruction and Development, Working Paper No. 132 2011).

⁷⁵ See Chapters 3 and 4 for more insight on the Committee's working groups.

⁷⁶ 'Having regard to the work of the BCBS Standards Implementation Group in monitoring and reviewing member countries' implementation of the Basel III framework, the Commission should provide update reports on an ongoing basis, and at least following the publication of each Progress Report by BCBS, on the implementation and domestic adoption of the Basel III framework in other major jurisdictions, including an assessment of the consistency of other countries' legislation or regulations with the international minimum standards, in order to identify differences that could raise level playing field concerns.' Parliament and Council Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms n 68.

⁷⁷ European Commission, *Institutional Arrangements for the Regulation and Supervision of the Financial Sector*, (Internal Market Directorate General 2001) at: <http://ec.europa.eu/finance/general-policy/docs/cross-sector/supervision/arrange_en.pdf> Accessed 10 January 2017.

seem to be insulated from the political accountability mechanisms that exist both at the domestic and the European level⁷⁸. This thesis, however, focuses on the BCBS' work and therefore leaves aside an otherwise complementary and interesting discussion about European financial regulation and its accountability in the context of the EU.

As the last few paragraphs have explained, an involvement of the institutions of liberal democracies in TRNs like the BCBS has been marginal. It thus comes as no surprise that TRNs possess two features: decentralisation and diversity⁷⁹. First, decentralisation means that there is not one locus of representation or legitimacy (hence it is difficult to hold the Committee accountable). As I said before, unlike countries and international organisations (IOs), TRNs do not derive their powers from a public mandate. Additionally the people involved in the work of the BCBS are unelected officials that are nominated on a technical and professional basis (i.e., because they have certain knowledge). Second and more importantly, the work of TRNs like the BCBS is diverse because they share the regulatory space⁸⁰ with other IOs, nongovernmental organisations (NGOs), global firms, and the global media⁸¹. In addition to this, the main language in which their work operates is also diverse and uncertain, having many potentially relevant languages coming from public international law⁸², economics⁸³, administrative law⁸⁴, human rights⁸⁵, and business performance and competitiveness⁸⁶.

⁷⁸ Giandomenico Majone 'The Rise of the Regulatory State in Europe' (1994) 17 *West European Politics* 3, 77-101; Giandomenico Majone *The Agency Model: The Growth of Regulation and Regulatory Institutions in the European Union* (European Institute of Public Administration 1997).

⁷⁹ James N Rosenau, 'Governance in the Twenty-First Century' (1995) *Global Governance* 1, 13-43; Nico Krisch, Benedict Kingsbury 'Introduction: Global Governance and Global Administrative Law in the International Legal Order' (2006) 17 *The European Journal of International Law* 1; Roderick A W Rhodes, *The New Governance: Governing without Government* (n 14); Anne-Marie Slaughter *A New World Order* (n 49); Robert Keohane 'Global Governance and Democratic Accountability' (n 53); Julia Black 'Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes', (n 48).

⁸⁰ Mark Thatcher, David Cohen, 'Reshaping European Regulatory Space: An Evolutionary Analysis' (2008) 31 *West European Politics* 4; Jody Freeman, Jim Rossi, 'Agency Coordination in Shared Regulatory Space' (2012) 125 *Harvard Law Review* 5.

⁸¹ Manuel Castells, *Communication Power* (OUP 2011), 84.

⁸² Chittharanjan F Amerasinghe, *Principles of the Institutional Law of International Organizations* (Cambridge University Press 2005).

In general terms, a lack of clear accountability standards and mechanisms in the case of some IOs⁸⁷ and TRNs has been recognized⁸⁸. As a response to this ‘accountability gap,’ different proposals for improving transnational democratic governance have been developed.

Habermas⁸⁹ suggests that the diminishing role of traditional categories for thinking about legitimacy in globalisation (such as the lack of a uniform *demos*, and therefore a delegation to a single political *locus*) could be substituted by a universal dimension based on human rights. Rosenau⁹⁰ highlights the existence of fragile and perhaps unusual ‘pockets’ of governance that have gained certain coherence. Some of them are highly institutionalized, others are yet nascent. He cites NGOs, cities, *micro-regions*, social movements, state-sponsored mechanisms, and industry-sponsored mechanisms⁹¹ as part of the architecture of global governance for the 21st century. Rosenau acknowledges, however, that:

[i]t is an unfinished story, one’s need for closure would assert. It needs a conclusion, a drawing together of the “big picture,” a sweeping assessment that offers some hope that somehow the world can muddle through and evolve techniques of cooperation that will bridge its multitude of disaggregated parts and achieve a measure of coherence...⁹²

⁸³ Jonathan Michie, John Grieve Smith, *Global Instability: The Political Economy of World Economic Governance* (Routledge 1999).

⁸⁴ Nico Krisch, Benedict Kingsbury ‘Introduction: Global Governance and Global Administrative Law in the International Legal Order’ (n 79).

⁸⁵ Jack Donnelly, *International Human Rights* (Westview 2007).

⁸⁶ Thomas Friedman *The World is Flat: A Brief History of The Twenty-First Century* (Farrar, Straus and Giroux 2007).

⁸⁷ Robert Keohane, ‘Global Governance and Democratic Accountability’ (n 53); Benedict Kingsbury, Nico Krisch, Richard B Stewart ‘The Emergence of Global Administrative Law’, (2005) 3 *Law and Contemporary Problems* 6, 17.

⁸⁸ Reinard Hüssle ‘Even clubs can’t do without legitimacy: Why the anti-money laundering blacklist was suspended’ (n 46); David Zaring, *Informal Procedure, Hard and Soft, in International Administration* n 64; Barr, Michael and Geoffrey P. Miller ‘Global Administrative Law: The View from Basel’ (n 67).

⁸⁹ Jürgen Habermas, *The Postnational Constellation* (Polity Press 2001).

⁹⁰ James Rosenau ‘Governance in the Twenty-First Century’ (n 79).

⁹¹ By state-sponsored or industry-sponsored mechanisms Rosenau means different devices created either by the institutions of the state (e.g. international organizations, forums, etc.) or by private organizations (e.g. the World Economic Forum).

⁹² James Rosenau ‘Governance in the Twenty-First Century’ (n 79), 39

From another perspective, Held proposes to construct a democracy for cosmopolitan governance by extrapolating democratic values of the many models, such as participation, free speech, and transparency to global governance⁹³. Bohman identifies the challenge that globalisation poses as it cannot be based on a single ‘people’ (*demos*). On the contrary Bohman argues that there are several peoples (*demoi*) and suggests to set a ‘democratic minimum’ in transnational governance that ‘aims at elaborating conditions of non-domination necessary for democratization.’⁹⁴ In this way democracy could be a way for ‘rectifying injustices’⁹⁵. Finally, Krisch proposes to legitimise transnational regulation by pluralism, identifying those institutions that deserve respect from those which, because they are not inclusive, do not⁹⁶.

These approaches are very interesting and they shed light on the possible solutions to the legitimacy gap that TRNs like the BCBS pose. Nevertheless, as Black rightly states, ‘there has been very little sustained research on how non-governmental regulators respond to competing accountability and legitimacy claims, and even less on how these responses may be affected by their relationship with other regulators in polycentric regulatory regimes.’⁹⁷

A caveat is in order. I recognise that accountability and legitimacy are not the same phenomenon, although they are closely related to each other. The purpose of this thesis is to explore alternative accountability mechanisms in relation to the work of financial TRNs like the BCBS. An ulterior research question that I do not address in the thesis is how legitimate those mechanisms are. The question of their legitimacy is a normative one, that needs a conceptual framework against which to assess the

⁹³ David Held, ‘From Executive to Cosmopolitan Multilateralism’ in David Held, Mathias Koenig-Archibugi (eds.) *Taming Globalisation: Frontiers of Governance* (Polity Press 2003).

⁹⁴ James Bohman ‘From Demos to Demo: Democracy Across Borders’ (2005) 18 *Ratio Juris* 3, 293-314.

⁹⁵ *ibid* 307.

⁹⁶ Nico Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68).

⁹⁷ Julia Black ‘Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes’ (n 48), 154-155.

appropriateness and rightfulness of a particular accountability mechanism. Nevertheless, the diversity of proposals wanting to validate their claims about how globalisation *should* work eloquently speaks about the hardship of finding transnational legitimacy⁹⁸.

4. The research question and the structure of the following chapters of the thesis

The question that the thesis seeks to answer is whether the exercise of regulatory powers by the Basel Committee of Banking Supervision is subject to accountability mechanisms. Thus, the thesis aims at exploring and mapping possible accountability mechanisms to hold the BCBS accountable. This means that those mechanisms must have consequences for the Committee in the form of punishments and commendations (albeit in a softer way). Thus, the next chapter (chapter 2) introduces the reader to the complexities of the BCBS and its role in transnational financial regulation. The chapter explains the Committees' most important instances of exercise of regulatory power: the Concordat of 1975, and the three Basel Accords (Basel I, Basel II, and Basel III). All these standards are central for the discussion of the Committee's accountability, not only because they have greatly influenced global financial regulation, but, most importantly, because they have been the main object of accountability claims. Chapter 2 provides a history of the BCBS' beginnings which suggest that the Committee should be considered as exercising 'regulatory power' which in turn calls for accountability mechanisms and concludes with the discussion and implementation of Basel II.

Chapter 3 starts by explaining the negotiating and publication of Basel III in the context of the 2008 financial crisis. The second part of the chapter explains the BCBS'

⁹⁸ Nico Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68).

organizational identity and decision making and concludes that the Committee is not a simple and informal network of cooperation between central banks and financial supervisors. On the contrary, it has routines and institutions for decision making. The regulatory outcomes (e.g. the Accords, the Concordat, and other best practices issued by the Committee) have been enforced both by the BCBS' members and by other participants, such as countries outside the G-10 or G-20. In other words it could be argued that the BCBS designs the entry requirements for newcomers to the global financial system. The chapter also explains the governance of the BCBS by task forces specialized in different topics (e.g. financial systemic risk, capital regulation, and liquidity regulation); the committee (*sensu stricto*), in which officials in charge of financial supervision from member countries take part; and the governing body that gathers together member presidents of central banks and heads of banking supervision. I explain that the governing body revises the Committee's decision, which in turn overlooks the task force's work. These mechanisms are internal and part of the governance of the BCBS.

Chapter 3 explains the governance network of the Committee that includes the heads of state of the G-10 and (since 2009) the G-20. The BCBS regularly produces reports for the G-10 or G-20 meetings. The chapter explains the role of the permanent Secretariat of the BCBS and the scope of its influence and powers, as well as the dynamics of the consultation processes. The conclusions of the chapter are that the BCBS has a clear organizational identity, that it is at the centre of global financial regulation, and for that reason can be a target of accountability claims.

Chapter 4 argues that financial TRNs such as the BCBS lack a clear status in public international law. The BCBS, on the one hand, is not a fully fledged international organization, having been conceived of as informal settings for transnational

coordination. On the other hand, however, it is more than mere mechanisms for coordination between public officials from different states. As I explain in chapters 2 and 3, the BCBS has an organizational identity. In this chapter I argue that the BCBS exercises regulatory power which is essential for tracing the BCBS' accountability. If the Committee is simply a forum of coordination with no binding power, the problem of its accountability deficit might be inexistent or futile. I argue, however, that the BCBS does exercise regulatory power, which consists in the ability to modify behaviour through regulatory tools even when acting in an informal way. I also explain that the BCBS possesses some mechanisms based on 'soft law' through which it can enforce its standards. This is also associated with the fact that the banking regulatory community confers some professional authority to the BCBS' standards.

Chapter 5 analyses the recent academic discussion from political scientists and lawyers about accountability. The analysis is necessary for the thesis because there is not a clear cut concept of what accountability is. Therefore I search for a concept that is applicable not only to the governance processes embedded in the state, but also to TRNs. I argue that this concept should work with softer versions of what it means to hold an organization or individual accountable, and this is relevant to the work of the BCBS. By softer versions I mean accountability mechanisms where reputation and informal authority are the main incentives for getting a justification from the Committee, as opposed to legal authority and punishment. A definition of accountability is also necessary because the concept of communicative accountability that builds on the working concept of accountability which I put forward in chapter six needs to be rigorous. Therefore, in chapter 5 I put forward a working concept of accountability which purpose is to help identifying key elements of accountability processes.

For the purpose of my working concept, accountability is the process, by which one or more external claims are issued requesting and obtaining a justification or explanation from a person or organization that exercises regulatory power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow.

In chapter 5 I explain that the working concept of accountability has the minimal elements that any accountability mechanism should have from an external point of view. This means that the working concept's elements are those which an external viewer might identify in any process of accountability. Nevertheless, further analysis of the context of an accountability process provides two additional elements which are internal. This means that the accountee's beliefs and perceptions determine these internal elements. They are first, a sense of need on the accountee's behalf that generates the justification in the first place; and second, a perception that the process has real or potential consequences for the accountee. Additionally to the elements of the working concept, the latter ones are also necessary for an accountability process to exist. Chapter 6 precisely provides the conceptual framework to identify the internal elements.

Chapter 6 uses Luhmann's concept of communication for understanding accountability in transnational regulation. In this vein, the thesis argues that the Luhmannian theoretical framework is especially valid for transnational regulation because it understands communication as an anarchic, decentralized process that nonetheless manages to stabilize expectations. First, it emphasizes the common understanding of past and present communication. And second, Luhmann's model of communication adapts in a better way than other accounts of accountability to the environment of decentralisation and uncertainty in global governance processes. For

Luhmann, communication organizes itself by a series of unplanned selections. He calls this way of organization *autopoiesis* (i.e., self-reference). At the core of Luhmann's theory is his concept of communication. Luhmann's idea of communication, however, departs from the metaphor of transmission, and finds it limited. When transmitted, information does not 'travel' or 'leave' one point to another⁹⁹. For Luhmann, communication is not a 'thing' but a connection¹⁰⁰. The idea of transmission also assumes that there is a two way process between transmitting and receiving. In communication, however, meaning is also essential to the process¹⁰¹. Although I will further explain the concept of meaning in chapter 6, Luhmann explains that meaning is the expectation to connect with other similar communicative events.

For Luhmann, selection is at the core of his concept of communication. Communication is a chain of communicative events. Each event links with one another by selecting each other. Communication is the sequential selection of events that forms meaning¹⁰². For Luhmann, behind a given social agreement there is a sequence of events that were selected through trial and error by a community of understanding. Communication, therefore, is a chain of sequential communicative events. While each one is a unity – e.g., a comment in the news paper – each one is able, however, to be analyzed as the product of three selections: presentation, expression, and appeal¹⁰³.

⁹⁹ Perhaps this is understandable because Shannon and Weaver explain communication as a transmission of signals that 'travel' from one point to the other. They refer to radio signals that need a transmitter and a receiver. When communication is social, however, the metaphor of transmission is no longer useful. See Claude E Shannon, 'A Mathematical Theory of Communication' (1948) *The Bell System Technological Journal* 27, 379-423, 623-656.

¹⁰⁰ 'The metaphor of transmission locates what is essential about communication in the act of transmission, in the utterance. It directs attention and demands for skillfulness onto the one who makes the utterance. But the utterance is nothing more than a selection proposal, a suggestion. Communication emerges only to the extent that this suggestion is picked up, that its stimulation is processed.' Niklas Luhmann, *Social Systems* (Stanford University Press 1995), 139.

¹⁰¹ *ibid* 140.

¹⁰² David Seidl, *Luhmann's Theory of Autopoietic Systems* (Ludwig Maximilian Universität München 2004), 7.

¹⁰³ *ibid*, 142.

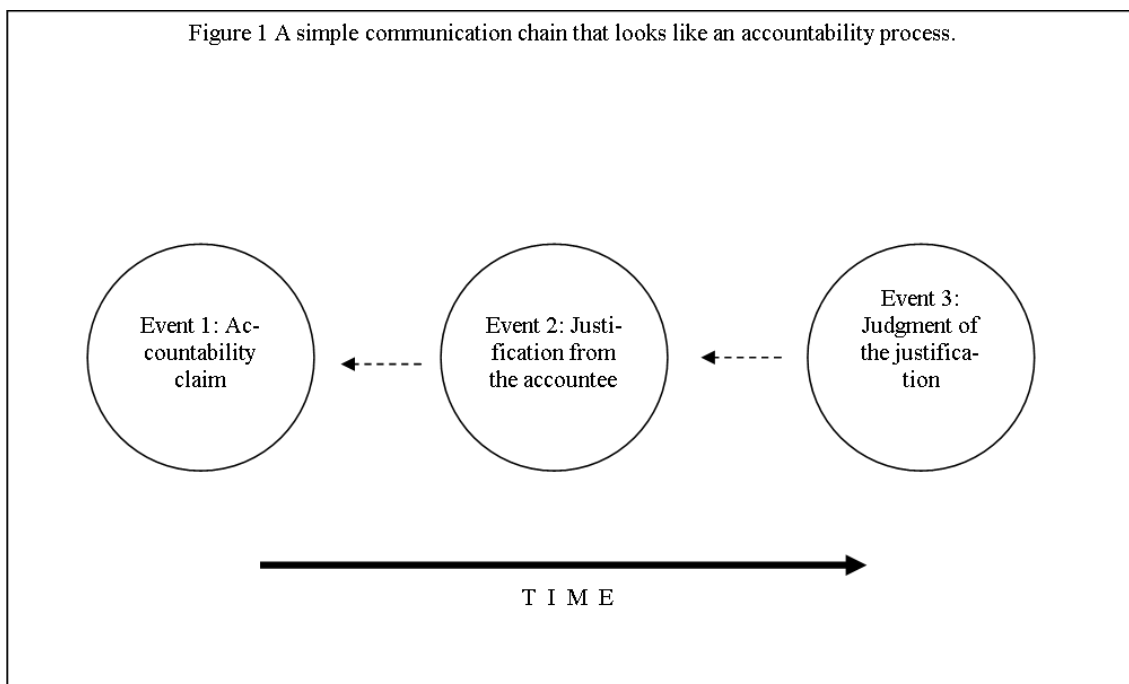
Luhmann also calls them *information*, *utterance*, and *understanding*. I seek to apply Luhmann's concept of communication to accountability.

It does so by following the working definition put forward in chapter 5 and identify three stages: there is an accountability claim at the beginning of the process; next, the accountee answers the claim and issues a justification; and finally, the justification is judged according to a set of standards and it is decided which consequences, if any, should follow. Communicative accountability is then the process by which a sequence of connected communicative events takes the form of the working definition of accountability. A communicative event can be an article in the comment section of a newspaper, a television interview, a comment in a social network (*facebook*, *twitter*, *etc.*), a justification in a press release, or a journalistic article in the media. For Luhmann a communicative event is a point in the communication process¹⁰⁴.

The interconnection of different communicative events that look like accountability processes happens at three levels (i.e., the same three levels associated with Luhmann's concept of communication). Figure 1 provides a visual representation of the process.

¹⁰⁴ Niklas Luhmann, *Social Systems* (n 100), 81.

Figure 1 A simple communication chain that looks like an accountability process.



Firstly, the events that form the three-stage process that looks like accountability (i.e., the accountability claims, the justifications, and the judgments of those justifications) mention the same theme. Not only do they have the same theme, however, but also those events make reference to each other. This means, for instance, that using the first level of analysis (i.e., Luhmann's *information*) there is a communicative event that has the form of a judgment and that explicitly refers to another communicative event that takes in turn the form of a justification from the accountee. This communicative event refers in turn to another one that takes the form of an accountability claim.

A chain of communication may have three or more events shaped in the form of an accountability process that refer to the same theme. Only if the sequence shares the same language and resonates with a shared perspective from an epistemic community there is coherence in the chain of communication. Most significantly, Luhmann's third selection (i.e., *meaning*) gives a common perspective. The selection of *meaning* in each communicative event can potentially chime with various epistemic and professional communities. If the discussion is about the law, it chimes with the legal community. If it

is about the technical merits of a certain public policy, it resonates in a scientific or technical community (e.g., if the discussion is about the best way to build a bridge, it chimes with engineers and builders). In the rest of the thesis I flesh out this idea of communicative accountability with reference to qualitative empirical data in relation to the case of the BCBS.

Chapter 7 analyses the qualitative data set and analyses five examples where the BCBS issued a justification in response to a claim – or set of claims – that was later judged by several actors. The examples revolve around the impact assessments of the implementation of Basel II, the effects of Basel II implementation on small and medium enterprises (SMEs), the discussion about the over-complexity of Basel III, and the BCBS' proposal for losing the rules on liquidity, Basel III being detrimental for the United States' economy.

In each of the 5 examples I trace three stages: first, an accountability claimant asks for an account; second, a justification from the BCBS addressed that account; and third, the Basel Committee's justification is judged. I argue that these examples resemble accountability processes as they comply with the elements of the working concept set out in chapter 5. These five examples start with an accountability claim that sets the theme and the tone for the following steps (e.g. the justification and the judgment). The chapter also argues that each example resonates with the financial community for three reasons: first, the claims, justification, and judgments used the language of the banking regulatory community; second, the claims, justification, and judgments chimed with the expectations and standards of this community; and third, because the claim, justification, and judgment come from a group or individual with high standing in the financial community. The second part of this chapter thus addresses

the question of whether the five examples put forward in this chapter are accountability processes.

For that analysis I use the evidence from the case study of the BCBS to flesh out the concept of communicative accountability. I use qualitative empirical data – extracts from the specialist press’ communications – in relation to the BCBS’ Basel II and Basel III negotiations and implementation. I also explain that communicative accountability claims have consequences for the Committee. By issuing justifications in response to some claims and not others, the BCBS manages expectations in the relevant professional community of financial managers and regulators. This matters because a failure to manage expectations can mean that the Committee is no longer seen as an effective instrument for financial regulation, undermining its work and authority.

The final chapter concludes and synthesizes my findings. I highlight in particular the relevance of the language and expectations of a professional community of bankers, financiers and banking regulators in the communicative accountability processes to which the BCBS is subject to.

The thesis contributes to the relevant literature of socio-legal studies by proposing a way to identify accountability processes in complex and decentralized global regulatory environments. Its contribution in particular is a concept of communicative accountability that further develops an account of the role of professional and epistemic communities when holding TRNs accountable. This concept of communicative accountability suggests that in order to advance certain values and standards in TRNs like the BCBS one first needs to convince the financial community about the pertinence of those values and standards.

Finally, the chapter highlights the limits of my argument and identifies further questions for research. The thesis concludes that while communicative accountability can effectively render TRNs like the BCBS accountable, it lacks sufficient legitimacy. A higher degree of ‘formal’ authority is needed to have the authority to ask for the account. This thesis therefore contributes towards the quest for alternative ways of understanding and improving accountability mechanisms in globalized regulatory institutions.

Chapter 2. The history and governance of the Basel Committee on Banking Supervision (1st part)

This chapter and the following one explain the history and governance of the Basel Committee. The first part (this chapter) explains the origins and historical evolution of the Basel Committee on Banking Supervision until the negotiation and publication of Basel II. In the next chapter (the second part) I explain the process of Basel III the main features of the BCBS' governance that came as a result of its history. These two chapters are an introduction for the reader into the work of the BCBS. But I argue also that the BCBS underwent a transition from a passive coordination forum for sharing experience and best practices to a financial TRNs with governance mechanisms similar to the ones domestic agencies have.

The Committee started as a result of the crisis of the system devised in Breton Woods in the 1970s. In turn, each of the BCBS milestones (the Concordat, and the three accords: Basel I, Basel II, and Basel III) were the response of the international financial regulatory community, through the BCBS, to the challenges faced by international banking at a given time. Along the development of the BCBS other players (countries, groups, and people) have been influential in the Committee's outcomes and its governance. I will further explain their role in the second part when I analyze the governance processes inside the Committee.

The conclusion of chapters 2 and 3 is that the Committee works as an informal network of regulators. At the same time, it is a central piece for international financial regulation (IFR)¹⁰⁵, and a meeting point for the banking regulatory community. In doing

¹⁰⁵ Pierre-Hugues Verdier, 'The Political Economy of International Financial Regulation' (n 16) Loc. 1405.

so the BCBS deploys technical professional expertise also in order to seek to improve the international regulatory framework of the banking industry.

This chapter has three sections. The first introduces the Group de Contact as a predecessor of the BCBS. The second explains the foundation of the Committee and the final section explains the first years of the BCBS and its three main milestones Basel I, and Basel II, leaving for the next chapter the explanation of Basel III.

1. The precedents of the BCBS: The Euro-Currency Standing Committee and the *Groupe de Contact*

The Euro-Currency Standing Committee was established by the G-10 Governors (the heads of each member's Central Bank) as a way to supervise and report the evolution of the Eurodollar market. The Eurodollar market began as the market of transactions in dollars in Europe but the concept now refers to any kind of transaction denominated in dollars outside the US¹⁰⁶. By the end of the 1960s and the beginning of the 1970s the Eurodollar market began to be a source of distress for the international financial community¹⁰⁷. While the analysis of the Euro-Currency Standing Committee used macro-prudential analysis and currency imbalances, another group used a different approach: micro-prudential supervision of the banks. This group was the Groupe de Contact.

¹⁰⁶ "Euro-dollars (...) are deposit liabilities, denominated in dollars, of banks outside the United States." Milton Friedman, *The Euro-Dollar Market: Some First Principles* (University of Chicago Selected Papers, No. 34, 1970), at: www.chicagobooth.edu/~media/44CEE6C8A25B4FF2A48925163DAA2F85.pdf Accessed 15 January 2017.

¹⁰⁷ Goodhart's account of the early years of the BCBS is complete and uses direct sources that he managed to consult from the archives of the Committee. Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65), Loc 356.

The Groupe de Contact was an initiative of some officials working at the financial regulatory agencies of the six countries that by then formed the European Economic Community (EEC): France, Italy, Germany, Belgium, Netherlands, and Luxembourg. The Groupe came along as an informal initiative¹⁰⁸ and its main objective was to discuss the best way to regulate the financial industry. The Groupe de Contact soon included representatives of the US and Switzerland. Its purpose was an informal exchange of views and encouraging convergence of regulatory practices, however, no binding commitment was ever sought¹⁰⁹.

According to Goodhart the guiding principles for the first meeting of the Groupe de Contact were four: 1) It should be very informal with only one participant per country and his/her substitute; 2) the Groupe should meet every quarter of a year; 3) invitations should be sent to particular individuals (and not to the institution they work for); 4) the European Council should be informed and should be able to send one ‘observer’, the EC should also refrain to attempt at turning the Groupe into an EC advisory committee¹¹⁰.

When the UK, Ireland, Denmark, and Norway were starting the negotiations to enter the EEC, the Groupe de Contact decided to invite representatives from these four countries. The emphasis was on the like-mindedness of current and potential members of the Groupe rather than the official role they had in their regulatory agency¹¹¹. The

¹⁰⁸ With the time, the Groupe de Contact became one of the EU official networks for financial regulation, but prior to 1975, it remained as a very informal meeting of officials on a personal basis. European Commission (2000) *Institutional Arrangements for the Regulation and Supervision of the Financial Sector*, p. 14; see:

<http://ec.europa.eu/finance/general-policy/docs/cross-sector/supervision/arrange_en.pdf> Accessed 15 February 2016.

¹⁰⁹ Goodhart’s account of the early years of the BCBS is complete and uses direct sources that he managed to consult from the archives of the Committee. Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 400.

¹¹⁰ *idem*, Loc. 448.

¹¹¹ “[C]haque pays aura seulement un représentant dans le “club” qui sera toujours la même personne”. *ibid*, Loc. 490.

like-mindedness consisted in having a similar professional approach towards cross-banking regulation and the willingness to create transnational standards. The agenda for the meetings was very technical, revolving around what members might think the best practices for regulating banks¹¹². There was no chairman or a permanent secretariat. The meeting was chaired by the representative of the country that hosted it and the occasional secretariat had the main role of recording the minutes. The Groupe de Contact was one of the BCBS' main predecessors because most of the participants in it were also representatives of their countries in the Basel Committee. The next section explains the creation of the BCBS.

2. The foundation and evolution of the Basel Committee on Banking Supervision

The BCBS' original name was the Basle Committee on Banking Regulations and Supervisory Practices. The Committee was informally known as the Basle Committee on Supervision. In 1990, Chairman Muller proposed to change it and the Committee became the Basle Committee on Banking Supervision. The name of the city where it stands (Basle) was written in the Anglophone way. Nevertheless, in 1998 the Committee finally changed its name to the *Basel* Committee when it signed a tax agreement with the local authorities of Basle¹¹³. From that point onwards the official name of the Committee has the German spelling and not the English one. Therefore, this thesis commonly refers to the BCBS as the Basel Committee on Banking Supervision.

¹¹² “1. How best to present bank accounts. 2. What bank ratios are enforced in each country. 3. Ability of the home supervisor to undertake examination of branches in host countries (NB the home/host terminology had not been adopted by then, but that was what was meant). 4. Credit insurance. 5. Mergers between banks and insurance companies.” *idem*, Loc. 501.

¹¹³ *idem*.

By the year 1974 it was clear to many members of central banks that a different approach towards financial regulation was needed. The Euro-currency Standing Committee was analysing the risks to the global economy from a macroeconomic perspective, but the collapse of Bankhaus Herstatt – a smaller German bank with overseas operations – provoked a shift¹¹⁴. Bankhaus Herstatt was declared insolvent by German regulators in June 1974. No one expected, however, that the repercussions of this regulatory action would almost paralyze the foreign exchange market (*FX*) in New York. Because Herstatt was declared insolvent in the middle of the day in Germany, the New York representative of the bank refused to pay any obligation some hours later, leaving the US dollars that it owed unpaid¹¹⁵. The event cost financial institutions an approximate of 620 million dollars in losses¹¹⁶ and made clear that an alternative approach to transnational banking regulation was needed, one that would take into account an analysis at the micro-prudential regulation of banks.

As a consequence of the Herstatt incident, the Group of 10 (G-10)¹¹⁷ Governors of Central Banks decided to create a forum to analyse and discuss the regulation of transnational banking. Unlike the Euro-currency Standing Committee, the new forum would include officials from banking regulators who, in most country members of the G-10, worked at regulatory agencies specialized on financial regulation, and shared

¹¹⁴ This part of the chapter follows the exposition of Goodhart. His account of the early years of the BCBS is complete and uses direct sources that he managed to consult from the archives of the Committee. *ibid.*

¹¹⁵ The Economist, *The Long, Dark Shadow of Herstatt* (London, April 12th 2001), See: <www.economist.com/node/574236> Accessed 10 March 2016.

¹¹⁶ Koleva, Gergana 'Icon of Systemic Risk Haunts Industry Decades After Demise' *American Banker* (New York, 23 June 2011) see: <www.americanbanker.com/bankthink/bankhaus-herstatt-icon-of-systemic-risk-1039312-1.html> Accessed 10 March 2016.

¹¹⁷ The G-10 is a group conformed by the United States of America, Canada, Japan, Germany, France, the United Kingdom, Netherlands, Belgium, Italy and Sweden – and joined by Luxemburg and Switzerland

these regulatory functions with the central bank¹¹⁸. The new approach brought about a new type of expertise.

One of the main perceived problems by the G-10 Governors was the shared responsibility of two or more central banks for failure of banks that had branches in other countries. This later evolved as the parent/host responsibility. While most of the G-10 Governors thought that the main responsibility as the lender of last resort should lie with the central bank of the parent financial institution, others believed that the central banks of the host organization (i.e., the branch) should also be responsible. But, in order to create a workable system, the regulation of both parent and host organization should be coherent, hence the need to develop a mechanism of coordination between the banking regulatory authorities in different countries.

The BCBS was therefore created in 1975 with the name of “The Committee on Banking Regulation and Supervisory Practices”. The first meeting was held on February 1975 and the Committee was chaired by George Blunden and Michael Dealtry was the first Secretary. Both officials came from the Bank of England. The Committee was at the same level as the Euro-currency Standing Committee and its membership included all the countries of the G-10 plus Luxembourg. All their members would be represented by two officials, one coming from the prudential regulatory agency for banks and the other from their respective central bank. The G-10 Governors agreed that the central bank official would be the expert on foreign exchange. Although Luxembourg was not a

¹¹⁸ According to Goodhart, these agencies were: Belgium: Central Bank, Commission Bancaire, Financière et des Assurances; Canada: Central Bank, Office of the Superintendent of Financial Institutions (OSFI); France: Central Bank, Commission Bancaire; Germany: Central Bank, Bundesaufsichtsamt für das Creditwesen (BaKred); Italy: Central Bank; Japan: Central Bank, Ministry of Finance; Luxembourg: Institut Monétaire Luxembourgeois; Netherlands: Central Bank; Sweden: Central Bank, Financial Supervisory Authority; Switzerland: Central Bank, Eidgenössische Bankenkommission (EBK); UK: Central Bank; USA: Board Fed NY, Office of the Comptroller of the Currency (OCC) Federal Deposit Insurance Corporation (FCIC). Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65) Loc 302.

member of the G-10, the Governors agreed that the country would have only one representative from the *Institut Monétaire Luxembourgeois* (the regulatory agency for the banking industry)¹¹⁹.

As I argued before, most of the experts on banking regulation had already been working in the Groupe de Contact. When the G-10 heads of central banks decided to create a committee to tackle the problem of transnational banking, the names of the Groupe's participants came up as the officials that would also partake in the new Committee. The Groupe de Contact, however, continued its work with a bigger constituency and eventually was the basis for the European Union's advisory committees on banking regulation¹²⁰.

The goals of the Committee on Banking Regulation and Supervisory Practices were included in the opening remarks that George Blundel gave to the participants of the first BCBS' meeting:

First, we have not been given any instruction to find answers to specific questions or to conclude our discussions by any specific date. We are intended to be a standing committee meeting from time to time, as and when and where we ourselves think appropriate, and discussing issues of current importance in the field of supervision.

Secondly, we are not intended to attempt to harmonise supervising techniques, riding roughshod over existing practices and legislation in the separate countries represented here. It is appreciated that we cannot commit our countries to such changes. In words which I understand [Blundel's] were used by the President of the BIS at a Governors' meeting, our aim should be '*to learn from each other rather than to make far-fetched attempts to harmonise everything we do*'. We have to try to understand how things are done in each of the countries represented here and why they are done as they are and to see whether there are techniques in other countries which could usefully be adopted in, or adapted for, our own systems; we should also consider whether there are techniques *which we could recommend to the Governors for general adoption, irrespective of the legislative framework against which they would be applied*.

¹¹⁹ *ibid*, Loc 998.

¹²⁰ European Commission, *Institutional Arrangements for the Regulation and Supervision of the Financial Sector* (European Commission 2000), 14; see: <http://ec.europa.eu/finance/general-policy/docs/cross-sector/supervision/arrange_en.pdf> Accessed on 14 April 2016.

Thirdly, I understand that we are encouraged to be quite frank in expressing doubts and criticisms and asking questions about how supervision is carried out in other countries.(...)

Fourthly, it was clearly the wish of the governors that we should concentrate on problems affecting external, international markets. Matters of purely domestic importance and techniques for dealing with them may be of interest but are not of direct relevance to the problems with which we are primarily concerned round this table. They are already, for many of the countries represented here, subject to discussion in the informal EEC Groupe de Contact, known to many of us as the Dondelinger Group¹²¹, and I understand that it is now intended that representatives of the non-EEC countries belonging to this Committee should in future meet from time to time with that group to discuss such questions¹²².”

According to Goodhart, the Committee’s mandate was at first interpreted quite narrowly. In this vein, the specialists in the BCBS would provide expert knowledge to the alternatives put forward by the G-10 Governors but limiting themselves to what the latter accepted consensually¹²³. Gradually, however, the Committee’s work encompassed wider goals, by also providing direction in the form of soft law regarding the best practices for banking regulation¹²⁴. The expertise of the Committee shifted during the years from foreign exchange markets to minimum capital requirements and from capital requirements to liquidity ratios.

As Goodhart shows, the delegates of each country were mostly the same people that travelled to Basle on a regular basis¹²⁵. This provoked that, as in the Groupe de Contact, a ‘club-like’ atmosphere grew the Committee. Consequently, the personal element of each individual member was stronger than the institutional one¹²⁶: the role of professional expertise and authority in these dynamics was very relevant and the job title was secondary.

¹²¹ Albert Dondelinger worked at Luxemburg’s Institut Monétaire and a was a very active member of the Group de Contact.

¹²² From George Blundel’s opening remarks, quoted by Charles A E Goodhart, C.A.E. *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 1055.

¹²³ *ibid*, Loc 1368.

¹²⁴ *ibid*, Loc 1368.

¹²⁵ The only exceptions were Japan and the US, *ibid*, Loc 1372.

¹²⁶ *ibid*, Loc 1638.

The work of the BCBS can clearly be seen by its regulatory milestones. The Committee has produced four salient documents that influence the way banking regulation works, domestically and most relevantly for this thesis, in the business of transnational banking. These milestones are: 1) the Concordat of 1975; 2) The Basel I Accord; 3) The Principles of Banking Supervision; and 4) the Basel II Accord. In the next section I explain each one of them. From 1974 to 2016, 10 chairmen have presided over the BCBS¹²⁷:

The BCBS was founded as a group that shared the same regulatory understandings about transnational banking regulation. They also came from a professional community with shared banking regulatory expertise and in which personal and professional connections were very important. Although at first the mandate of the Committee received a narrow interpretation, which meant that its work would consist in advising about best practices only, with time the BCBS' work did not only coordinate the effort of its members but also set normative standards. In the next sections I will explain the negotiation of these standards and their scope.

3. The role of coordination, expertise and transparency in the BCBS: the Concordat, Basel I and Basel II

The evolution of the Committee's work can be better understood by looking at the documents that have set standards for banking regulation. This is the reason I structure this chapter along the Concordat, the Basel I, and Basel II accords.

¹²⁷ See: <www.bis.org/bcbs/chairmen.htm> Accessed 10 April 2016.

a) **The Concordat and the importance of coordination**

The complexity of the tasks and therefore the outcomes of the Committee have increased over the years. The text of the Concordat was brief (a dozen of pages) and showed simple principles to coordinate the BCBS's regulatory agencies and distribute their responsibilities in the case of cross-border banking. This was known with time as home-host coordination. The evolution of the Committee's response shows its change from a simple coordination forum into a much more complex standard setter. The Concordat is a set of principles and best regulatory practices that the then Committee on Banking Regulation and Supervisory Practices issued from 1975 to 1979. The first document was published in 1975 and consisted of only five pages¹²⁸. The relevant problem at the time was how to enhance the cooperation between central banks when a financial institution in one country had branches or subsidiaries in others. The Concordat tackled this problem and suggested some principles to enhance central banks and regulatory agencies cooperation both to avoid the problem and, if it took place eventually, to alleviate the situation.

The Concordat acknowledged the diversity of status that bank establishments had in different countries. The document classified the banks as 'parent', 'branches', 'subsidiaries' and 'joint ventures' (also known as 'consortium banks'). While branches were 'integral parts of a foreign parent bank', subsidiaries and joint-ventures were fully fledged banks in the country they operated in, although there was a direct relationship between them and the parent bank overseas¹²⁹.

¹²⁸ Committee on Banking Regulations and Supervisory Practices, 1975, *Report to the Governors on the supervision of banks' foreign establishments BS/75/44e*, see: <<http://www.bis.org/publ/bcbs00a.pdf>> Accessed 10 April 2016.

¹²⁹ 'Three types of foreign banking establishment are distinguished: branches, which are integral parts of a foreign parent bank; subsidiaries, which are legally independent institutions incorporated in the country of

The Concordat states that the responsibilities of parent and host authorities are shared concerning liquidity, solvency, and foreign exchange positions of parent banks with branches or subsidiaries in host countries. To enhance cooperation, the Concordat proposed a set of measures¹³⁰: Parent authorities should have the possibility to directly inspect the foreign operation of their banks. In order to facilitate this measure the parent bank should report when one of its branches or subsidiaries' requirements has been waived or made more flexible. The host authority should also be able to send the reports of such situations to the parent authority. When the direct inspection by the parent authority was not feasible, then it could ask the host authority to carry out the inspection on its behalf. The host authority could in turn send a report with the relevant findings. Although the Concordat acknowledged that this direct communication between authorities was often banned by banking secrecy laws, it also suggested trying to modify the relevant domestic regulations in the matter when possible.

The last version of the Concordat was finished by the members of the Committee and then sent to the G-10 Governors for their approval. After authorising it, the Chairman of the BCBS wrote a letter to other central banks which had not G-10 membership, asking for comments. Several favourable comments came Mr. Blundel's way¹³¹. This shows that, from its inception, the BCBS had a wider role than influencing the adoption of best regulatory practices among its members, and, the consequences of its work reached to a wider audience. It also shows the leadership of the BCBS' choice – conscious or unconscious –to select the global central banking and financial regulatory community as the main audience of its work.

operation and controlled by one foreign parent bank; and joint ventures, which are legally independent banks incorporated in the country of operation and controlled by two or more parent institutions, most of which are foreign and not all of which are necessarily banks. *ibid*, 1.

¹³⁰ *ibid*, 4.

¹³¹ Charles A E Goodhart *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 2102.

In 1977 the Committee addressed the common practice of banks creating subsidiaries in other countries with more flexible rules to circumvent the regulatory capital requirement set in one country. A parent bank could, by ‘establishing subsidiaries, create an equity capital pyramid which enables it to circumvent restriction imposed by the supervisory authorities in the form of capital adequacy ratios.’¹³² The paper suggested analysing the consolidation of balance sheets, in particular all of a banking group’s risk-bearing assets regardless if they were held by the parent bank of its subsidiaries¹³³. The paper was presented to the G-10 Governors who ‘strongly endorsed it’¹³⁴, but suggested to resubmit part of the document, further explaining if the consolidation of balance sheets could be extended to joint ventures and minority holdings. In March 1979 the addendum was presented again to the G-10 Governors and endorsed by them¹³⁵.

By 1979 these principles and regulatory practices about discerning the responsibilities of a bank’s parent and host authorities and assessing a bank’s soundness by consolidating their balance sheets, were referred to as ‘the Concordat’¹³⁶. The Concordat has been revised and amended during the years, meanwhile, to distinguish the parent and host authorities’ responsibilities regarding *cross-border* banking (i.e., when there is a parent bank with branches and subsidiaries) has remained the dominant

¹³² *ibid*, Loc 2117.

¹³³ BS/77/46 Committee on Banking Regulations and Supervisory Practices (1977) *Consolidation of bank’s balance sheets: aggregation of risk-bearing assets as a method of supervising bank solvency*, see: <<http://www.bis.org/publ/bcbs00b.pdf>> Accessed 10 April 2016.

¹³⁴ Charles A E Goodhart, C.A.E. (2011) *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 2140.

¹³⁵ Committee on Banking Regulations and Supervisory Practices *Consolidated Supervision of Banks’ International Activities* (CBRSP March 1979) see: <<http://www.bis.org/publ/bcbsc112.pdf>> Accessed 15 February 2016.

¹³⁶ According to Goodhart, Peter Cook, by then the Chairman of the Committee, christened the document as ‘the Concordat’ evoking the other Concordat signed by Francis I and the Pope, that involved ‘a set of understandings between sovereign parties, but without being based on a common legal authority or being legally binding.’ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 2152.

theme of the Concordat's main theme¹³⁷. The most important additions the document has suffered have responded to bank failures (e.g., Banco Ambrosiano, BCCI, and of course the 2008 credit crunch) and novel situations such as internet banking and global systemically important banks. In the following paragraphs I explain each one of them.

The failure of Banco Ambrosiano reached the newspapers' front pages in 1982. It involved somehow the Vatican's *Instituto per le Opere de Religione* (IOR) – the Vatican's bank – the alleged murder of Ambrosiano's President Roberto Calvi whose body was found hanging from Blackfriars Bridge in London, and the suicide of Calvi's secretary¹³⁸. Aside from the scandalous findings, Banco Ambrosiano had divested funds overseas through a 'non-bank holding' in Luxembourg and subsidiaries in Peru and Nicaragua¹³⁹. Obviously, the Ambrosiano's failure led to questioning if the principles set out in the Concordat were sound. As a consequence, the Committee revised the document and proposed amendments on March and May 1983¹⁴⁰.

Almost ten years later, the Bank of Credit and Commerce International (BCCI) was declared bankrupt. Similarly to the *Banco Ambrosiano's* case, the BCCI had used non-bank holdings and structured its operations through loopholes in the Concordat's principles so that no G-10 banking authority could effectively assess all its balance

¹³⁷ According to the web-page of the BCBS, up to December 2015 and after 1979, 40 documents related to the Concordat had been released, see: http://www.bis.org/list/bcbs/tid_24/page_2.htm

¹³⁸ The Ambrosiano's scandal was colorful enough and has since elicited much intrigue and speculation regarding the involvement of the Sicilian mafia, the Masons, politicians and the Italian Catholic church hierarchy. See, CE. DI. B. (1985) *Le Crisi bancarie, il caso del Banco ambrosiano*, Studi di Diritto e Legislazione Bancaria; from a more journalistic view, see: <http://www.nytimes.com/1982/07/28/world/italy-s-mysterious-deepening-bank-scandal.html?pagewanted=all> Accessed 15 February 2016.

¹³⁹ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 2231.

¹⁴⁰ 'Where groups contain both banks and non-bank organizations, there should, where possible, be a liaison between the banking supervisory authorities and any authorities which have responsibilities for supervisions these non-banking organisations, particularly where the non-banking activities are of a financial character. Banking supervisors, in their overall supervision of banking groups, should take account of these groups' non-banking activities, and if these activities cannot be adequately supervised, banking supervisors should aim at minimising the risks to the banking business from the non-banking activities of such groups' BCBS *Principles for the Supervision of Banks' Foreign Establishments* (BIS 1983) see: www.bis.org/publ/bcbssc312.pdf Accessed 10 February 2016.

sheet¹⁴¹. These banking failures caught the Committee's attention and constituted examples against which the Concordat's standards were assessed.

Electronic banking brought another challenge for cross-border banking supervision. To tackle it, the BCBS, through its Electronic Banking Group¹⁴² issued a document setting out some principles in 2003¹⁴³. The Committee acknowledged that new features in internet banking bring about new risks. Among these new features are: “the unprecedented speed of change related to technological and customer service innovation, the ubiquitous and global nature of open electronic networks, the integration of e-banking applications with legacy computer systems and the increasing dependence of banks on third parties that provide the necessary information technology”¹⁴⁴. The document recognized fourteen principles for e-banking which belonged to three broad categories of issues: 1) board and management oversight; 2) security controls; 3) legal and reputational risk.

Some of the e-banking characteristics were also present in the 2008 credit crunch and what experts and commentators have called ‘the Great Recession’¹⁴⁵. This financial crisis affected all the work of the BCBS, as I will explain below, but most importantly they impacted on the understandings and principles that the Committee had been suggesting since its inception. The cross-border banking issue was a salient one because of the global repercussions of the financial crisis and because it was not

¹⁴¹ The BCCI was controlled by the sheik of Abudabi and operated through two holdings: one in Luxembourg and one in Grand Cayman. The Luxembourg leg was a non-banking holding and was not carrying any banking business there, however, it had subsidiaries in many countries and its main operations were done in London, but they were reported elsewhere. Through this loopholes and weaknesses, no single authority was able to supervise the complete operation of the BCCI. See: Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 2248.

¹⁴² The EBG is working group within the Committee, next chapter will spell out the structure and functioning of the working groups.

¹⁴³ BCBS (2003) *Risk management principles for electronic banking*, see: <www.bis.org/publ/bcbs98.htm> Accessed 15 February 2016.

¹⁴⁴ *ibid.*

¹⁴⁵ Joseph Stiglitz, *Freefall, Free Markets and the Sinking of the Global Economy* (Penguin 2011), xi.

localized in only one national or regional market. As a consequence, the BCBS fostered the creation of Regulatory Colleges as mechanisms of ‘relevant supervisors that are formed for the collective purpose of enhancing effective consolidated supervision of an international banking group on an ongoing basis.’¹⁴⁶ The document was issued on 2010¹⁴⁷ and the Committee published a final version on 2014¹⁴⁸. The final document put forward seven principles for effectively structuring supervisory college’s work: collaboration and information-sharing as the college’s objectives; transparency and flexibility when creating the college’s structures; effective and two-way information-sharing; the efficiency, ease of use, integrity and confidentiality of communication exchange; the promotion of collaborative work; the college should complement the interaction of the supervised entity with home or host authorities, and the college should be prepared to tackle an eventual crisis¹⁴⁹.

Finally, as a result of the 2008 financial crisis, the Financial Stability Board (FSB) recommended the BCBS to produce a methodology to reduce ‘the moral hazard posed by systemically important financial institutions.’¹⁵⁰ Therefore, in documents published in 2011 and 2013¹⁵¹, the Committee put forward a mechanism to identify the Global Systemically Important Banks (G-SIBs) and supervise them accordingly – as the Committee recognized these banks were *too big to fail*¹⁵². The G-SIBs are financial

¹⁴⁶ BCBS *Good practice principles on supervisory colleges* (BIS 2010), see: <www.bis.org/publ/bcbs177.pdf> Accessed 10 April 2016.

¹⁴⁷ *ibid.*

¹⁴⁸ BCBS *Principles for effective supervisory colleges* (BIS 2014), see: <www.bis.org/publ/bcbs287.pdf> Accessed 10 April 2016.

¹⁴⁹ *ibid.*

¹⁵⁰ FSB *Reducing the moral hazard posed by systemically important financial institutions, FSB Recommendation and Time Lines* (FSB 2010), see: <www.financialstabilityboard.org/publications/r_101111a.pdf> Accessed 10 February 2016.

¹⁵¹ BCBS *Global systemically important banks: updated assessment methodology and the higher loss absorptency requirement* (BIS 2013) see: <<http://www.bis.org/publ/bcbs255.pdf>> Accessed 11 February 2016.

¹⁵² ‘The negative externalities associated with institutions that are perceived as not being allowed to fail due to their size, interconnectedness, complexity, lack of substitutability or global scope are well recognized’. BCBS *Global systemically important banks: updated assessment methodology and the*

institutions that, because of their sheer size and complexity, are particularly relevant for financial supervision. The 2011 document explains the rationale for the measure:

The rationale for adopting additional policy measures for G-SIBs is based on the “negative externalities” (i.e. adverse side effects) created by systemically important banks which current regulatory policies do not fully address. In maximising their private benefits, individual financial institutions may rationally choose outcomes that, from a system-wide level, are sub-optimal because they do not take into account these externalities. These negative externalities include the impact of the failure or impairment of large, interconnected global financial institutions that can send shocks through the financial system which, in turn, can harm the real economy. This scenario played out in the recent crisis during which authorities had limited options other than the provision of public support as a means for avoiding the transmission of such shocks. Such interventions also have implications for fiscal budgets and taxpayers. Moreover, the moral hazard costs associated with direct support and implicit government guarantees may amplify risk-taking, reduce market discipline, create competitive distortions, and further increase the probability of distress in the future. As a result, the costs associated with moral hazard add to any direct costs of support that may be borne by taxpayers.¹⁵³

The classification of G-SIBs is based on qualitative approximate variables that describe the attributes of such institutions. The methodology aims at identifying those banks that, given the case they fail, can provoke shocks in the whole financial system and the real economy. The methodology, however, does not assess the *probability* of the bank failing but its importance to the global financial system¹⁵⁴. A global indicator was named ‘Loss-Given-Default’ (LGD). It is composed of 5 sub-categories: size, interconnectedness, the lack of substitutes or financial institution infrastructure for the services they provide, their global (cross-jurisdictional) activity, and their

higher loss absorvency requirement (BCBS 2011), 1, see: <<http://www.bis.org/publ/bcbs207cn.pdf>> Accessed 10 February 2016.

¹⁵³ *ibid.*

¹⁵⁴ *ibid.*

complexity¹⁵⁵. The LGD may have a maximum of 100 points and each single sub-category counts for one fifth (20 points) of the total¹⁵⁶.

All these standards are related to cross-border banking and stemmed from the Concordat. The complexity of the standards – and the problems the BCBS has attempted to tackle – has increased from 1975. The issues that the Concordat addressed and the documents described in this subsection are a big part of the Committee’s work and it is possible to see the leadership and guidance that the BCBS has had over the years. The evolution of the Concordat shows the Committee’s approach towards regulating cross-border banking. At first, the Concordat relied entirely on the domestic regulators and its content was minimal with a handful of principles. At the end however, it issued detailed regulation for systemically important banks, moving the centre of decision from the member countries to the BCBS.

The next section shows the negotiation and implementation of Basel I. As this section argues, the Concordat’s implementation refers to the changing role of the Committee. From a different perspective, the negotiation of Basel I sheds light on the relevance of the banking regulatory community’s endorsement in the Committee’s work.

b) The Basel I Accord and the role of reputation

Basel I was originally called the *Accord on International Convergence of Capital Measurement and Capital Standards* and was published on July 1988¹⁵⁷. It was only

¹⁵⁵ *ibid.*

¹⁵⁶ *ibid.*, 5.

dubbed Basel I until the second version of the Accord (Basel II) began its discussion in 1997. In this section I first explain the problem that the Basel I accord tried to tackle; second, I explain the considerations and negotiations that led up to the publishing of this accord, and third, I explain some of the standards Basel I put forward.

As previously said, up to 1987, the Committee's work had mainly covered the principles and standards regarding cross-border banking supervision, especially the cooperation and shared responsibility of home and host authorities when supervising a bank which had subsidiaries overseas. Nevertheless, as early as 1974 a document from the BIS mapped the different standards towards banks' minimum capital requirements, acknowledging the disparity in measuring capital adequacy requirements (CAR) among many countries. While most of Continental European countries required risk weighted ratios, none of the Anglo-Saxon ones did so¹⁵⁸.

F. R. Dahl, from the Federal Reserve Bank of New York explained the importance of CAR for financial regulation and the status of subordinated debt in the US¹⁵⁹. Dahl summarized one of the most relevant purposes of CAR, that it is 'thought of as serving (1) as a cushion to absorb losses, and hence protect depositors and creditors, in both a going concern and in liquidation; (2) as a curb to excessive leveraging and risk-taking by bank managements; and (3) as a protection to earnings for absorbing losses and meeting contractual obligations to depositors and creditors.'¹⁶⁰

¹⁵⁷ BCBS *International Convergence of Capital Measurement and Capital Standards* (BCBS 1988) see: <<http://www.bis.org/publ/bcbasc111.pdf>> Accessed 10 April 2016.

¹⁵⁸ The report was produced by Rene Larre, the then General Manager of the BIS (1974). Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 3126.

¹⁵⁹ Dahl, F. R. (1976), *Subordinated debt in bank capital structures in the United States*, in Charles A E Goodhart *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 4176 and ff.

¹⁶⁰ Dahl explains that subordinated debt could enhance the stability of a bank providing more resources in the long term and shares some characteristics with equity. However it is not a perfect substitute because it has several disadvantages that increase a bank's risk. First, by having to pay annual fixed charges and

The question of whether subordinated debt could be counted as part of the capital for CAR purposes was at the centre of regulatory standards' discussion for international operations¹⁶¹. Subordinated debt shares some of the features of equity and it is a tool for banks to capitalize in the long run with less risk¹⁶², however, to consider it as capital for CAR purposes was not totally justified because it did not provide the stability that equity did¹⁶³.

The BCBS' members realized that the standards for domestic operations were different among countries and, overall, that CAR standards for domestic operations were stricter than those for international financial operations. This situation created an incentive for regulatory competition¹⁶⁴ and for circumventing domestic regulations by stimulating the growth of international markets¹⁶⁵. Thus, the challenge was to level the playing field in two ways: first, to raise the CAR standards for international banking, and second, to homologize different capital adequacy ratios among domestic jurisdictions.

The then chairman of the BCBS, Peter Cook, first introduced the need to render uniformity among different CARs among the Committee's members and to therefore

redemption payments to creditors, regardless the financial health of the bank, subordinated debt might put an unnecessary stress on the bank; second, the equity margin out of which losses can be absorbed decreases with the payment of the debt service; third, the repayment of subordinated debt at its maturity date could de-capitalize banks if not planned thoroughly; fourth, acquiring subordinated debt could diminish the ability of the bank to contract new debt in the case of a critical situation; in this vein, 'acceleration clauses' that are common in this type of contract can bring forward the date for the entire repayment of the debt, just as the bank is most vulnerable. Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 4176 and ff.

¹⁶¹ *ibid*, Loc 3137.

¹⁶² Subordinated debt is a loan or security that ranks below to other obligations regarding the claims on assets or earnings, see: <<http://www.investopedia.com/terms/s/subordinateddebt.asp>> Accessed 10 April 2016.

¹⁶³ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 4176 and ff.

¹⁶⁴ Regulatory competition is the phenomenon of lowering or lifting domestic regulatory standards so that regulatees would move from one jurisdiction to another because of the regulation better suits the regulatees' strategies. See Robert Baldwin, Martin Cave, Martin Lodge *Understanding Regulation: theory, strategy, and practice* (OUP 2013).

¹⁶⁵ BS/82/4, see: Charles A E Goodhart *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 3148.

create a CAR for banks with international operations at the beginning of the 1980s¹⁶⁶. By 1982, the Secretariat of the Committee produced a paper on ‘Capital adequacy and international banking activity,’ which contained a general section on the role of capital; a detailed definition of the constituents of capital; a map of the diverse ratios used by various countries; a section on the decreasing capital ratios, and, finally, a set of suggestions for introducing ‘a more systematic treatment of capital adequacy.’¹⁶⁷ Cook suggested that the Committee should make a draft report on this question to the G-10 Governors pointing out: 1) an endorsement of the principle of no further erosion of capital ratios; 2) the desirability of greater convergence in capital requirements; 3) the desirability of the risk assets ratio for measuring capital adequacy; and 4) the desirability of a common definition of capital for banks with international operations¹⁶⁸.

The G-10 Governors endorsed a shorter version of the paper that, nonetheless, emphasized the need for greater convergence in national definitions of bank capital and the improving of the methods to measure capital adequacy¹⁶⁹. As early as 1982, the G-10 Governors and the BCBS’ members agreed that greater convergence towards stricter capital ratio requirements was needed. Following the principle put forward by the Concordat, the universe to measure CAR ought to be a consolidated balance sheet. Goodhart argues that there were three main reasons why it took almost six years to come up with an official document that set the higher standards among the members of the Committee. The first one was that although there was an agreement on the principles on capital adequacy, it took some time to achieve consensus on the specific details. The second was that the BCBS did not have – and did not want to have – the ability to force certain standards upon members that did not want to endorse them. As chapter 3

¹⁶⁶ *ibid*, Loc 3189.

¹⁶⁷ *ibid*, Loc 3189.

¹⁶⁸ *ibid*, Loc 3203.

¹⁶⁹ *ibid*, Loc 3229.

discusses, this feature has been a permanent one, and decisions in the Committee are still made by consensus and not by majority. The third reason pointed out by Goodhart was that until 1984 chairman Volcker ‘injected some sense of urgency’ to setting higher CAR worldwide¹⁷⁰.

From December of 1982 to February of 1984 a sub-group chaired by Dahl – the same official of the FRB – and composed also of people from Belgium, France, Germany and the UK was in charge of putting forward a common view of the main ‘constituent elements of capital’¹⁷¹ with special emphasis on subordinated debt and hidden reserves for prudential purposes, and to assess the different methods for measuring capital adequacy as well as suggesting their usefulness for different regulatory objectives¹⁷². The complexity of the issue was such that the Dahl sub-committee could only advance part of the first objective by early 1983¹⁷³. The Committee then extended a new mandate to the Dahl sub-group:

To consider further the constituent elements of capital with a view to offering a basic conceptual blueprint of the elements of the capital base which might have general application. Although recognising that some countries will include some elements of capital in the definitions in their own system, which are excluded in others (and vice versa), it should nonetheless be possible, ignoring particular current national practices, *to offer a common definition*.

To examine the nature and different degrees of risk present in the different categories of asset held by banks (and contingent liabilities) – with particular reference to interbank claims –and to suggest relevant risk weightings to be applied in relating these risks to capital resources.¹⁷⁴

Then again, the Dahl group found it very difficult to come up with simple definitions that would encompass the complexity and diversity of practices among many countries for both listing the constituent elements of capital, and describing the best

¹⁷⁰ *ibid*, Loc 3250.

¹⁷¹ From the terms of reference given by Chairman Cook (BS/82/69), see: *ibid*, Loc 3250.

¹⁷² *ibid*, Loc 3260.

¹⁷³ *ibid*, Loc 3261.

¹⁷⁴ BS/83/30, see: *ibid*, Loc 3189.

methods for weighting risk. The first and the second reports of the Dahl sub-group were discussed on February 1984 BCBS' meeting¹⁷⁵. Goodhart hypothesises that the meeting did not end with a happy note because Peter Cook, the then Chairman of the BCBS wrote to K. O. Pöhl (the new Chairman of the G-10 Governors) on March 1984 reporting that meeting's results. Cook's report has a grim overtone:

I should report a strong consensus among most members at our discussion that the current degree of convergence in the constituents of capital or in capital adequacy measurement in member countries is not such as to give any confidence that the application of one country's rules to the banks in another country could be undertaken in any meaningful way for comparability purposes.¹⁷⁶

According to Goodhart, a change in the international context brought about a change in the disposition of the US' authorities to ratchet up the standards for CAR. What is called the Mexico, Argentina, and Brazil crisis (the MAB crisis) provoked a severe situation for the banks based in New York. As a result, the US Congress wanted to raise the standards for CAR unilaterally but financial institutions convinced the legislators that doing so would suppose a loss in competitiveness towards the American banking industry¹⁷⁷. To avoid the harmful consequences of a unilateral move, the most important banking centres should also raise their standards¹⁷⁸. Whether or not the competitiveness of American firms would be affected by stricter rules enforced unilaterally, the case is that Paul Volcker – the then chairman of the FRB – put extra pressure on the G-10 Governors to achieve convergence on capital adequacy ratios

¹⁷⁵ *ibid*, Loc 3313.

¹⁷⁶ *ibid*, Loc 3322.

¹⁷⁷ Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (Peterson Institute for International Economics 2008), 49-50.

¹⁷⁸ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 3322.

through the BCBS¹⁷⁹. Thus, Volckner injected a new sense of urgency in the quest for convergence of regulatory capital standards¹⁸⁰.

The G-10 issued a mandate to the BCBS to: '1. Assessing comparability of different measures of capital adequacy, and 2. The most practical options for attaining over different periods of time comparable and adequate minimum international capital standards.'¹⁸¹ Chairman Cooke recognized the almost impossibility of creating a single encompassing framework that unified the diverse approaches towards capital adequacy that states had. Nevertheless, Cooke thought that a common framework of reference would be feasible and could give a qualitative equivalence to the diverse countries' approaches towards CAR¹⁸².

The two original questions remained unchanged: what should be considered as capital for CAR and which particular weight should be given to different types of capital using the risk-weighted ratios. Additionally, the later agreement within the Committee on stopping the erosion of minimum capital standards created the need to converge towards a number of CAR that would be necessarily higher for some countries that had liberalized their approach to capital adequacy.

By September 1986 the Committee arrived at six different definitions – they called them tiers – of capital:¹⁸³ These were the candidate components of a definition of CAR, however, there was no consensus among the Committee's members as to which of them to cut out in the final definition¹⁸⁴. The usefulness of the technical analysis of

¹⁷⁹ *ibid.*

¹⁸⁰ Wolfgang H Reinicke, *Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980-1990* (Edward Elgar 1995).

¹⁸¹ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 3356.

¹⁸² Peter Cook's note of 18 June 1984 (BS/84/41), *ibid.*, Loc 3322.

¹⁸³ Christopher Tompson, Secretary of the BCBS, 9 September 1986 (BS/86/63), *ibid.*, Loc 3441.

¹⁸⁴ *ibid.*, Loc 3441.

different standards and the equivalence of each one of them had been exhausted. The Committee needed an impulse from outside: a different – more political – approach was needed. It is not surprising therefore, that until that external boost finally came, the Committee’s work to create a convergent standard for CAR remained unfruitful.

This exogenous impulse towards convergence of CARs came in the form of a bilateral negotiation between the US and the UK. The negotiations began on September 1986 between Chairman Volcker and Governor Robin Leigh-Pemberton. Volcker suggested that both countries could join efforts to upgrade their capital adequacy regulation in tandem, as an agreement between them favoured both and legitimized the regime before their own banking industry¹⁸⁵. By the end of the year 1986 the two countries had agreed on a regime with a common definition of capital and five categories of risk-weighted assets for both on and off-balance sheet activities¹⁸⁶. The negotiations had been behind closed doors and not even the Chairman of the BCBS – Peter Cook, a senior official at the Bank of England himself – knew about them until the moment the agreement was officially announced¹⁸⁷.

The agreement between the US and the UK was disclosed at the next meeting of the Committee in 1987. The announcement came as a shock for all the members. Nevertheless, bilateral negotiations provided the external stimulus that convergence of CAR needed. Being both New York and London the main financial centres of the world, the American and British governments could enforce the agreed standards without any formal acquiescence from other governments: if foreign banks wanted to

¹⁸⁵ Solomon, Stephen (1995) *The Confidence Game*, (Simon and Schuster 1995), quoted by *ibid*, Loc 3522.

¹⁸⁶ While on-balance sheet activities encompass most of the traditional banking operations (e.g. lending, savings, investments, etc.), off-balance sheet activities encompass novel operations such as swaps, futures, options, etc. See: <www.investopedia.com/articles/investing/071513/understanding-offbalance-sheet-financing.asp> Accessed 10 April 2016.

¹⁸⁷ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 3605.

participate in New York or London's financial markets they would have to comply, even if their home governments had different regulations¹⁸⁸.

The British and American *démarche*¹⁸⁹ gave other members of the BCBS the opportunity to negotiate a new standard on capital adequacy within the Committee, but with the incentive of the credible threat embodied by the US-UK bilateral agreement. As Tarullo put it: 'If Basel ever was a venue for US and UK regulators simply to impose their preferred standards on other financial centers, it ceased to be so very quickly.'¹⁹⁰ The final version of the Basel I accord was a fruit of 'a spirit of compromise' as Peter Cook had written some months before¹⁹¹, where all members had to give something in¹⁹².

The accord was intended to apply to banks on a consolidated basis (i.e., considering parent banks, branches, subsidiaries and joint ventures). The Committee stated, however, that it would keep revising the evolution of ownership structures in the banking industry to adapt the accord so that it applied to banks on a consolidated basis at all times¹⁹³.

Capital was divided into two tiers: a) equity capital: 'Issued and fully paid ordinary shares/common stock and non-cumulative perpetual preferred stock (but excluding cumulative preferred stock)'¹⁹⁴; and b) supplementary capital: undisclosed

¹⁸⁸ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation*, (n 177), 54.

¹⁸⁹ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 3605.

¹⁹⁰ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation*, (n 177), 54.

¹⁹¹ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 3383.

¹⁹² The Germans would have to accept a capital definition much inclusive than the one they had. The Japanese in turn accepted a higher CAR but in return a concession was made on their behalf by adding the revaluation of assets as a form of tier 2 capital. See Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177), 54.

¹⁹³ BCBS (1988) *International Convergence of Capital Measurement and Capital Standards*, p. 2 see: <<http://www.bis.org/publ/bcbsc111.pdf>> Accessed 10 April 2016.

¹⁹⁴ *ibid.*

reserves, revaluation reserves, general provision/general loan-loss reserves; hybrid debt capital instruments; subordinated term debt; and deductions from capital¹⁹⁵. The Accord also contained a rule stating that the 50% of capital for supervisory purposes must always be Tier 1 capital (i.e., equity capital).

In order to measure the capital adequacy of a bank, the Basel I accord mandated a weighted risk ratio approach. Different assets or off-balance sheet items would count differently for CARs' purposes. In this vein, the Committee classified assets into five type of risk ratios (0%, 10%, 20%, 50%, and 100%). If an asset was classified with 0% risk ratio it meant that the bank should not back the asset up in its capital, for supervisory purposes (e.g., a bond issued by an Organisation for the Economic Cooperation and Development's – OECD's – member central government¹⁹⁶). If, on the contrary, an asset or an item was risk weighted as 100% (e.g., a loan to a private company) the bank should increase its regulatory capital accordingly¹⁹⁷.

The Basel I accord set the minimum regulatory capital as 8% of total assets. Half of it (4%) must be composed of core capital (equity capital and disclosed reserves, i.e., Tier 1 capital). The type of risk against which the assets were weighted was credit risk, i.e., the risk of a bank's counterparty defaulting. Although other risks are acknowledged (e.g., investment risk, interest rate risk, exchange rate risk, etc.), the BCBS only considered credit risk in the accord¹⁹⁸.

¹⁹⁵ *ibid.*

¹⁹⁶ The risk ratio for sub-political units (i.e., states part of a federation or municipalities) was higher, even when issued by sub-political units within OECD states.

¹⁹⁷ The rules were intended to be as simple as possible, however, complications were unavoidable. The Basel I Accord has some exceptions to the rules like the weighting of collateral and mortgage debt. For further reference see: BCBS *International Convergence of Capital Measurement and Capital Standards* (BCBS 1988), <www.bis.org/publ/bcbasc111.pdf> Accessed 10 April 2016; see also: Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation*, (n 177), 55.

¹⁹⁸ BCBS *International Convergence of Capital Measurement and Capital Standards* (BCBS 1988), 8, see: <<http://www.bis.org/publ/bcbasc111.pdf>> Accessed 10 April 2016.

By 1990 the accord was fully implemented among the BCBS' members¹⁹⁹. Surprisingly, many other countries happily implemented Basel I too, even when it was designed only for bigger banks with international operations in developed countries²⁰⁰. During the 1990s the accord suffered some changes related with the methodology to risk-weight the assets of sovereign debt²⁰¹. They were triggered by the inclusion of Mexico and Kuwait as members of the Organization for Economic Cooperation and Development (OECD)²⁰².

Basel I, as it is recognized now, was a successful standard which positioned the BCBS in the eyes of the banking and banking regulatory communities. The decision making process that resulted in Basel I is also eloquent of the advantages and disadvantages of the structure of the Basel Committee²⁰³. First, it showed the limitations that a consensus decision had, in that one or a handful of countries can veto the decision of the majority. It also became apparent that an external political influence was necessary to break a given deadlock. Second, it showed the importance of the technical work of the Committee's members that laid down the analysis so that both the US-UK agreement and Basel I were possible. With the relative success of Basel I the Committee decided to give the accord and upgrade at the end of the 1990s. Basel I was widely enforced even in countries that were not members of the Committee and which financial systems did not need – at least in the BCBS's view – such a standard. But next section argues that this reputation did not back the work of the BCBS when negotiating and implementing Basel II.

¹⁹⁹ There was a transition period set by domestic regulators in order for their banks to comply with the minimum capital requirement of 8%.

²⁰⁰ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997*, (n 65), Loc 4023.

²⁰¹ *ibid*, Loc 4023.

²⁰² Particularly the first country had in the past had serious difficulties to pay its sovereign debt and some members of the Committee thought that the approach taken by the Committee of risk-weighting the instruments issued by OECD countries needed a re-calibration. *ibid*, Loc 4023.

²⁰³ *ibid*, Loc 4124.

c) **The Basel II Accord: when transparency and participation are not enough**

The BCBS announced the beginning of negotiations of Basel II in 1998 after pressure from the US' regulators who had criticised the shortcomings of the previous accord²⁰⁴. Nevertheless, unlike its predecessor, Basel II did not come as a result of a clear objective. Basel I had a good definition of the problem of un-uniform CAR standards, and therefore provided a clear solution (i.e., a standardised minimum regulatory capital for most important financial and banking centres). Basel II, however, tried to upgrade Basel I, but lacking did not possessed a clear consensus from the banking regulatory community²⁰⁵.

In addition, this time the process lasted longer. Basel II took almost 10 years from the beginning of its negotiation to the final stages of enforcement. In this case, the process towards Basel II is relevant because the Committee went from being a relatively known organization only among financial experts and central bankers, to become a widely known mechanism for transnational financial regulation²⁰⁶. Additionally, the relevance of the Committee as a forum for international financial regulation grew during the years of Basel II. This subsection discusses the problem the BCBS sought to tackle with Basel II, the history of its negotiation and implementation, and the regulation finally laid down by this accord.

Both members and non-members of the BCBS had adopted the standards of Basel I. By the year 1997 some problems became apparent. First, banks found at least

²⁰⁴ Mainly Alan Greenspan and William McDonough, respectively chairman of the FRB and the FRB of NY. See Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177).

²⁰⁵ *ibid.*

²⁰⁶ Henry Penikas, *History of Banking Regulation as Developed by the Basel Committee on Banking Supervision in 1974-2014 (Brief Overview)* (Banco de España 2015).

two ways for arbitrage (i.e., for circumventing the minimum capital set by Basel I). One took the form of mortgage securitization; the other was the result of using novel risk management models²⁰⁷. Second, the fix 8% minimum regulatory capital did not fit some banks with more complex operations; therefore a different measurement of regulatory capital was thought to be needed, one more sensitive towards risk. And third, Basel I gave a great deal of flexibility to domestic authorities in terms of implementation, however, this delegation also created sensible disparities in the interpretation of the accord at the domestic level²⁰⁸.

In 1998 Tom de Swaan – then Chairman of the BCBS – announced the beginning of the process for a new regulatory framework on capital adequacy that would upgrade Basel I. Shortly after the announcement, the Committee issued a consultative paper delineating its proposal for the changes and additions. This paper was later known as the ‘Consultative Paper 1’ or CP-1²⁰⁹.

The CP-1 laid down a first draft of the structure of Basel II by proposing three ‘pillars.’ The first one would be the capital adequacy ratio as proposed by Basel I, that would ‘serve as an “standardized” approach for capital requirements at the majority of banks’²¹⁰, but clarifying and broadening the scope of Basel I²¹¹. The first pillar proposed measuring the risk of some bank’s assets and operations by borrowing the classification from rating agencies. In this case the regulatory capital would be weighed against the rating that each asset or item had. If a certain asset was not rated, then its risk ratio would be 100%.

²⁰⁷ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177).

²⁰⁸ *ibid.*, Loc. 1169.

²⁰⁹ BCBS *A new capital adequacy framework* (BCBS 1998), see: <<http://www.bis.org/publ/bcbs50.pdf>> Accessed 10 April 2016.

²¹⁰ *ibid.*

²¹¹ *ibid.*

The second pillar consisted on supervisory review and, finally, a third pillar would encompass ‘market discipline’²¹². BCBS’ consultation processes were similar to other public consultations carried out by national regulators before enacting new rules. The new feature gave the decision making process of the BCBS more transparency and publicity to the drafts that were being discussed²¹³.

The Committee received almost 200 comments from many interested parties, although it decided not to publish them on its web page. Nevertheless, many comments were released to the public by their sponsors. Tarullo, in turn has reproduced some of the critical comments of the BCBS first proposal²¹⁴.

The mechanism proposed for using external agency ratings to measure risk was not welcomed by many. First, only a few borrowers were large or important enough to have a rating and their treatment under the proposal was the same given by Basel I (mostly 100% risk ratio). Because most of the borrowers would not have external ratings, the mechanism was thought unfair and its advantages few. Second, the Asian financial crisis of the late 1990s had proven that rating agencies did not possess a sound methodology, rather they had reflected the market sentiment as good ratings before the crisis was visible had plummeted in the aftermath²¹⁵.

Some officials and representatives of the banking industry in emerging markets argued that the proposed framework would create disincentives for investments in their countries because their banks lacked external ratings. In this vein, sound institutions with good credit history would have an unfavourable risk weighting²¹⁶.

²¹² *ibid.*

²¹³ Michael Barr, Geoffrey P. Miller *Global Administrative Law: The View from Basel* (n 67).

²¹⁴ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation*, (n 177).

²¹⁵ *ibid.*, loc. 1290.

²¹⁶ *ibid.*

The rating agencies themselves criticised the framework of the CP-1 because they felt it would create incentives for ‘agency shopping’, i.e., that financial institutions would select the agency with the best ratings. They argued that this could impact negatively on their independence and credibility²¹⁷.

The proposed method for measuring operational risk also drew criticism. Representatives from the banking industry argued that, unlike credit or market risk, operational risk was unable to be quantified in any significant way²¹⁸. Finally, banks criticised that the internal risk based approach (IRB) was not fully developed. They argued that, unlike the external rating approach, this one could really measure banks’ real risks²¹⁹.

As a result of the feedback that the Committee received, a new consultative paper (CP-2) was issued changing the components of the original first pillar of CP-1. This document took a deeper look at the internal risk based approaches (IRB) that some banks could use to assess the level of regulatory capital they needed. It set out two different IRB, one in which the qualifying banks could use supervisors’ formulas for measuring the risk of each one of the bank’s exposures (i.e., the foundational internal ratings-based approach, or F-IRB) and another where banks could also use its own estimates for ‘its exposure in the event of default, loss if default occurred, and maturity of the exposure’²²⁰ (called advance IRB or A-IRB). The CP-2 maintained a methodology to measure market risk and the controversial operational risk. Additionally, this version excised all reference to rating agencies for the purpose of measuring risk ratios. The paper reinforced the mechanisms for supervisory review

²¹⁷ *ibid.*

²¹⁸ *ibid.*

²¹⁹ *ibid.*

²²⁰ *ibid*, loc. 1420.

(pillar 2)²²¹ and for ‘market discipline’ (pillar 3), though in the latter case the definition was still rather vague²²².

The increasing securitization that banks used was one of the problems that triggered the Basel II in the first place. Consequently, the CP-2 had a new methodology for a basic calculation of the securities that the bank held. Finally, the CP-2 set a date for the publication of Basel II at the end of 2001²²³. The complexity – and length – of the CP-2 also grew: the document consisted on more than 460 pages and 10 sections²²⁴.

There were 260 comments issued in this second consultative process²²⁵ mostly by financial institutions and banking associations. Tarullo synthesised the recurrent themes that CP-2 comments had²²⁶. Banks and other financial organisations connected with them generally applauded the introduction of the IRB and A-IRB approach. On the contrary, comments from an academic milieu were sceptical about the feasibility of implementing internal rankings to measure the risk of banks. The participants of this consultation processes tended to criticise also the measure proposed for operational risk, as well as the requirement of capital charges for unexpected losses. One stark criticism was directed at the methodology for measuring risk for some assets related to small and

²²¹ “The BCBS proposed four principles directed at regulators: ‘1) Banks should have a process for assessing their overall capital in relation to their risk profile and a strategy for maintaining their capital levels. 2) Supervisors should review and evaluate bank’s internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the results of this process. 3) Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum. 4) Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.” *ibid*, loc. 1476-1477; See also: BCBS *Consultative Document Pillar 2 (Supervisory Review Process)* (BCBS 1988) at: <www.bis.org/publ/bcbsca08.pdf> Accessed 10 April 2016.

²²² BCBS *Basel II: The New Basel Capital Accord – second consultative paper* (BCBS 2001), at: <www.bis.org/bcbs/bcbscp2.htm> Accessed 10 April 2016.

²²³ BCBS *Basel II: The New Basel Capital Accord: an explanatory note* (BCBS 2001), 1, at: <www.bis.org/publ/bcbsca01.pdf> Accessed 10 April 2016.

²²⁴ BCBS (2001) *Basel II: The New Basel Capital Accord – second consultative paper* n 219.

²²⁵ See: <www.bis.org/bcbs/cacommments.htm> Accessed 10 April 2016.

²²⁶ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177), loc. 1461 and ff.

medium-sized enterprises (SMEs) and, again, for assets in emerging markets. For these participants in the processes, the proposal punished both types of borrowers (i.e., SMEs and emerging markets) unfairly. Finally, most comments coming from banking institutions argued that the proposals set out by the CP-2 in all likelihood would increase the percentage of regulatory capital for banks²²⁷.

The conclusion that Basel II, as it had been drafted in the CP-2, would increase the regulatory capital for banks was possible because the BCBS had sponsored a second quantitative impact study (QIS2) among some banks. By filling in some statistical forms, the banks which partook in the exercise viewed that the minimum regulatory capital tended to increase under the measurements proposed by the Committee²²⁸. As a result of the CP2, the BCBS decided not to comply with the date of late 2001 for the publication of Basel II and moved it to ‘during 2002’²²⁹.

From June 2001 to February 2005 the BCBS published a handful of proposals with the goal of making some parts of Basel II clearer. This included 7 documents on: expected and unexpected losses (July 2001), the IRB approach (August 2001), changes in the credit risk mitigation techniques, the operational risk and reductions on the disclosures under pillar 3 (September 2001), the IRB approach for securities (October 2001), changes on the risk-weight curve on credit card exposures and SME’s exposures (July 2002), a second set of proposals for treating asset securitizations (October 2002), and guidelines to banks for handling operational risks (February 2003)²³⁰.

²²⁷ *ibid*, loc. 1489.

²²⁸ *ibid*, loc. 1481.

²²⁹ In a press release on 25 June 2001 the Committee acknowledged some of the problematic areas with the CP-2 and move the final date for publishing Basel II to 2002, see: <www.bis.org/press/p010625.htm> Accessed 10 April 2016; the date was confirmed on 13 December 2001 by another press release; the implementation phase would finish by 2005, see: <www.bis.org/press/p011213.htm> Accessed 10 April 2016.

²³⁰ See: <www.bis.org/list/bcbs_all/sdt_1/page_28.htm> Accessed 10 April 2016, and Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177), loc. 1522.

There were also a set of quantitative impact studies (the QIS3, QIS4, and QIS5) for assessing the impact of Basel II F-IRB and A-IRB on banks. One more consultation paper (the CP-3) was published by the BCBS on 29 April 2003²³¹. The new CP-3 still considered the three pillars but changed the third pillar from ‘market discipline’ to ‘public disclosure’. It also included seven documents that the Committee had published from July 2001 to February 2003²³².

The Committee received 187 responses to the CP-3²³³. The responses broadly replicated what had been said in previous consultations²³⁴. However, the Institute of International Finance (IIF) with other like-minded parties stressed that the risk-weighted capital requirements were pro cyclical²³⁵. This meant that banks would be required to hold more capital when borrowers greatly needed financing and releasing credit when the conditions were stable. The argument of pro-cyclicity rest upon other criticisms as well (e.g. that the methodology to measure standard capital – i.e., the one set in Basel I and replicated in pillar 1 of Basel II – increased regulatory capital for most banks) and it resurfaced during the sub-prime crisis that led to the ‘great recession’ as one of the most relevant criticisms to Basel II²³⁶.

Finally, on June 2004 the final version of Basel II was published by the Committee with the title ‘Basel II: International Convergence of Capital Measurement

²³¹ BCBS (2003) *Basel II: The New Basel Capital Accord – third consultative paper*, see <http://www.bis.org/bcbs/bcbsep3.htm>

²³² BCBS (2001) *Basel II: The New Basel Capital Accord – second consultative paper* n 121.

²³³ See: <www.bis.org/bcbs/cp3comments.htm> Accessed 10 April 2016.

²³⁴ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation*, (n 177), loc. 1549.

²³⁵ IIF, *IIF Response to the Third Consultative Paper of the Basel Committee on Banking Supervision* (IIF 2003), see: <www.bis.org/bcbs/cp3/inofinfi.pdf> Accessed 10 April 2016; see also Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177), loc. 1549.

²³⁶ Charles A E Goodhart, Avinash D Persaud, ‘How to avoid the next crash’, *Financial Times*, (London 30 January 2008); The arguments of Goodhart are also in Charles A E Goodhart, M A Segoviano ‘Banking Stability Measures’(2009) (IMF, *IMF Working Paper*).

and Capital Standards: a Revised Framework'²³⁷. The document consisted of 347 pages (as opposed to the 26 pages of Basel I) and the length of Basel II correlated with its complexity. The new framework contained the three pillars outlined at the outset of the negotiating process (i.e., in CP-1) but it also took on the modifications suggested along the way.

The first pillar concerned different approaches to measure credit risk, operational risk, and market risk. As announced, it recognized the definition of capital put forward by Basel I but it added a third tier. Tier 1 capital would be equity capital; tier 2 was defined as 'supplementary capital' and consisted on: 1) undisclosed reserves; 2) revaluation reserves; 3) general provisions/general loan-loss reserves; 4) hybrid debt capital instruments; and 5) subordinated term debt. Finally, tier 3 capital consisted on short-term subordinated debt covering market risk. Under the same pillar (the first) Basel II regulated credit risk under three approaches: 1) 'the standardized approach' which was similar to the one of Basel I with some outlined six types of 'risk-buckets' (0%, 10%, 20%, 50%, 100% and 150%) according with different exposures (i.e., different types of assets: claims on central governments, non central governments, banks, securities firms, corporate debt, secured by residential property, etc.) the bank was classifying. Basel II allowed that an external credit rating institution could be used to classify assets, given the case it complied with eligibility criteria subject to the judgment of the domestic regulator²³⁸. 2) Pillar 2 also considered and regulated the foundation internal risk-based approach for credit risk (F-IRB) and the advanced internal risk-based approach (A-IRB). 3) Pillar 3 regulated the securitization exposures'

²³⁷ BCBS *Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework* (BCBS 2004), see: <www.bis.org/publ/bcbs128.pdf> Accessed 10 April 2016.

²³⁸ *ibid*, 27-28.

credit risk, and, finally, 4) the standards for measuring operational risk and market risk²³⁹. More than half of Basel II was devoted to pillar 1 (190 out of 347 pages).

Pillar 2 was concerned with laying down the principles for supervisory review process (19 pages). Finally, pillar 3 regulated market discipline and described the information banks needed to disclose and the manner to do so (16 pages). Finally, the last hundred pages of the Accord explained some of its concepts and methodologies in detail²⁴⁰.

If the negotiation of Basel II had been bumpy the implementation process was even more complicated. Three features explain why: the diverse policy milieus from the US and EU's backgrounds; the complexity of Basel II; and the influence of domestic politics in the end result of the agreement. In the next paragraphs I explain these three features.

First, whereas the US (and the UK's) approach towards financial regulation has been traditionally based mainly on principle-based regulation by a case-by-case basis – e.g., the proverbial nods, frowns, and pats in the back from the Bank of England to its regulatees²⁴¹ and *principle based regulation* that the extinct Financial Services Authority designed²⁴² – the approach taken in Continental Europe is based on the enforcement of a written statute against which the auditors assess a bank's compliance²⁴³. Thus, while the Europeans pushed for a more detailed version of Basel II, their Anglo-Saxon counterparties wanted an accord that laid down principles solely.

²³⁹ *ibid.*

²⁴⁰ *ibid.*

²⁴¹ Charles Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 4124.

²⁴² Julia Black, Martyn Hopper and Christa Band 'Making a success of Principles Based Regulation' (2007) *Law and Financial Markets Review*; Julia Black 'The Rise, Fall and Fate of Principles Based Regulation' (LSE, Law, Society and Economy Working Papers 17/2010, 2010).

²⁴³ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177) loc. 1481

The European representatives in the BCBS also wanted to use the end version of Basel II to translate it – rather, transposing it – into European legislation. The Americans, on the contrary, found that they had not a favourable political context back home to impose Basel II on all banks, and therefore decided to apply it only to the bigger institutions²⁴⁴. This partial application of Basel I came to be known in the US as ‘Basel 1A’, mostly because, with the exception of the bigger banks – those with more than 250 billion dollars of consolidated assets or with 10 billion dollars of international exposures – all the other banks would still abide by Basel I²⁴⁵.

The second complication had to do with the perceived complexity of Basel II. While the problem to tackle in the case of the Basel I process was clear enough (i.e., to prevent the erosion of regulatory capital and to get the convergence of international standards for measuring it), in the case of Basel II that clarity was absent, as this subsection argued before. What the Committee had was some concerns related to the increasing securitisation of international banking as it was being used as an opportunity to circumvent the target standard set in Basel I. This translated in a series of shortcomings present in the first capital accord; however, the BCBS did not and would not have a clear idea of how to tackle those concerns and shortcomings. Neither had the Committee the necessary expertise to design its own risk models, which thus needed to be borrowed from the banks²⁴⁶.

Third, the increasing visibility of the BCBS from 1997 onwards also created an incentive – or a need – for politicians to chime in. Chancellor Schroeder of Germany was critical of how the BCBS was risk-weighting the SMEs’ exposures and threatened

²⁴⁴ Michael Barr, Geoffrey P. Miller *Global Administrative Law: The View from Basel* (n 67).

²⁴⁵ Andrew Cornford, *The Global Implementation of Basel II: Prospects and Outstanding Problems* (UNCTAD 2008).

²⁴⁶ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177).

to disavow Basel II if the treatment of SMEs did not change²⁴⁷. In the US, some legislators (Senator Sarbanes most notably) raised concerns about how the A-IRB approach of Basel II could lower the regulatory capital for those banks which qualified to use it²⁴⁸. In the US, the implementation process of Basel 1A was also slowed down by the differences that officials at the Comptroller of the Currency had with their counterparts at the FRB²⁴⁹.

Thus, while by 2005 Basel II was already a European Directive²⁵⁰ and its implementation at the EU's member countries was well on their way, it was not until 2006 that the principles of Basel II referring to A-IRB started to be enforced in the US²⁵¹. By the next year the sub-prime crisis had started and, with it, what we now know as the 'great recession' began. As I said before 'the jury is still out' deliberating whether Basel II was part of the problem or, on the contrary, it was part of the solution and the delay of its implementation worsened the crisis. Other authors argue that the 'great recession' shows the big failure of all international financial regulation created since the 1970s²⁵². For the history of the Committee, however, the negotiation process of Basel II contributed to the increasing visibility of the BCBS and its consolidation as the main locus for transnational financial regulation.

Although the process of negotiation and implementation of Basel II had clear upgrades (as opposed to the Basel I), it lacked a strong consensus about which the particular problem was and therefore what the solutions for tackling that problem should be. Instead, the BCBS put in place consultation processes and quantitative studies to enhance the transparency and legitimacy of the process. As chapter 3

²⁴⁷ It did change eventually, *ibid.*

²⁴⁸ *ibid.*

²⁴⁹ *ibid.*

²⁵⁰ *ibid.*

²⁵¹ Michael Barr, Geoffrey P. Miller *Global Administrative Law: The View from Basel* (n 67).

²⁵² Pierre Huges Verdier, 'The Political Economy of International Financial Regulation' (n 16).

discusses, however, those mechanisms did little for speeding the implementation of Basel II.

4. Conclusion: the evolution of the BCBS and the role of the banking regulatory community

This Chapter has shown how the BCBS evolved from an informal group of professionals with banking expertise to a formal Committee central to the transnational regulation of banking activity. Through a detailed analysis of the history of the Committee's work, in particular the Basel I and II accords, this chapter seeks to show that the Committee is involved in what can be called 'regulation' (albeit in a softer way) of transnational banking activity, and that this activity relies significantly on collective professional authority and expertise. Moreover, the discussion has shown that the Committee's work is embedded in a transnational discussion process with large numbers of comments being issued by banks, banking associations, experts, and governments arguing about the accord's proposed banking standards. As chapters 5, 6, and 7 put forward, this transnational discussion process at times assumes the features of what this thesis calls communicative accountability.

The next chapter continues the narrative about the evolution of the BCBS. It explains the context of the sub-prime crisis, the credit crunch, and the financial crisis of 2008. It then concludes the history of the Committee by explaining the process that ended up with the publication of Basel III. The next chapter also explains the governance of the Committee and some of its organizational features which are necessary to make sense of the concept of communicative accountability that this thesis puts forward.

Chapter 3. The History and Governance of the Basel Committee on Banking Supervision (2nd part)

This chapter analyses the BCBS last regulatory milestone: the Basel III accord, and discusses the governance structures and processes of the Committee. These accounts are central to the development of the argument of this thesis because they show the exercise of the regulatory powers of the BCBS as well as the increasing formation of specific structures that constitute the backdrop to the debate about the accountability of the BCBS. The processes to negotiate and enforce the BCBS's standards such as the Basle III Accord, and the development of a more complex internal governance structure are part of a development in which the BCBS is turning itself into a regulatory agency that operates in the transnational arena and that is becoming increasingly subject to claims about the accountability of its regulatory actions.

1. Basel III: the last regulatory milestone in the BCBS' history

In the negotiation process of Basel III we can see the final point of the BCBS' regulatory evolution. In the course of four decades, the BCBS was transformed from an informal meeting point for discussing best practices into a standard enforcing agency at the centre of the regulatory response to the 2008 financial crisis.

As I did with Basel I and Basel II I divide this chapter into three sections. The first explains the salient features of Basel III; second section explains how the lack of liquidity and the complicated measurements of risk were at the centre of the financial crisis and motivated the BCBS' response in the form of Basel III; and the third explains the negotiation and implementation process of this third accord;

a) The rules of Basel III

The Basel III accord (or ‘Basel III’) shows the importance that the BCBS had to this point. Basel III was central for tackling the perceived main problems of the 2008 financial crisis, which were, among others, the massive amount of leverage taken by banks, and the low levels of liquidity they had. The standards that Basel III set out speak eloquently about both the central place that the Committee holds in the transnational regulatory institutions and the regulatory character that the BCBS possesses. The Committee is thus more than a coordination mechanism for banking regulators as I will explain in chapter 4.

The Committee published the first version of Basel III on December 2010²⁵³ with their proposed rules. Some adjustments were made in June 2011²⁵⁴, to introduce the risk of credit valuation adjustments (CVA) to the risk of counterparty default. The Committee explained that, during the financial crisis, most of the risk attributed to counterparty credit risk was caused by CVA losses and only one third was caused by actual counterparty failure²⁵⁵.

The new framework tried to overcome the problems that the financial crisis of 2008 showed. The BCBS’ summed up those problems that it thought were the cause of the financial crisis. First, banks in many countries had built up excessive leverage and underwent a gradual erosion of both the level and quality of their capital. Second, many banks were not keeping adequate levels of liquidity in case a ‘credit crunch’ – like the

²⁵³ BCBS *Basel III: A global regulatory framework for more resilient banks and banking systems* (BCBS 2010), see: <www.bis.org/publ/bcbs189_dec2010.pdf> Accessed 10 April 2016.

²⁵⁴ BCBS *Basel III: A global regulatory framework for more resilient banks and banking systems* (BCBS 2011) see: <www.bis.org/publ/bcbs189.pdf> Accessed 10 April 2016.

²⁵⁵ *ibid.*

one in 2008 – happened. Third, and due to the lower capital and liquidity levels, the banking industry was ill-prepared to cope with the levels of off-balance sheet exposures that had built up. According to the Committee, the crisis was amplified by a ‘pro-cyclical deleveraging process’ and by the way banking industries were interconnected. This caused in turn that the market lost confidence in the solvency of banking institutions, which in turned weakened them. The bad shape of the banking system damaged the rest of the financial system and the real economy. It also provoked a massive shortage of liquidity and credit availability. As a result, the public sector stepped in ‘with unprecedented injections of liquidity, capital support and guarantees, exposing taxpayers to large losses.’²⁵⁶

The BCBS proposals to tackle these issues revolved around strengthening regulatory capital, especially equity capital and retained earnings, harmonizing what Basel II had called ‘Tier 2 capital’ (undisclosed reserves; revaluation reserves; general provisions/general loan-loss reserves; hybrid debt capital instruments; and subordinated term debt), and completely excising short-term subordinated debt (what was known as Tier 3 capital).

The new framework also raised capital requirements for ‘the trading book’ – i.e., what was known as ‘off-sheet’ items – and complex securitisation exposures through a ‘stressed value at risk’ (VaR) capital requirement. The VaR is based on a continuous 12-month period of high financial stress²⁵⁷. Additionally, the Committee introduced higher capital requirements for ‘resecuritisations’²⁵⁸, raised the standards for the supervisory review process (Basel’s II Pillar II), and for the information banks should disclose (Pillar III).

²⁵⁶ *ibid.*,1.

²⁵⁷ *ibid.*, 11.

²⁵⁸ *ibid.*

In this vein and with the same spirit of measuring minimum regulatory capital with the worst case scenario, the BCBS mandated that banks measured counterparty credit risk with stressed inputs (i.e. in a worst case scenario). This feature tackled the concern that Basel II was pro-cyclical, demanding too much capital in bad times and less capital in good ones. In this vein, and as I explained earlier, the credit valuation adjustment (CVA) was also introduced. This adjustment considered the risk of counterparty's assets deteriorating – as happened with sub-prime securities in the 2008 financial crisis. The CVA complemented the credit risk from counterparty failure²⁵⁹.

Moreover, in response to the close interconnectedness of banks and financial institutions through the derivatives markets, Basel III adhered to the Committee on Payments and Market Infrastructures²⁶⁰ (CPMI) and the IOSCO's initiative to establish central counterparties (CCPs)²⁶¹. Basel III tried to incentivize migration to CCP by requiring lesser capital for Banks with exposures at central counterparties.

Finally and most importantly, Basel III introduced a new framework for liquidity buffers so that a bank can survive at least a one month period of liquidity scarcity (the liquidity coverage ratio or LCR) or have 'enough stable resources' for one year (the net stable funding ratio or NSFR). Additionally, as I explained in last chapter when speaking about the Concordat, Basel III introduced a new regime for systemically important financial institutions (SIFIs), i.e., the banks which failure produces grave

²⁵⁹ *ibid*, 12.

²⁶⁰ The CPSS is another committee hosted at the BIS which role is to promote 'the safety and efficiency of payment, clearing, settlement and related arrangements, thereby supporting financial stability and the wider economy.' See: <www.bis.org/cpmi> Accessed 10 April 2016. The Committee first name – as appears in Basel III – was the Committee on Payments and Settlement Systems.

²⁶¹ Central counterparties are similar to clearing houses: 'A central counterparty (CCP) is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. A CCP becomes counterparty to trades with market participants through novation, an open offer system, or another legally binding arrangement. For the purposes of the capital framework, a CCP is a financial institution' BCBS *Capital requirements for bank exposures to central counterparties* (BCBS 2012), 1, see: <www.bis.org/publ/bcbs227.pdf> Accessed 10 April 2016.

repercussions on the global financial system and the real economy. The whole framework consisted on 616 pages which cover parts of Basel II that were still applicable, plus the reforms of Basel III.

The BCBS importance is apparent when matching the proposals of Basel III with the problems that caused the 2008 financial crisis. In the next section I analyse these problems.

b) The sub-prime crisis, the *credit crunch* and the financial crisis of 2008

The effects of the greatest financial crisis of the developed world are still felt in 2016: banks bail outs; governments' defaults; investment banks, commercial banks, and normal companies declared bankrupt; and a sluggish economic growth. International banking regulation, however, was at the centre of the financial crisis. As I explain at the end of chapter 2, Basel II – which included a big section on securitization – was being implemented in Europe since 2005 and its enforcement in relation to some US' banks was set to start by 2007²⁶². By this time, however, the sub-prime crisis was well on its way.

In the running-up of the crisis a bubble developed on the house prices in the US²⁶³. The rise on housing prices in the US was due to more flexible conditions for borrowing money to buy a new house. This allowed new-comers to get mortgages at very low cost to pay the house of their dreams. The problem was that many of these borrowers – who formed the so called 'sub-prime' segment of the market – could not

²⁶² Andrew Cornford, *The Global Implementation of Basel II: Prospects and Outstanding Problems* (n 245).

²⁶³ Robert Schiller, *Finance and the Good Society* (Princeton University Press 2012).

have been able to borrow money under normal circumstances (e.g., because of their low income)²⁶⁴. All the incentives in this case reinforced each other: house prices were going up because there was new demand for houses. Nevertheless, the demand was driven by a relaxing of the requirements to get a loan because, so the banks thought, if the borrower could not pay, the guarantee of the loan – the house – could be sold and the debt repaid in no time. As long as the prices went up, all these incentives were present.

When the bubble blew up, however, banks stopped lending money to borrowers –sub-prime or not – provoking a drop on the demand side of the market which in turn, caused decreasing prices. Suddenly the value of assets serving as the loan’s collateral were much lower than expected. The sub-prime crisis affected the banks so deeply because they had huge non-assessed exposures in this market. These exposures – in the forms of securities – were backed against residential loans which had been ‘sliced and diced’, mixing the good loans from solvent borrowers with ‘toxic’ ones from sub-prime creditors²⁶⁵.

This process was a product of financial innovation. First, sub-prime loans were pooled. The idea behind this operation was that somehow the higher risk of toxic loans would be cancelled out because these pools were distributed among different cities in the US and prices in each locality would change differently²⁶⁶. But secondly, these pools were used to back securities (collateralized debt obligations or CDOs) that sliced into tranches that rating agencies such as Moody’s and Standard & Poors rated as ‘triple-A’. There was a clear conflict of interest between rating agencies and the banks,

²⁶⁴ Philip Coggan, *Paper Promises* (Penguin 2011), 142.

²⁶⁵ *The Economist* ‘The origins of the financial crisis’ (London 7 June 2013), see: <www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article> Accessed 15 February 2016.

²⁶⁶ This did not happened and prices fell uniformly across the US by 2006, Philip Coggan, *Paper Promises* (n 264), 142.

as the banks paid for the rating thus creating for rating agencies an incentive to be less rigorous with the assessment.

The sub-prime crisis first caused the failure of two investment banks based in New York: Bear Stearns and Lehman Brothers²⁶⁷. But it also triggered a crisis of confidence in the whole banking system: because it was so hard to know which bank had or did not have toxic exposures, every bank was afraid of short-term lending to any other bank. This provoked a credit-crunch that dried up liquidity in the markets. In Britain Northern Rock failed on 2007 and the complete banking industry had to be bailed out in the UK and across the developed world.

The bailing out of the banks and the ‘counter-cyclical’ policy that many governments implemented to tackle the recession increased the budget deficit of southern European countries. When the markets were not convinced that several governments would service their debts, a second wave of economic unrest started. Italy, Spain, Ireland, Portugal, and most notably Greece, had trouble convincing their lenders they were able to pay their debt. At the other side of the world, China first followed the example of Western countries and expanded its public budget during the years after the sub-prime crisis. Nevertheless, the Chinese effort lost steam and provoked a drop in its domestic market which in turn has brought other economies down with China – e.g., its suppliers of raw materials like Brazil.

Howard Davies has listed some of the possible causes of the financial unrest – the ‘great recession’ – that the sub-prime crisis made apparent²⁶⁸. For the author the sub-prime crisis was just a trigger of a wider social process with deeper roots. Among them, Davies argues that there were global imbalances; regulatory failures;

²⁶⁷ Andrew Ross-Sorkin, *Too Big to Fail* (n 10).

²⁶⁸ Howard Davies, *The Financial Crisis: Who is to blame?* (Polity 2010).

shortcomings from accountants, auditors, and rating agencies; failures from financial firms and markets; irrational expectations; and passivity from the media²⁶⁹. Davies paints a complex picture of the 2008 financial crisis. All in all, however, a failure in banking regulation was deeply felt. Because the BCBS had become a very visible – and perhaps the most important – locus of transnational banking regulation it was natural that many fingers pointed to Basle when allocating the blame for the financial crisis. And the reaction of the international banking regulatory community represented at the Basel Committee tends to prove them right²⁷⁰. That reaction was the Basel III accord.

In the next section I explain the negotiation of Basel III. This stage of the recent history of the BCBS is relevant for the thesis because it shows the influence and involvement of the banking regulatory community that pointed out the limitations of Basel II and pressed for a new standard (i.e., Basel III). The following section also explains the BCBS reluctance to accept Basel's II shortcomings at first, until there was a consensus in the banking regulatory community that a new standard was needed.

c) The negotiation and implementation process of Basel III

Basel II was not yet fully implemented in 2008²⁷¹. In the years following the publication of Basel II the BCBS still issued addenda and explanatory papers in relation to some of its features. In the following paragraph I describe some of these addenda in order to show Basel II shortcomings. The realisation of these limitations by the Committee was one of the reasons why the BCBS started the negotiation of Basel III.

²⁶⁹ *ibid.*

²⁷⁰ Anat Adamati, Martin Hellwig, *The Banker's New Clothes* (n 12).

²⁷¹ Christian M McNamara, , Thomas Piontek and Andrew Metrick (2015) *Basel III A: Regulatory History*, (Yale Program of Financial Stability Case Study 2014-1A-V1 2014).

On May 2006 the Committee announced that the risk calibration originally set by Basel II would remain unchanged. In this case the BCBS based its conclusions on two quantitative impact studies (QIS4 and QIS5)²⁷². On June 2006 the Committee released its paper on ‘Home-host information sharing for effective Basel II implementation’²⁷³. Then again on July 2008 the Committee started a consultation process on the guidelines for computing capital for incremental risk²⁷⁴ and some revisions to the Basel II market risk framework²⁷⁵. Some months later, the Committee issued more documents for consultation: more revisions to the Basel II market risk framework²⁷⁶, some guidelines for computing capital for incremental risk in the trading book²⁷⁷, and proposed enhancements to Basel II that were related with the sub-prime securities that triggered the crisis in the first place²⁷⁸. The BCBS published final versions of these documents on 13 July 2009²⁷⁹. Finally, the Committee issued a proposal to strengthen the resilience of banks which consisted of two documents, one directed to the resilience of the banking sector²⁸⁰ and the other proposing a new international framework for liquidity risk measurement²⁸¹.

²⁷² BCBS *Press Release: Basel Committee maintains calibration of Basel II Framework* (24 May 2006), see: <www.bis.org/press/p060524.htm> Accessed April 10 2016.

²⁷³ BCBS *Home-host information for effective Basel II implementation* (2 June 2006), see: <www.bis.org/publ/bcbs125.htm> Accessed April 10 2016.

²⁷⁴ BCBS *Guidelines for computing capital for incremental risk in the trading book* (BCBS 2008), see: <www.bis.org/publ/bcbs141.htm> Accessed April 10 2016.

²⁷⁵ BCBS *Proposed revisions to the Basel II market risk framework* (BCBS 2008), see: <www.bis.org/publ/bcbs140.htm> Accessed April 10 2016.

²⁷⁶ BCBS *Revisions to the Basel II market risk framework- consultative version* (BCBS 2008), see: <www.bis.org/publ/bcbs148.htm> Accessed 10 April 2016.

²⁷⁷ BCBS *Guidelines for computing capital for incremental risk in the trading book – consultative version* (BCBS 2009), see: <www.bis.org/publ/bcbs149.htm> Accessed 10 April 2016.

²⁷⁸ BCBS *Proposed enhancements to the Basel II framework* (BCBS 2009), see: <www.bis.org/publ/bcbs150.htm> Accessed 10 April 2016.

²⁷⁹ BCBS *Press release: Basel II capital framework enhancements announced by the Basel Committee* (13 July 2009), see: <www.bis.org/press/p090713.htm> Accessed 10 April 2016.

²⁸⁰ BCBS *Strengthening the resilience of the banking sector* (BCBS 2009), see: <www.bis.org/publ/bcbs164.htm> Accessed 10 April 2016.

²⁸¹ BCBS *International framework for liquidity risk measurement, standards and monitoring* (BCBS 2009), see: <www.bis.org/publ/bcbsca.htm> Accessed 10 April 2016.

It was clear that the framework designed for Basel II had not considered the circumstances that had triggered the 2008 financial crisis. At first, however, officials at the BCBS defended Basel II and argued that the addenda and clarifications published after the accord's issuance in 2004 were necessary to tackle the surfacing features that the financial crisis brought. They emphasized that these additions were simple calibrations to Basel II and that a new accord was not needed²⁸². By 2009, however, it was clear that Basel II had been overcome by the financial crisis and that a new framework was indeed necessary²⁸³.

There were already voices that forecasted a full revision of Basel II and maybe a new accord altogether²⁸⁴. Mario Draghi, the then president of the Italian Central Bank announced that a new accord named Basel III would fix the pro-cyclical effects that Basel II finally had²⁸⁵. Jaime Caruana, the BIS' president was however convinced that the shortcomings of Basel II should be corrected but a new accord should not *replace* Basel II. When asked whether Basel II should be replaced – or ‘ditched’ – by a new framework, he explained that he did not think of changing the rules from scratch, ‘we have seen that models are more imperfect than we thought (...) Basel II is evolving.’²⁸⁶ Nevertheless, Adair Turner – who was the head of the Financial Services Authority – addressed the gap that Basel II had on liquidity issues and advanced the idea that the work the BCBS was carrying out on the issue at that time was already a new accord: Basel III:

²⁸² *Reuters News* ‘The credit crisis that gripped global markets...’ (London, 16 October 2007); ‘Banks and regulators are stitching to Basel II although its value may not yet be fully realised’ *The Asian Banker* (28 February 2009).

²⁸³ Sloan, Steven, ‘Basel II may be replaced before it’s fully in force’ *American Banker* (New York, 17 April 2009).

²⁸⁴ ‘Interview with Lord Turner of Ecchinswell, chairman of the Financial Services Authority, with Peter Thal Larsen Banking Editor of the Financial Times’ *Financial Times* (London, 17 October 2008).

²⁸⁵ ‘Update 1- Basel II banks rules face thorough overhaul-BOI’, *Reuters* (London, 8 July 2009).

²⁸⁶ Patrick Jenkins, ‘BIS chief calls for evolution not revolution’, *Financial Times* (London, 20 September 2009).

Liquidity is an area where there was not nearly enough attention in the past 15 years. Enormous intellectual effort went into the design of the Basel II capital adequacy regime. And very little attention went into liquidity. The developed world moved away from the idea that it had hard-and-fast rules. You must have this percentage of your assets in clearly liquid assets. You must have this percentage of loans to assets or core stable retail funding to total assets.’ And we realize that that was wrong and there are work programs within Basel to agree on some common global liquidity standards. It is an agenda which quite wrongly we weren’t on for the last 15 years (...) I think it is effectively Basel III.²⁸⁷

During this time, on 2009, the G-10 decided to enhance the membership of the Committee to members of the G-20 plus other countries with significant financial markets. As of 31 December 2015 the membership of the BCBS comprised 28 countries and 45 institutions²⁸⁸. Basel III was then a product of the negotiation between the new members of the Committee.

The aftermath of the financial crisis provided momentum for reaching these upgrades sooner rather than later. On September 2009, the G-20 Governors and Heads of Banking Supervision (GHOS, as a body that I will explain in the second part of this chapter) authorized the Committee to put together a new framework to address the problems that the financial crisis had unveiled. The GHOS’ mandate asked the BCBS to raise the quality, consistency and transparency of Tier 1 capital (common equity and disclosed reserves), introducing a leverage ratio for banks and a buffer for liquidity, to design mechanisms that can act counter-cyclically, and to explore the possibility to place a capital surcharge on systemically important banks²⁸⁹. In response to the G-20’s mandate, on October 2010 the BCBS published a report with the Committee’s response to the financial crisis. The report put forward the ‘building blocks of Basel III’: higher quality and levels of capital (especially common equity); better coverage of risk; an

²⁸⁷ ‘UK Regulator Turner Doesn’t See Asset Bubble in Europe, US Property and Equity’, *The Wall Street Journal* (New York, 30 October 2009).

²⁸⁸ Chile, Malaysia and the United Arab Emirates are observers, see: <www.bis.org/bcbs/membership.htm> Accessed 15 February 2016.

²⁸⁹ ‘Q+A-Basel Committee close to agreeing new bank capital rules’ *Reuters* (London, 4 December 2009).

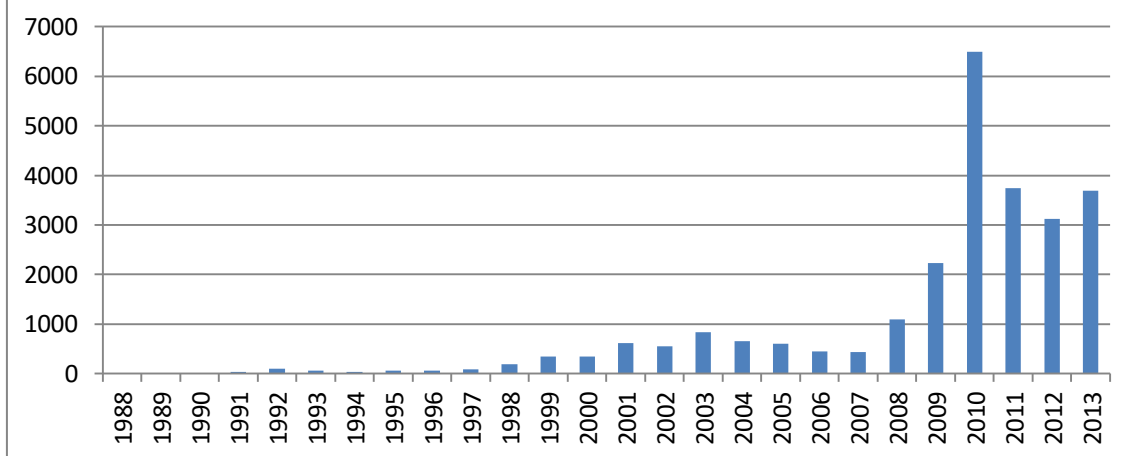
internationally harmonised leverage ratio to limit excessive risk taking; capital buffers; minimum global liquidity; and stronger standards for supervision²⁹⁰. By the time the BCBS issued its response to the G-20 governors it was a central piece of the regulatory framework for cross-border banking. What started as mere and simple suggestions in the form of the Concordat of 1975, was now an authoritative document with high complexity. At the end of this process the governance structures of the Committee were in place. They speak about a distinct organisational identity of the BCBS, as I will explain in the next part of the chapter.

Though the work of the BCBS can be at times highly technical, the visibility of the BCBS increased over time. This is an important point because it shows that the BCBS was more and more drawn into public debates about the value and limitations of its work, which, as this thesis shows in later chapters, started to shape an emerging process of holding the BCBS to account for its regulatory actions. The BCBS is a more recognizable body since the aftermath of the 2008 financial crisis. Table 3.1 shows this trend by mapping the number of articles from both the specialist financial and generalist press, from daily news papers, news agencies, and magazines in the English speaking world, which mention the BCBS from 1988 to 2013²⁹¹. The vertical axis shows the number of items that referred to the BCBS.

²⁹⁰ BCBS *The Basel Committee's response to the financial crisis: report to the G20* (BCBS 2010) see: <www.bis.org/publ/bcbs179.pdf> Accessed 10 April 2016.

²⁹¹ The table's information comes from the *Factiva* database from January 1988 to December 2013 searching for the terms 'Basel Committee'.

3.1 Number of articles referring to the BCBS by year



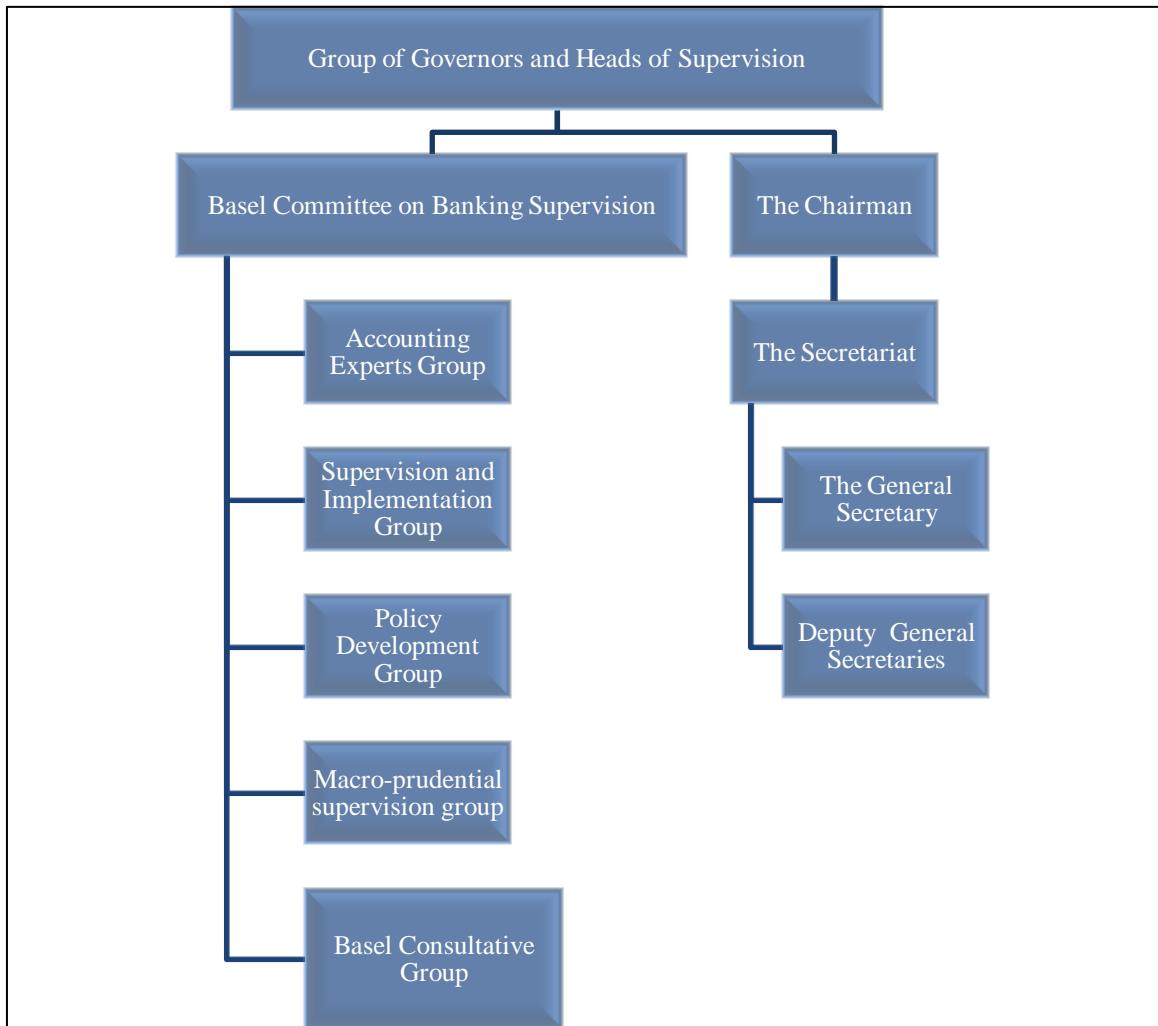
As a result of the higher exposure to the public eye, the ‘club-like’ atmosphere that the Committee had at its inception was no longer sustainable. In recent years the BCBS has modified its governance structure to adapt it to its more visible and central role in transnational banking regulation. In this vein, a charter was published in 2013 stating that the Committee is ‘the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.’²⁹² In this second part of the chapter I will discuss the charter with the purpose that the reader has a better understanding of the BCBS’ governance structure. It is important to take into consideration the Committee’s governance mechanisms because they have a bearing on how the BCBS started to respond to increasing claims from the professional financial community evaluating the work of the BCSC, and thus seeking to hold it to account²⁹³.

²⁹² BCBS Charter (BCBS 2013), 1, see: <www.bis.org/bcbs/charter.pdf> Accessed 10 April 2016.

²⁹³ At the beginning of the doctorate, when the research started, there was scarce information about the Committee. As table 3.1 shows, from 2010 onwards discussion of the work of the BCBS by the generalist media, the specialised financial publications, and the academic publications on the matter grew exponentially.

2. The BCBS' Governance and its distinct organisational character

As of December 2015, the structure of the BCBS is shown in the following organization chart²⁹⁴.



This section is divided into three parts. In the first part I discuss the internal structures for the governance of the Committee: the Governors and Heads of Supervisors (GHOS), the Secretariat, the Sub-groups and other structures as they are specified by the Charter. In the second section I will discuss the formal consultative

²⁹⁴ See: <www.bis.org/bcbs/organigram.pdf> Accessed 15 February 2016.

process that the Committee has carried out. Finally, the third section explains the expert work that the BCBS conducts, with a particular focus on the role of the professional community of banking regulators with which it chimes with. This matters because, as I will discuss in subsequent chapters, this wider professional community becomes a group that is seeking at times to hold the BCBS accountable.

2.1. Manufacturing cross-border regulation: the internal structure and organisation of the BCBS

a) The GHOS as the oversight body of the Committee

The Committee's high level structure is the Group of Governors and Heads of Supervision (GHOS). The GHOS consists of central bank governors and, in the countries where there is an agency regulating banks, the heads of banking supervision²⁹⁵. When the membership of the Committee expanded in 2009, those new members came to belong to the GHOS too. As of the end of 2015, the membership of the Committee consisted in 28 countries and 45 regulatory institutions from those countries²⁹⁶.

The GHOS meets ordinarily twice a year in Basle, Switzerland. During the history of the BCBS the Governors have either issued different mandates for actions that the Committee ought to do (e.g., Basel II and Basel III) or have authorized some of the BCBS' regulatory outcomes (e.g., the liquidity coverage ratio, or LCR). They also appoint the Chairman of the Committee who is ordinarily also one of GHOS'

²⁹⁵ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65).

²⁹⁶ See: <www.bis.org/bcbs/membership.htm> Accessed 27 December 2016.

members²⁹⁷. The GHOS' decisions are consensual. The real technical work, however, happens in the committee as I explain in the next section.

b) The committee as the highest decision making body of the BCBS

The committee (with a lower case initial) is comprised of one representative from the central bank or prudential banking regulator from each country of the G-20, or from the country which membership is authorized by the GHOS²⁹⁸. The committee meets four times a year. Historically, one of those meetings was held outside Basle and hosted by a member institution each time. The Chairman of the BCBS can summon the committee more than four times a year, if needed and its members can participate either physically or by teleconference²⁹⁹.

The committee is in charge of fulfilling the BCBS' mandate and of creating standards for banking supervision. It can also decide the organisational structure of the BCBS³⁰⁰. The participants in the committee ought to be senior officials of their own institutions with the authority to bind their institutions to the decisions taken³⁰¹. The BCBS' charter establishes that institution's representatives should have at least the level

²⁹⁷ In recent times the chairman/chairwoman must be one of the members of the GHOS however in the early times it could be another senior official from one of the BCBS' institutions (e.g., Peter Cook).

²⁹⁸ As I have explained above there are currently three countries with the status of observers: Chile, the United Arab Emirates, and Malaysia.

²⁹⁹ BCBS *Charter* (BCBS 2013), Secc. 8.1, see: <www.bis.org/bcbs/charter.pdf> Accessed 20 April 2016.

³⁰⁰ *idem*, Secc. 8.2.

³⁰¹ In the early times, the senior official from the central bank – if the central bank was represented at the Committee – used to be the expert on FX markets. Perhaps this choice was based on the original vocation of the BCBS: to control cross-border banking issues. See: , Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65).

of ‘head of banking supervision, head of banking policy/regulation, central bank deputy governor, head of financial stability department or equivalent.’³⁰²

The committee’s decisions are taken by consensus and, when they might be in the interest of the public, they are communicated by the appropriate channels (the BCBS web-page and/or a press release). Nevertheless, the minutes of the meetings are not public, nor had they been made public in the past³⁰³. The committee can create sub-groups and taskforces, and also disband them.

The committee’s meetings are typically introduced by a statement from the Chairman in which he talks about his understanding about the current situation of banking regulation and the challenges ahead, also he points out the communication he has had with the G-10 Governors (the GHOS). A central topic to discuss during the meeting was the last bank which failed (given the case there was one) to see what have been done wrong and which regulatory features need to be changed³⁰⁴. The committee is responsible for the decision making of the BCBS, however, most of the technical work is carried by the Committee’s groups and taskforces. Their work resembles that of specialised unities and areas of most domestic regulatory agencies because the groups and taskforces provide the detailed work for the committee’s decision making³⁰⁵. Additionally, because both groups and taskforces consist on experts on a particular topic (e.g. regulatory capital, liquidity, implementation, etc.) they are the point of contact between the Committee’s regulatory outcomes and the banking regulatory community. I explain their organisation in the next section.

³⁰² BCBS *Charter* (BCBS 2013), n 209, Secc. 8.3.

³⁰³ Charles Goodhart explains that he was only able to take hold of short synthesis of each meeting of the Committee and not the complete transcript of it. Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65).

³⁰⁴ *ibid.*

³⁰⁵ Peter Schuck, *The Limits of Law* (Westview 2000).

c) The Groups and taskforces as the source of the BCBS' specialised expert knowledge

As said above, given the decentralised approach of the BCBS organization, most of the work of the Committee is done in groups, working groups and task forces. Groups form part of the permanent structure of the BCBS and comprise senior officials that 'guide or undertake themselves major areas of Committee work.'³⁰⁶ In turn, working groups are technical and their members are experts on a sub-field of financial regulation³⁰⁷. Task forces, finally, are the opposite of the BCBS' groups because they are created for specific jobs and for a limited time. Their members are technical experts from the Committee's institutions. Given the case, there are 'high-level' taskforces created by the Committee that consist of BCBS' representatives and deal with specific issues that need the 'prompt attention of the Committee.'³⁰⁸ The Chairman of the Committee manages both the committee and the Secretariat. His role is similar to the head of a regulatory agency at the domestic level.

d) The Chairman and the Secretariat of the Committee as the visible voice of the BCBS

The Chairman is the main spoke person for the Committee. Thus, in this thesis research research he is the one who most often justifies and clarifies the Committee's positions. He presides over the committee's meetings and monitors de work of the BCBS. He reports to the GHOS when appropriate and communicates its mandate to the members

³⁰⁶ BCBS, *Charter*, n 209, Secc. 9.1.

³⁰⁷ *ibid*, Secc. 9.2.

³⁰⁸ *ibid*, Secc. 9.3.

of the Committee³⁰⁹. He or she is appointed by the GHOS for a three year period that can be renewed once³¹⁰.

The Secretariat is based at the BIS in Basle. It provides the infrastructure for the meetings of the committee and the work of the groups, working groups, and taskforces. The staff of the Secretariat is composed by professional civil servants from the BCBS' members on a temporary secondment basis³¹¹. In turn, a Secretary General directs the work of the Secretariat. He or she reports to the Chairman and manages the financial, material, and human resources that the Committee needs³¹². A selection panel of BCBS and/or GHOS members and a senior representative of the BIS put down a list of candidates, from which the Chairman appoints the General Secretary for a period of 3 years that can be extended without limitation³¹³. In the absence of the Chairman he or she can design the General Secretary to preside over the meetings of the committee³¹⁴. Finally, Deputies Secretaries General assist the General Secretary in his or her duties and substitute for him or her in case of absence. They are appointed by the Chairman and the General Secretary³¹⁵.

2.2. The external governance of the BCBS

In this section I explain the external influences on the BCBS' work. The section has two parts. In the first one I speak about the formal external influences in the form of consultative processes. In the second part I analyse the informal influences of other

³⁰⁹ *ibid*, Secc. 10.2.

³¹⁰ *ibid*, Secc. 10.1.

³¹¹ This means that the staff from the Committee are formally employees at their own national regulators and work at Basel with that status; they are not normally BIS employees.

³¹² BCBS, *Charter*, n 209, Secc. 11.2.

³¹³ *ibid*, 11.2.

³¹⁴ *ibid*, n 209, Secc. 10.2, (a).

³¹⁵ *ibid*, n 209, Secc. 11.3, (a).

transnational or international institutions, networks or groups, and the wider impact of the professional community of banking regulators in the BCBS' work. These features are important because, as I explain in subsequent chapters, they play a central role in the communication about the BCBS and its regulatory work, which sometimes takes the form of an accountability process, as the following chapters argue.

a) The consultative processes

Before the process that led to Basel II, consultative papers used to be open only to the members of the BCBS and the G-10 Governors (i.e., what came to be the GHOS). In the 1980 the then Committee's Chairman Peter Cook saw the need to distribute the publications of the Committee among a broader audience (e.g., the members of the BIS), however, it was not until 1999 with the CP-1 of Basel II that the Committee started to open the drafts for comments from every interested party (e.g., other governments which were not members of the Committee, the industry, and Non Governmental Organizations – NGOs).

From 1999 onwards consultative processes at the BCBS resemble public consultations that many national regulators use before enacting general rules³¹⁶. With the introduction of this feature in 1999, the industry did not have to lobby its national regulator to get a version of the draft-rules anymore³¹⁷ and BCBS' decision making processes became a bit more transparent. Additionally this improvement levelled the playing field for every interested party. The bumpy road that Basel II took, however, illustrates the disadvantages that an open consultation process might also have³¹⁸.

³¹⁶ See for example: <<http://stakeholders.ofcom.org.uk/consultations/how-will-ofcom-consult>> Accessed 19 April 2016.

Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177)

³¹⁸ *ibid.*

Typically BCBS' consultative processes work by first issuing a document (a 'paper') with the proposal of the standard that the Committee is willing to adopt. The paper sets a period within which the Committee will receive comments. After that timeframe the BCBS analyses the Comments and publishes them in their web page. The BCBS then acknowledges the comments generally (classifying them by theme) and explains why it is accepting some of them and rejecting others.

The 2013 Charter mandates consultative processes to non-member authorities and to the general public. In the first case, the BCBS has some mechanism to consult its decision with non-member authorities. These mechanisms are the Basel Consultative Group, International Conferences of Banking Supervisors (ICBS)³¹⁹, the Financial Stability Institute (FSI) (a joint effort of the BCBS and the BIS³²⁰), and the regional groups of banking supervisors³²¹. Non-member authorities can also be invited to working groups and task forces. Second, public consultations should normally have a timeframe of 90 days and are compulsory for BCBS' standards but not for its guidelines or sound practices³²². In the next section I explain the informal influences of the professional community in the work of the BCBS.

b) The work of the BCBS and the features of the professional community with which it chimes

According to the Charter, the BCBS produces standards, guidelines and sound practices.

Members of the Committee are required to follow standards like Basel I, Basel II, and

³¹⁹ These are hosted by the BCBS every two years. BCBS, *Charter*, n 209, Secc. 15.2, (a).

³²⁰ The FSI was created in 1999 to 'assist financial sector supervisors around the world in improving and strengthening their financial systems', see: <www.bis.org/fsi/index.htm?m=3%7C17> Accessed 20 April 2016.

³²¹ BCBS, *Charter*, n 209, Secc. 15.

³²² *ibid*, Secc. 17.

Basel III. The Charter establishes, however, that those standards are minimum requirements and that its members might go well beyond them³²³. The Committee is emphatic to say that it expects that standards should be incorporated – or transposed – into domestic or regional regulation within the timeframe it sets for this purpose. Nevertheless, if literal transposition is impossible, the member country should enforce ‘the greatest possible equivalence of standards.’³²⁴

But standards are not the only possible outcome of BCBS’ decision making. The Charter also recognizes guidelines and sound practices which form an important part of the ‘regulatory’ activity of the BCBS. Guidelines are elaborations on the Committee’s standards when some aspects are considered desirable for prudential regulation and supervision of banks, providing additional guidance for implementation purposes³²⁵. Finally, sound practices describe actual observed practices that the Committee considers worth promoting. The goal at publishing sound practices is that members compare them with their actual practices and ‘identify potential areas for improvement.’³²⁶

Thus, the BCBS decision making is divided into these three categories. Standards must be ‘transposed’ or translated into domestic regulation, however, this ‘duty’ is not a formal one, though: the Committee does not have a legal binding authority to do so. The other types of outcomes (i.e., the guidelines and sound practices) resemble suggestions from the BCBS which would do them as an organisation with authority on the field. These outcomes are stronger than they seem if we both consider the place of the BCBS in the transnational financial regulatory framework and before the professional community of bankers and banking regulators. I explain both issues in

³²³ *ibid*, Secc. 12.

³²⁴ *ibid*, 12.

³²⁵ *ibid*, Secc. 13.

³²⁶ *ibid*, Secc. 14.

the next sections in order to show the architecture of financial regulation and the influence of the professional banking regulatory community in the work of the BCBS.

c) The place of the BCBS in the context of transnational regulation

The picture of transnational financial regulation is complex³²⁷. As Verdier explains³²⁸, the Breton Woods agreement did not contemplate the existence of an international organization for transnational finance. It assumed that the IMF as the guardian of global macroeconomic balances and the World Bank as the provider of finance for countries would be enough for global equilibrium. The crisis of Breton Woods, however, made necessary other arrangements like the BCBS and other TRNs (IOSCO, IADI, etc.) that have common features. They were informal, club-like structures that counted on the acquiescence of the global financial industry, the professional community of banking regulators and big country players in international relations (i.e. the G-7)³²⁹.

The BCBS is one of the central loci for transnational banking regulation, however it shares the regulatory space with other organizations that also specialize in global financial regulation. The list is complex and long. Davies and Green³³⁰ mention the World Trade Organization, the OECD, the Financial Action Task Force (in charge of anti-money laundering measures), the G-7 (Canada, Italy, France, Germany, the UK, the US, and Japan), the IMF and the World Bank, and finally some associations related to accounting and auditing standards (the IASB, the PIOB, and the IAASB).

³²⁷ Howard Davies, David Green *Global Financial Regulation: The Essential Guide*, (Polity Press 2008), Loc 795.

³²⁸ Verdier, Pierre Huges 'The Political Economy of International Financial Regulation' (n 16).

³²⁹ *ibid.*

³³⁰ Howard Davies, David Green *Global Financial Regulation: The Essential Guide*, Polity: Cambridge, (n 327), Loc 795.

Some other IOs, TRNs, and other mechanisms for transnational financial governance are closer to the BCBS (e.g., the BIS, the IOSCO, the IAIS, and the FSB). I have explained the role of the BIS in the foundation for the BCBS. Additionally, some of the BIS committees like the Committee on Payments and Market Infrastructures (CPMI) are included in Basel III as mechanisms for the implementation of the accord (i.e., this has to do with central counterparties in their role as clearing houses for securities). Other BIS' committees like the Committee on the Global Financial System³³¹ are also related to the BCBS because both are hosted by the BIS.

At the centre of the financial transnational regulatory space stands the Financial Stability Board which, as a result of the financial crisis, was appointed by the G-20 governments as the leader and coordinator of the global effort to preserve stability in the financial markets³³². The BCBS is part of the FSB and, as such, has developed Basel III as a key component of financial transnational regulation.

The BCBS usually works with other two TRNs: the IOSCO and the IAIS. Together they form the Joint Forum and coordinate the transnational standards about banking (the BCBS), securities (the IOSCO), and insurance (the IAIS). The objective of the Joint Forum is 'to support banking, insurance and securities supervisors in meeting their regulatory and supervisory objectives and, more broadly, to contribute to the international regulatory agenda in particular where risks exist across or in gaps between the three supervised sectors.'³³³

Finally, the BCBS is also a member of the Monitoring Group, a group that coordinates the standards for accountancy and audit with a perspective of transnational

³³¹ The CGFS monitors developments and potential sources of stress in global financial markets for central bank Governors, see: <www.bis.org/cgfs/index.htm?m=3%7C15> Accessed 10 April 2016.

³³² The FSB is as of 2013 a private non-for profit organization under Swiss law, headquartered at Basle too. See: <www.fsb.org> Accessed 10 April 2016.

³³³ See: <www.bis.org/bcbs/jfmandate.htm> Accessed 10 April 2016.

regulation. The IOSCO, the European Commission, the FSB, the IAIS, the International Forum of Independent Audit Regulators, and the World Bank are also members of the Monitoring Group³³⁴.

So there is plenty of complexity in the tasks each TRN or body specialises regarding global financial regulation. As a conclusion we could say that there are five main areas of specialisation: 1) macro-economic stability (led by the IMF, the World Bank, and the BIS); 2) audit and accountancy standards; 3) securities and derivatives regulation (the IOSCO); 4) insurance regulation (the IAIS); 5) and banking regulation (the BCBS). Overseeing all these structures are the FSB, the G-20, and the G-7.

Accordingly, the BCBS is a key part of the transnational regulatory effort. Additionally the Committee is the most important TRN for banking prudential regulation. The role of the BCBS, however, does not rely upon an institutional structure alone but it is intrinsically related also with the expert knowledge that the people at the BCBS have and the professional community they also form part of which, in turn, is relevant for explaining the links between the work of the Committee and the wider banking regulatory community. In the next section I explain the main features of this professional community, in order to show the influence they have in the BCBS work and, as I will further explain in the subsequent chapters, in the Committee's accountability.

³³⁴ See: <www.iosco.org/about/?subsection=monitoring_group> Accessed 10 April 2016.

d) The influence of the banking regulatory community in the work of the BCBS

Like many other professional communities, the banking regulatory one is organised along the centre-periphery category with a hierarchy based on the technical expertise of its members. First, the centre-periphery category means that there are some geographical locations that are more important than others for the banking regulatory profession. As a general rule those who work in the world's main financial centres (e.g. London, New York, Zürich, Basle, or Frankfurt) are higher up in the profession than those located elsewhere³³⁵. Second, the professional trajectory of an expert also shapes his or her standing among his or her peers. Some of the most influential people in the financial, banking, and banking regulatory community have usually been banks' CEOs or have worked at the higher echelons of the financial industry. Some others have been top officials of central banks and financial regulators who later have worked at the highest levels of responsibility in international organizations such as the European Central Bank (ECB), the IMF, the World Bank, and the Bank of International Settlements (BIS). Finally, some influential people in the financial community work at business schools or faculties of economics mainly in North America and Western Europe. Furthermore, it is common practice that some members of the financial profession combine two or three of these backgrounds³³⁶.

This is clearly the case of the BCBS. Guided by its predecessor – the Groupe de Contact – the Committee has kept its 'club-like' atmosphere up to a point. People at the Committee have a professional standing and high technical knowledge which is the cause why they are appointed by politicians. Additionally, the 2013 Charter reinforces

³³⁵ Gunter Teubner, 'Introduction' in Gunter Teubner (ed.) *Global Law without the State* (Aldershot 1999).

³³⁶ E.g., Anne Krueger, John Lipsky, and Ben Bernanke.

this dynamics by stating that new members of the Committee would be those countries that are particularly important for transnational finance³³⁷. In other words, if the country is too ‘far away’ from the centre of the financial profession, then it makes no sense to grant it membership to the BCBS³³⁸.

At the higher echelons, the banking regulatory community involves individuals knowing each other personally³³⁹, however, communication about the issues pertaining to the professional community have other more permanent and impersonal channels too (e.g., newspapers and other media outlets). Some channels are more important than others. In the case of newspapers and magazines, the news source (or ‘media outlet’) that publishes the information is very relevant. There is also a hierarchy among financial newspapers, journals, and magazines. Firstly, the dominant language of publication is English. Table 3.2 shows the number of articles referring to the BCBS in each of the official languages of the Committee³⁴⁰; the pieces written in English are the most numerous by far. Secondly, some media outlets are more important than others. In the analysis of the qualitative data set this thesis finds that the banking regulatory community regarded some sources more highly than others.

³³⁷ BCBS *Charter* n 209, Secc. 9.

³³⁸ Currently the BCBS’ members cover almost 80% of the worlds commerce, see: <<http://theconversation.com/the-g20-economies-explained-in-12-charts-33887>> Accessed 10 April 2016.

³³⁹ They have either work together in their domestic institutions, or they have partaken in the international workshops and congresses that the BIS, the IMF, the World Bank or the BCBS organize every now and then. If the institutions are based in Basle, Switzerland (like in the case of the FSB, the BIS, or the BCBS) chances are that they have been in the same social events. In this vein, Goodhart is eloquent: ‘At this stage the Committee, and particularly its Chairman, felt it was important to recognise the full extent of the international banking market and that wider circulation of President Zijstra’s letter to authorities other than the G10 was therefore needed. This perception of the importance of the wider international financial community led to the holding of the first international conference of banking supervisors on 5-6 July 1979 (BS779/20) in London. With 150 delegates from 80 countries coming, the BCBS could transmit the core message of the Concordat to a wider, but still a private and professional audience’ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 2153.

³⁴⁰ The table is the result of searching for the words ‘Basel Committee’ – or the equivalent term in French, Italian, German, or Spanish – using the database *Factiva*.

This can be related to the centre-periphery paradigm. Thus, those newspapers based in the main financial centres (New York, London, and Frankfurt) will necessarily have more diffusion than others located nearer to the periphery (Buenos Aires, Johannesburg or Delhi). Additionally, if the publication specializes in banking or finance, its influence also grows.

In this vein, I found that the articles in the *Financial Times*, the *Wall Street Journal*, *The Economist*, *Bloomberg news*, and *The Banker* are more influential in the discussions around the BCBS' work than the financial sections of *The Times*, the *Daily Telegraph*, and *The Guardian* in the United Kingdom; and the *New York Times* and the *Washington Post* in the U.S., even when both are based in the same financial centres. Finally, news agencies like *Reuters*, *Associated France Press*, and *Deutsche Welle* also play an important role. Similarly, the journalists specialised in finance are a key part of the conversation³⁴¹.

Language	No. of articles published from 1988 to 2013
English	28500
French	5784
Italian	2363
German	2170
Spanish	1966

Most significantly, however, the language that an article uses and the concepts it touches upon are central for its diffusion among the transnational banking regulatory community. I will further explain this feature in chapter 7. For now it suffices to say that the case of Jamie Dimon – the CEO of J.P. Morgan Chase – criticising the BCBS' decision to raise the levels of capitalisation for systemically important banks (also

³⁴¹ E.g., Andrew Ross-Sorkin, Philip Cohan, and Brook Masters.

called SIFIs) is very eloquent. Mr. Dimon was a very distinguished member of the financial profession³⁴² and some have called him ‘the most powerful banker in the United States, and perhaps the world’³⁴³. Likewise, his remarks were reported by important ‘media outlets’ such as the *Financial Times* and the *Wall Street Journal*. Nevertheless, instead of using a technical argument to attack the measures of the BCBS in relation to SIFIs (e.g., that more regulations imposed upon systemically important banks would only delay the economic recovery in the US and Europe), he criticised the BCBS for being ‘anti-American.’ Chapter 7 will show that many other members of the financial community dismissed Mr. Dimon’s remarks for considering them ‘political.’ Thus, this example shows that the use of technical language (or lack thereof) in the discussion about the BCBS’ standards matters. It can make the difference between being a part of the Committee’s relevant conversation or being excluded from it. Dimon’s remarks about Basel III being anti American were not influential, not even outside of the banking regulatory and financial community.

Most importantly, my research suggests that the BCBS tends to only participate in conversations that use the language of the financial, banking, and banking regulatory community. Other conversations – even those that could be related to transnational finance – are off-boundaries for the BCBS (e.g., human rights, transparency, fairness, etc.). Chapter 7 expounds this finding. So far this discussion advances the idea that the BCBS is a very technical organisation. Not only is it in charge of creating technical standards for global banking regulation, but also – and in the spirit of the Groupe de Contact – the Committee sees itself as a ‘think tank’ for financial regulators³⁴⁴. Being a

³⁴² Jamie Dimon still was both things at the time of the writing up of the thesis.

³⁴³ ‘J.P. Morgan Chase’s Dimon emerges as a banking power’ *Washington Post* (Washington, D.C., 17 September 2011).

³⁴⁴ Interviews to former members of the Committee on July 2011 (Oxford, UK) and November 2011 (Basle, Switzerland).

‘think tank’ means that their role is only technical and never leaves the realm of expert knowledge in relation to prudential banking regulation. Likewise, being a ‘think tank’ - one would expect - can protect the BCBS from political or legal accountability claims which have been issues from different quarters, as chapter 7 explains.

The BCBS’s knowledge is very technical and banking related. So much so that Goodhart criticises the Committee for not being more open to other expert knowledge from other disciplines (e.g., the law, accountancy, and economics)³⁴⁵. He points out that expert knowledge from the banking regulatory profession is different from that of the economists, lawyers, or accountants³⁴⁶. BCBS’ expertise has to do with the prudential supervision of banks and, as such, it depends on the historical evolution of the banking industry³⁴⁷. The specialized knowledge of banking regulators dwells on concepts such as ‘loss-given-default’ (i.e., the negative externalities that a bank creates when it files bankruptcy), and ‘liquidity’ (i.e., what the right liquidity ratio is for a sound banking systems). The inputs for this knowledge in the case of the BCBS have not been academic discussions but lessons learnt from financial disasters³⁴⁸. The expert knowledge of the banking regulatory community to which the BCBS belongs to is one accrued during time and has regard to the ‘best practice’ to regulate banks³⁴⁹.

³⁴⁵ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 12990.

³⁴⁶ *ibid.*

³⁴⁷ In this vein Verdier argues that international financial regulation is path dependant. Pierre Hugues Verdier ‘The Political Economy of International Financial Regulation’ (n 16).

³⁴⁸ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a history of the early years, 1974-1997* (n 65), Loc 12990.

³⁴⁹ This for instance is recognized by the 2013 Charter of the BCBS when it refers to ‘sound practices’ and defines them as ways to regulate the banks which are particularly valid and which the Committee suggests its members could learn from them. BCBS *Charter* n 209, Secc. 14.

3. Conclusion: The BCBS' *modus operandi*

The BCBS was, at least at its inception, a technical group of experts that aimed at learning from each other and try to standardise each country's banking regulatory practices so as to achieve some degree of convergence. Over the years, however, the Committee has become an actual regulatory agency. Formally speaking, though, the BCBS lacks 'teeth' or, in other words, the legal ability to enforce its decisions. This has not stopped it from expecting that its members will implement the standards decided by the Committee in the timeframe set and to emphasise in its charter that its members should have enough authority to represent – and bind – their institutions.

At the same time, the Committee has become a very important node for banking regulation and will continue to be so in the foreseeable future³⁵⁰. It is natural that its accountability has been questioned. The Committee responds to a handful of governments (the G-20 plus the European Union), does not have a mandate according to public international law, and not even country's parliaments or congresses mediate in the 'transposition' of the BCBS standards³⁵¹. From a different perspective, however, the Committee has increased its transparency over the years. Basel II was the first standard in the BCBS' history that incorporated a public consultation process –also called 'notice and comment' by some national agencies – and had a differential negotiation in the EU, the US, and some parts of the developing world that involved national governments, parliaments and industry organizations³⁵². The publication of the Committee's charter in 2013 was also a breakthrough for its transparency and legitimacy. It is rather

³⁵⁰ Daniel Tarullo, *Banking on Basel: The Future of International Financial Regulation* (n 177); Howard Davies, David Green, *Global Financial Regulation: The Essential Guide* (n 327); Henry Penikas, *History of Banking Regulation as Developed by the Basel Committee on Banking Supervision in 1974-2014* (n 206).

³⁵¹ Chapter 1 explained that the European Union is an exception in that the European Parliament and Council were involved in transposing Basel II and Basel III into European legislation.

³⁵² Michael Barr, Geoffrey P Miller *Global Administrative Law: The View from Basel* (n 67).

paradoxical however that Basel I –negotiated behind closed doors – managed to have wide acceptance and Basel II – with complicated consultation processes – became much more problematic³⁵³. This suggests that administrative structures that enhance transparency are not the only instruments by which the implementation of BCBS’ standards might improve their legitimacy and accountability.

But before discussing the accountability – or lack thereof – of the BCBS this thesis explores the question of the regulatory power of the Committee in the next chapter. Chapter 3 and chapter 2 have described the history of the setting of regulatory standards by the BCBS and governance of the BCBS. On the one hand, both its charter and its members emphasise that the Committee is only a standard setting body that takes decisions on a consensual basis and that implementation of its standards lies in the hands of its member’s institutions. On the other hand, however, the standards that the Committee has issued during the years have been more influential than mere suggestions. First, they have been implemented by members and non-members alike, and second, the 2013 Charter is clear in stating that all members are expected to ‘transpose’ the Committee’s standards in the given time frame.

So the question of whether or not the Committee exercises power is a very relevant one because it conditions whether or not the quest for its accountability is a central line of inquiry. If the Committee is just a cooperative instrument of G-20 governments to coordinate their efforts in relation to the regulation of transnational banking, then the issue of the BCBS’ accountability becomes a secondary one. The next chapter therefore discusses whether the BCBS can be considered as exercising regulatory power.

³⁵³ *ibid.*

Chapter 4. Power in Basel: does the BCBS exercise power and what challenges does this pose for its accountability?

1. Introduction

This chapter explores whether the BCBS exercises power. This question is very relevant to the thesis because, from the perspective of public international law, TRNs like the BCBS could be seen as authoritative forums of governance that *suggest* the course of action for a particular public policy. But as they lack binding power, and can not base their actions on a legitimate public mandate, the quest for their accountability could be futile.

A deeper look into the work of the BCBS and the implementation of its standards, however, leads us to the realization that it exercises a determinant influence over a plethora of regulatees. Without such influence, transnational regulation would take a different spin. Thus, I argue that the BCBS, like other financial TRNs, does regulate, though in a ‘soft’ way. Although the Committee lacks the binding powers of the State and its regulatory agencies (the monopoly of legitimate violence as Max Weber would put it³⁵⁴), through its informal authority the BCBS manages to shape conducts. In this case, if the Committee exercises regulatory power, the quest for its accountability becomes a relevant issue.

The chapter thus, first explores if the BCBS exercises regulatory power and finds that the BCBS does exercise it through various mechanisms. In this first section I stress the fact that the BCBS is more than a coordination mechanism, although it still needs the collaboration of its members. The second part of the chapter will describe and

³⁵⁴ Max Weber, *Politics as a Vocation*, (Fortress Press 1965).

explain some of the ways in which the BCBS exercises power. In this vein, I argue that it does so in a soft manner. At the same time, however, the section explains, in accordance with Brummer's ideas³⁵⁵, that the classical framework in relation to soft law does not fully conceptualize the work of the Committee. On the contrary, one of the salient features of the BCBS' work is its involvement in a wider community of experts, a feature that means that there are very powerful incentives for compliance with the BCBS' soft law regulation and that the standards issued by the Committee are more influential than typical soft law instruments. Finally, as a conclusion, the third section explains the accountability deficits of the BCBS. On the one hand, most of the criticism of the Committee's lack of accountability is the result of the absence of 'hard law' checks and balances. The BCBS indeed lacks a public mandate based on international law and its membership – and thus its representativeness – is quite reduced³⁵⁶. On the other hand, however, as I have explained in chapter 3, the Committee has evolved to include some limited forms of transparency like its consultation processes and the framing of its work through a written charter. Nevertheless, if one leaves aside for a moment the viewpoint of hard law – both national and international – one might encounter other subtle avenues for enhancing the Committee's legitimacy and accountability. As already mentioned in the introductory chapter, this thesis seeks to do this by exploring the idea of communicative accountability, i.e. a form of accountability draws on the fact that the BCBS is a TRN that is based within a specific professional context of banking regulation which exposes the BCBS and its employees to evaluations of its credibility in the eyes of its peers.

As other financial TRNs, the Committee operates outside the political structures that usually legitimize regulatory institutions in liberal democracies. One way to look at

³⁵⁵ Chris Brummer, *Soft Law and the Global Financial System* (Cambridge University Press 2011).

³⁵⁶ Nico Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68).

this shortcoming is to demand more institutionalization mirroring the political categories of the State (both at the domestic and at the international levels). Nevertheless, an alternative way for understanding these phenomena is to first find out different legitimising structures for the necessary work of TRNs and other actors that interact with them. The challenge is therefore to find ways for conceptualizing TRNs' action as part of a growing legal, albeit perhaps softer framework³⁵⁷.

Accordingly, I argue that the work of the BCBS stands somewhere in the middle, in between domestic regulation by nation-States and public international law, however, neither the constitutional standards of nation-states nor the institutional framework of public international law properly apply to the its work. At the same time, national governments and some international organizations are key elements without which the Committee's standards would be much less influential. As a result, it could be argued that the work of the BCBS stands in the 'shadows of the state'³⁵⁸.

This chapter refers to accountability as the way a powerful agency or person answers to others for their actions or decisions. Chapter 5 argues, however, that the concept of accountability is more nuanced and complex than what this basic notion might suggest. But the wider, vaguer, notion of accountability is enough for now to discuss the regulatory powers of TRNs in general and the BCBS in particular.

³⁵⁷ Kenneth W Abbott, Duncan Snidal, 'Hard and Soft Law in International Governance' (n 62).

³⁵⁸ Kenneth W. Abbott and Duncan Snidal, 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Ngarie Woods and Walter Matti *The Politics of Global Regulation* (Princeton 2009) 44-88.

2. Regulating without the state: The importance of standards in transnational regulation

New forms of accountability, the topic of this thesis, are highly relevant for state agencies, international organizations (IOs), and governance networks alike. While in the case of IO and states' agencies their accountability is in principle clearer, in the case of other less formal transnational associations, networks or clubs it is more problematic and evasive. As chapter 1 explained, TRNs are a driving force of transnational regulation. At the same time, their regulatory work is based on voluntary standards. Unlike their state counterparts, TRNs lack the binding power to enforce those standards (e.g., to impose monetary sanctions or to control their potential regulatees with permits or authorizations, as many domestic agencies do).

The lack of binding power might mean that TRNs do not exercise regulatory power because they are not able to impose their decisions through the use of force. Thus, *with no power comes no responsibility* and TRNs should not be held accountable. According to this view, domestic authorities of each State are the only ones regulating in actuality, concluding that they – and not TRNs – should be the ones held accountable.

Contrary to this view, I argue that TRNs like the BCBS are regulators through and through because their work is intended to set standards, gather information and shape conducts. Julia Black argues that regulation is 'the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes, which may involve mechanisms of standard-setting, information-gathering and behaviour-modification'³⁵⁹.

³⁵⁹ Julia Black, 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1, 20.

From the analysis of the BCBS' standards and their implementation it is clear that the Committee is a 'real' regulator, although the tools for enforcing its standards are based on soft rather than hard law.

The analysis of chapters 2 and 3 shows that the Committee has put in place mechanisms for standard-setting, information-gathering, and behaviour-modification. The BCBS mechanisms for standards-setting are the Basel I, Basel II, and Basel III accords which set minimums for regulatory capital, liquidity, market discipline, etc. As the practice of the Committee and its Charter say, the BCBS only sets minimum standards, leaving its members the freedom to enact stricter regulations. Another example comes from the BCBS' *Core Principles for Effective Banking Supervision* that set the best and soundest practices that supervisors should follow to prevent systemic risks. Second, the Committee has put in place mechanisms for information gathering as well. Sometimes these mechanisms take the form of quantitative impact studies, which model the probable impact of a given standard in a bank (e.g., the QIS 5 which assessed the feasibility of the A-IRB approach in some countries). Other times the mechanisms for information gathering are implementation reports by which national authorities report back to the BCBS the progress done while implementing the Committee's standards. Finally, the BCBS' regulatory outcomes have incentives designed to modify the conduct of the banks regarding regulatory capital. One example is to require more weight in terms of risk ratios depending on the type of instrument in question. Whereas, instruments like sovereign bonds have 0% risk (in the case of grits), securities possess higher ratios (150%³⁶⁰).

Thus, the work of the BCBS fits into Black's definition of regulation. At the same time however, it is also true that the implementation of the Committee's standards

³⁶⁰ BCBS *Basel III* n 254.

is always mediated through the agencies represented at the BCBS. This brings about a first objection to the idea that the Committee has regulatory power: that it would be the represented domestic agencies and not the Committee that create the regulation. The BCBS therefore, would only be a mechanism for coordination between national regulators.

While it is true that organizations or networks that exercise regulatory power also coordinate their member's efforts, mere coordination mechanisms (e.g., international conferences) lack permanence, organisational identity and cohesion. Participant States or agencies use them as forums to lower transaction costs for negotiating between them. They lack *regulatory* power, and as the States that take part in them do not delegate authority (formally or implicitly) to these coordination mechanisms, *prima facie* the challenges they pose for accountability are either nonexistent or less problematic. In the following paragraphs I discuss this point further and I argue that the BCBS is more than a framework for coordination, because it possesses a clear and distinct organisational identity different from the agencies that partake in it and it does exercise regulatory power independently from each member state contributing to its work.

A first argument to support the idea that the BCBS has regulatory power is that the Committee's standards are also applied by non-member countries. This happened in the case of Basel I adoption by Brazil, India, and other emerging economies in the 1990s³⁶¹ which did not have a say in the negotiations of Basel I³⁶². Although their compliance was voluntary, and one might assume that they were not obliged to live up

³⁶¹ Basel Consultative Group, *Impact and Implementation Challenges of the Basel Framework for Emerging Market, Developing and Small Economies* (BCBS, WP 27, 2014), see: <www.bis.org/bcbs/publ/wp27.pdf> Accessed 22 January 2016.

³⁶² Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67), Martin Marcussen, 'The Basel Committee as a Transnational Governance Network' in Martin Marcussen, Jacob Torfing (eds.) *Democratic Network Governance in Europe* (Springer 2007), 214-231.

to the standard, it is also true that non-compliance had – and has now more than ever – its consequences. First, the BCBS’ standards are used by IOs like the IMF and the World Bank to assess their borrowers’ creditworthiness³⁶³. Thus a country that follows the BCBS’ standards in its banking regulation is better equipped to receive the IMF’s blessing. Second, adopting the BCBS’ standards brings prestige for the implementing country and sends a positive signal to the market, which in turns attracts more credit and investments to that country³⁶⁴. The BCBS’ standards are so ingrained into the international financial system that a country may have one of two choices: either to implement the standards of the Committee or to exit the international financial system altogether³⁶⁵.

A second argument to support the idea that the BCBS exercises regulatory power is that there exist some mechanisms that can put pressure onto some members of the Committee so they compromise their original positions and move towards other members’ ones. This argument is slightly different than the first in that the tools of choice to enforce the Committee’s standards on other countries come from other countries’ tactics and do not in principle depend on IOs like the IMF or the World Bank. For instance, in the last stage of the negotiation of Basel I, the US and the UK threatened to bilaterally enforce a regulation on banking capital that would have been unacceptable to some of the other countries in the BCBS (e.g., Germany and Japan)³⁶⁶. This credible threat incentivised all members of the Committee to negotiate Basel I, knowing that they had to compromise to get a more favourable outcome than the one an UK-US agreement would impose on them. According to Braithwaite and Drahos³⁶⁷

³⁶³ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

³⁶⁴ Duncan R Wood, *Governing Global Banking: The Basel Committee and the Politics of Financial Globalisation* (Ashgate 2005).

³⁶⁵ Howard Davies, David Green *Global Financial Regulation: The Essential Guide* (n 327).

³⁶⁶ Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

³⁶⁷ John Braithwaite, Peter Drahos, *Global Regulation* (Cambridge University Press 2000).

global regulation has sometimes been disseminated across countries with mechanisms like treaties of commercial wars or the imposition of safeguards. In these cases, the adoption of a standard would not be understood without the external pressure put by other powerful countries. Member countries of the BCBS have a complex and diverse international agenda between each other which might, at times, draw near or repel different regulatory opinions at the BCBS' table³⁶⁸.

A third argument for the idea that the BCBS exercises regulatory power has to do with the form decision making takes within the Committee. While it is true that domestic agencies are primarily responsible for the ultimate outcome of the BCBS' standards in their local jurisdictions, oftentimes the regulatory outcome can be traced back to a collegiate process inside the Committee or other financial TRNs³⁶⁹. Because all the Committee's decisions have to be taken consensually, the final regulatory outcome could be very different had it been taken by each member alone. Tullock and Buchanan³⁷⁰ have explained how a result can vary substantially according to the voting procedure used in decision making processes with many participants. The fact that more participants are providing input into the decision of the BCBS might end up producing a different result than if each member would have unilaterally decided. Additionally, because the final agreement is consensual each representative has an additional pressure to compromise.

Finally, the BCBS' growing visibility over the years puts an extra pressure on its members to achieve consensus and simultaneously to produce effective and useful

³⁶⁸ An example is the threat to defect Basel II that the German Chancellor Schroeder brought up in 2001.

³⁶⁹ Roberto Durrieu, *Rethinking Money Laundering Offences: A Global Comparative Analysis* (DPhil thesis, Oxford 2012); Rainer Hülse, 'Even Clubs can't do without Legitimacy: Why the Anti-Money Laundering Blacklist was suspended' (n 46). In the case of international money laundering, for example, some of the measures implemented by national agencies are tightly linked to decisions and regulations issued by the Financial Action Task Force (FATF).

³⁷⁰ Gordon Tullock, James Buchanan, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (First published 1962, The Liberty Fund 1999).

standards and regulations to tackle the problems brought by transnational banking. Both within and without the Committee there is a conviction that it is very hard to regulate cross-border banking without the BCBS, as chapters 2 and 3 have shown. Consequently, the pressure to which the Committee is subject to has also increased so that the BCBS is now deemed as the responsible locus for providing useful and effective regulations for tackling cross-border banking³⁷¹. The necessity of transnational financial regulation and the correlative responsibility that agencies at the BCBS bear, have gradually become clearer for its members and could explain why consensus about Basel III was faster and more substantial in relation to earlier accords. More importantly, this growing visibility and media exposure means that the blame or prestige that comes up as a result of the design and implementation of the BCBS' standards is directed towards the Committee and not towards its individual members³⁷². This provides another argument why the BCBS is the one that exercises – also in the eyes of the media – regulatory power.

In sum, these arguments support the idea that the BCBS, like other financial TRNs, is not merely a coordination mechanism. It actually exercises regulatory power because for both members and non-members, what is decided in the Committee impacts their regulatory systems. Another objection, however, comes from public policy analysis and argues that even if the BCBS' members cannot or will not defect from the Committee's standards, they still have the ability to control implementation in their home countries. In this vein, according to Pressman and Wildavsky there is very often a disparity between public policy design and implementation³⁷³. In the case of the BCBS, regardless of the way the standards are designed, they will change in one way or another

³⁷¹ Howard Davies, David Green *Global Financial Regulation: The Essential Guide* (n 327), Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177) Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65).

³⁷² Dona Borak, 'Basel Liquidity Plan Praised For Tempered Approach' *American Banker* (New York, 8 January 2013); 'Banking supervisors may seek to simplify capital rules', *Reuters News* (London 12 March 2013).

³⁷³ Jeffrey Pressman, Aaron Wildavsky *Implementation* (University of California Press 1983).

at the time each country implements them³⁷⁴. This disparity between what was originally agreed on and the final result of implementation in some countries was one of the driving forces to amend Basel I and produce Basel II³⁷⁵. The objection implies that regulatory policy design is almost irrelevant for the final result.

While it is true that some countries have taken a flexible interpretation of the BCBS' standards in the past³⁷⁶, it is also true that the wording of the accords necessarily impacted implementation³⁷⁷. In other words, the way a regulatory outcome is designed has great influence on how implementation happens. That influence may sometimes take the form of unintended consequences, like the capital measurements of Basel II that allegedly created cyclical³⁷⁸. But it is one thing to say that there is a disparity between planning and implementation, and another different one, that any public policy design would not impact the final result. Members of the BCBS, as those of other TRNs, steer implementation in their jurisdictions, which in turn could provoke a plurality of regimes in different countries. In every case, however, implementation is correlated somehow with design. That is why negotiations inside the BCBS go a great length into the details and the wording of each one of the standards³⁷⁹.

³⁷⁴ Adrienne Heritier, Dirk Lehmkuhl 'The Shadow of Hierarchy and New modes of Governance' (2008) 28 *Journal of Public Policy* 1.

³⁷⁵ Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

³⁷⁶ Chile, for instance, implemented only a part of Basel II, and the US decided to keep Basel I for the smaller banks and enforce the A-IRB approach only on its bigger more complex banks. See, Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67); Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177). The lack of coherence at implementing the standards by many countries was one of the reasons why the BCBS decided to start negotiating Basel II. For the literature about unintended consequences see Peter Grabosky, 'Counterproductive Regulation' (1995) 23 *International Journal of the Sociology of Law* 4; Cass Sunstein, 'Political Equality and Unintended Consequences' (1994) 94 *Columbia Law Review* 4.

³⁷⁷ One of Basel II stumbling blocks was precisely the interpretation of A-IRB approaches to measure the credit risk of some exposures.

³⁷⁸ Charles A E Goodhart, Avinash D Persaud, 'How to avoid the next crash' (n 236).

³⁷⁹ Otherwise Germany's opposition to the original form to measure SMEs' exposures, would be completely irrational. See: *The Economist*, 'The Basle Perplex' (London 8 November 2001) at: <www.economist.com/node/852945> Accessed 15 April 2014.

Finally, a last objection against the BCBS being a ‘real’ regulator is based on the members of the Committee’s status as representatives of their states. In the previous two objections I have put examples that describe the Committee as a mechanism where the real decision makers are the representatives of member states. As a consequence of this, the BCBS could be a highly effective mechanism for coordination, where, just as the implementation of the Committee’s accords could be traced back to the BCBS, the accords’ content could be traced back to the states representatives. This picture would portray an image of the BCBS similar to a permanent international conference – or a forum – where countries’ representatives meet and create consensual standards for transnational banking regulation.

This portrayal, however, misses the point. Members of the BCBS are not so much representatives of their states but representatives from their regulatory institutions³⁸⁰. In this vein, they are unfit to represent and bind their countries according to public international law³⁸¹. Moreover, they are representatives of the banking regulatory community that happen to work in a particular agency. As I have explained in chapter 3, the countries that take part at the BCBS are those which the G-20 Governors believe to represent the most important financial centres of the world³⁸². This feature correlates with the way the banking regulatory professional community is

³⁸⁰ BCBS Charter n 291.

³⁸¹ It is not probable that the members of the Committee can bind their countries. The Vienna Convention of the Law of Treaties states: Article 7. ‘FULL POWERS 1. A person is considered as representing a State for the purpose of adopting or authenticating the text of a treaty or for the purpose of expressing the consent of the State to be bound by a treaty if: (a) He produces appropriate full powers; or (b) It appears from the practice of the States concerned or from other circumstances that their intention was to consider that person as representing the State for such purposes and to dispense with full powers. 2. In virtue of their functions and without having to produce full powers, the following are considered as representing their State: (a) Heads of State, Heads of Government and Ministers for Foreign Affairs, for the purpose of performing all acts relating to the conclusion of a treaty; (b) Heads of diplomatic missions, for the purpose of adopting the text of a treaty between the accrediting State and the State to which they are accredited; (c) Representatives accredited by States to an international conference or to an international organization or one of its organs, for the purpose of adopting the text of a treaty in that conference, organization or organ.’

³⁸² BCBS Charter n 291.

organized: on the one hand, the most important financial cities (e.g., London, New York, Hong Kong, Frankfurt, etc.) at the centre and less important places at the periphery; on the other, there is a hierarchy that goes from junior to more senior members of the community in terms of their level of experience, expertise, and prestige³⁸³.

In this guise, from its inception, the BCBS has been a ‘club-like’ network that brings together banking regulators, selecting them by their professional prestige, and not necessarily by their place in the bureaucratic hierarchy. So the countries’ representatives are members of a professional community that happen to work at each country’s central bank and/or banking supervisor. Goodhart, for example, mapped the frequency with which the same people partook in the BCBS’ meetings prior to Basel II and found that, with the exception of the representatives from the US and Japan, most of the people from the other 10 countries were regulars at the meetings³⁸⁴.

Thus the BCBS might be a think-tank for banking supervisors³⁸⁵, but it is a think-tank with regulatory power. No doubt, those who meet at Basle for better understanding the problems of transnational banking and providing possible regulatory solutions participate in a cognitive activity. At the end, however, they also produce a set of standards with consequences – unintended or otherwise – in the real world. Moreover, I venture to put forward the hypothesis that the influence of those standards depends heavily on the prestige they might have among the banking regulatory professional community. In this vein, the procedural safeguards put by the BCBS (i.e., a

³⁸³ Gunter Teubner, ‘Introduction’ in Gunter Teubner (ed.) *Global Law without the State* (n 335); Paul F Kjaer, Gunter Teubner, Alberto Febbrajo, *The Financial Crisis in Constitutional Perspective: the Dark Side of Functional Differentiation* (Bloomsbury 2011), Andrew Abbot, *The System of Professions* (University of Chicago Press 1988), Peter Haas ‘Introduction: Epistemic Communities and International Policy Coordination’ (46 *International Organization* 1, 1992).

³⁸⁴ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65).

³⁸⁵ Interview with a member of the BCBS, November 2011, Basle, Switzerland.

Charter, consultation processes, transparency in its decisions, etc.) would be less important for the fate of the Committee's standards than the reputation that those same standards have within the relevant professional community³⁸⁶. I will come back to this hypothesis when I analyse the qualitative data set in chapter 7.

As a conclusion for this section, it is clear that the BCBS is more than a coordination mechanism between countries and it does exercise regulatory power. The next relevant question is, however, how it exercises this power. It does so not by using the tools of public international law or domestic administrative law. On the contrary, the BCBS works through some of the mechanisms of what international relations theorists have called 'soft law.'³⁸⁷

3. Soft law as the way in which the BCBS enforces its standards

Chapters 2 and 3 explained the history of the BCBS' regulatory waves³⁸⁸ and governance. This section expands that analysis to the transnational context in which the BCBS' standards are applied. The question that I am seeking to answer is why and thus how the BCBS and its standards are so influential. The answer has to do with the way the BCBS regulates: using soft law within a professional community.

³⁸⁶ As explained earlier in chapters 2 and 3, Tarullo flags up the apparent paradox between the wide acceptance of Basel I, regardless of its lack of transparency, to the less successful fate of Basel II, despite its improvements in participation. Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

³⁸⁷ Kenneth W Abbott, Duncan Snidal, 'Hard and Soft Law in International Governance' (n 62); David Zaring 'Informal Procedure, Hard and Soft, in International Administration' (n 67).

³⁸⁸ Henry Penikas, *History of Banking Regulation as Developed by the Basel Committee on Banking Supervision in 1974-2014* (n 206).

Transnational regulation takes the form of soft law when three elements that Abbott and Snidal³⁸⁹ identify in hard law – typically the law of the states both at the national and international level – are altogether absent or take a weakened form. These three elements are: a) legally binding obligations, b) the degree of precision of those obligations, and c) that they ‘delegate authority for interpreting and implementing the law’,³⁹⁰. According to the authors, hard law has been used in international relations because it provides a number of advantages: e.g., reduces transaction costs by creating a framework for future coordination between parties; strengthens the credibility of the parties’ commitments; expands the catalogue of possible political strategies by creating mechanisms for settling disagreements; and resolves problems of incomplete contracting by delegating authority to courts or IOs that administer the treaty. Nevertheless, hard law has downsides too: it restricts the parties’ behaviour and brings along sovereignty costs³⁹¹.

Conversely, soft law circumvents these two problems. First, by a weaker legal binding, soft law instruments permit more flexibility to the parties’ future behaviour and second, by a weaker delegation it allows the parties to keep sovereignty over the issue at hand. In this way, parties do not have to subject themselves to external decisions over sensitive matters (e.g., climate change, the jurisdiction of the International Criminal Court, food safety standards, etc.)³⁹². Nor do they have to go through a burdensome process of negotiation with their own legislature and political factions.

According to Abbot and Snidal the most important incentive for implementing soft law in international relations is the growing complexity of the issues that national

³⁸⁹ Kenneth W Abbott, Duncan Snidal, ‘Hard and Soft Law in International Governance’ (n 62).

³⁹⁰ *idem*, 421.

³⁹¹ *idem*, 430.

³⁹² *idem*, 437.

governments have to solve at a transnational level³⁹³. The authors agree that a possible solution for these problems could be to delegate authority through hard law (i.e. a treaty or an international covenant) creating an international court or an IO specialized in the problematic issue at hand. Nevertheless, they also argue that this approach would bring very high sovereignty costs to the signing parties. For this reason – i.e., to avoid very high sovereignty costs – soft law mechanisms are more suitable for these complex and uncertain transnational problems (e.g. cross-border banking and the systemic important financial institutions’ performance in the BCBS’ case).

In summary, regulation based on soft law is, first, less legally binding, leaving the parties with more flexibility to behave. This means that the regulation’s contents are not legalized in a treaty or other similar instrument of international law. Second, it has less detail, typically the parties agreeing on some principles and benchmarks – i.e., some minimum standards. In this case the regulation delegates to relevant parties the ability to implement the standard flexibly. Third, soft regulation possesses a lower degree of delegation, so in principle is always possible to migrate to other mechanisms for transnational regulation, if the ones chosen are ill conceived or do not produce the desired results.

In this vein, the BCBS uses soft law by first issuing standards that lack legal binding power and with a lower level of detail³⁹⁴. As I explained in chapter 3, they are minimum standards and countries can enforce stricter ones if they want. Additionally, the Committee leaves some room for flexibility when the countries implement those standards. Finally, the Committee regulates by soft law because it lacks political

³⁹³ *idem*, 440.

³⁹⁴ It is true that some of the BCBS’ standards like Basel III have a greater level of detail, however, they leave some of its features as minimum requirements for the banks. National regulators can change those requirements enforcing stricter rules.

delegation from its members as they are not legally obliged to follow the BCBS' regulations.

The Committee acknowledges this soft power in Section 2 of its 2013 Charter which establishes that the BCBS:

'seeks to achieve its mandate through the following activities:

(a) exchanging information on developments in the banking sector and financial markets, to help identify current or emerging risks for the global financial system;

(b) sharing supervisory issues, approaches and techniques to promote common understanding and to improve cross-border cooperation;

(c) *establishing and promoting global standards for the regulation and supervision of banks as well as guidelines and sound practices;*

(d) addressing regulatory and supervisory gaps that pose risks to financial stability;

(e) *monitoring the implementation of BCBS standards in member countries and beyond with the purpose of ensuring their timely, consistent and effective implementation* and contributing to a "level playing field" among internationally-active banks;

(f) consulting with central banks and bank supervisory authorities which are not members of the BCBS to benefit from their input into the BCBS policy formulation process and to promote the implementation of BCBS standards, guidelines and sound practices beyond BCBS member countries; and

(g) coordinating and cooperating with other financial sector standard setters and international bodies, particularly those involved in promoting financial stability.³⁹⁵

By reading the tasks that the BCBS does – especially letters '(c)' and '(e)' – it is clear that, at least according to the Charter, the BCBS can produce regulation. A different matter is the degree of effective implementation of the BCBS' standards, which could be lower than expected. As the Charter sums up the practice of the Committee in the past, however, section 2 of the Charter is more than a good intention. I have explained in previous chapters that the Committee has been able to implement its

³⁹⁵ The emphasis is added. BCBS *Charter* n 291, Secc. 2.

standards in the past. Additionally, the Committee has enforced those standards using soft law. In this guise, a relevant question is which particular soft law mechanisms the Committee uses to enforce its standards and oversee their implementation by its members.

In sum, for Abbot and Snidal, soft law is a rational alternative when the issue at hand is very complex and the states face high sovereignty costs if they chose to delegate authority to a fully fledged IO. For other authors, however, soft law is the result of the work of a technocratic network that converges over a shared view of the world and a shared solution to specific problems (e.g., environmental, banking, or anti-trust regulation)³⁹⁶. In these cases, so the argument goes, it is very difficult for politicians to understand the complexity of the policy problems needed to solve, therefore they defer the question to specialised agencies with expert personnel³⁹⁷. At the transnational level, these agencies come together to better provide solutions to those problems that no single agency can solve by its own. In chapter 1 I have explained that these mechanisms are precisely TRNs. As a conclusion, the argument advances the idea that soft law does work because there is a common understanding of the problem among the relevant professional community, standards converge upon a shared solution and, therefore other members of the professional community – i.e., other regulators of the world – *model* the proposed answer in their own countries³⁹⁸.

Modelling is indeed one of the strategies that Braithwaite and Drahos put forward to explain the diffusion of global regulation³⁹⁹. When a regulatory standard is prestigious enough, other jurisdictions tend to apply it. This has happened with

³⁹⁶ Anne-Marie Slaughter, *A New World Order* (n 49); Pierre Hugues Verdier, 'Transnational Regulatory Networks and Their Limits' (n 2).

³⁹⁷ Peter Schuck, *The Limits of Law* (n 305).

³⁹⁸ David Zaring 'Informal Procedure, Hard and Soft, in International Administration' (n 67).

³⁹⁹ John Braithwaite, Peter Drahos, *Global Regulation* (n 364).

standards in food safety issued by the Codex Alimentarius Commission, and with some processes in the history of legal ideas. The Codex Alimentarius Commission is administered by the Food and Agriculture Organization (FAO) but its membership consists of experts on food safety. Since the World Trade Organization's Agreement on Sanitary and Phytosanitary Measures enforced the Codex Alimentarius standards, many countries have adapted their standards to meet those of the Codex⁴⁰⁰. In legal history, at least three 'waves' of legal transformation in the Western world have followed a process similar to modelling. First, many professional jurists in medieval universities developed the *ius commune* in Continental Europe using the scholastic method to interpret Justinian's *Digest* that was discovered by Irnerius in the University of Bologna and was developed by commentators (*glossatores*) and their disciples (*post-glossatores*). Second, in the 1500s legal humanism started a second wave in Europe that completely changed medieval understanding of the law towards a methodology that included linguistics and the humanities. And third, *codification* in the 1700s was influential enough to change legal paradigms not only in Continental Europe but in most of the world that did not have an Anglo-Saxon tradition⁴⁰¹. Just as these types of modelling, TRNs would work proposing a paradigm that is influential enough to make all opinions converge upon it.

In the case of the BCBS, its member countries are not willing to delegate authority to create an IO with a public mandate to regulate cross-banking supervision. Even if they were, however, the BCBS deals with a very complex subject: transnational financial regulation. It is difficult, therefore, to provide a specific mandate when there is

⁴⁰⁰ <www.fao.org/fao-who-codexalimentarius/en/> Accessed 15 January 2017.

⁴⁰¹ Randall Lesaffer, *European Legal History* (Cambridge University Press 2013), Manlio Bellomo, *La Historia del Derecho Común* (Il Signo Gallileo 1999).

not a clear idea as to how to tackle the inherent problems of the global financial system. So it makes sense that the BCBS operates with soft law tools.

Additionally, the Committee is composed of public servants that are also members of a professional community. This feature chimes with the idea of Slaughter⁴⁰² that soft law mechanisms are used in transnational financial regulation because there is a convergence upon the possible solution among a community of experts. In the BCBS' case, convergence within the professional community of banking regulators would explain some of its publications like the *Core Principles for Effective Banking Supervision* and other best practices (e.g., on corporate governance) that the BCBS issues from time to time⁴⁰³.

While this argument might explain those outcomes of the Committee that actually suggest a better way to proceed when regulating banks, however, it fails short in other cases in which the BCBS is enforcing its standards. None of the accords issued by the Committee (i.e., Basel I, Basel II, and Basel III) have shown a *natural* convergence on a given solution, on the contrary in all three cases there were other pressures that led to the result. In chapter 2 I explained how the bilateral agreement between the US and the UK banking regulatory authorities was a credible threat to other Committee's members and that triggered the negotiation of Basel I⁴⁰⁴. In the case of Basel II, there was never truly a point of convergence even when implementation was on its way. On the contrary, the US and the EU authorities never found common

⁴⁰² Anne-Marie Slaughter, *A New World Order* (n 48).

⁴⁰³ For more best practices issued by the Committee, see: <www.bis.org/bcbs/publications.htm?a=1&tid=136&mp=any&pi=title> Accessed 10 February 2016.

⁴⁰⁴ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65).

ground⁴⁰⁵. Thirdly, I have advanced the opinion that Basel III was a result of the higher pressure and visibility that the BCBS had as a result of the 2008 financial crisis.

Theoretically soft law is utilized when the subject at hand is very complex, costs to commit to a full delegation of powers to an IO are high, and countries can participate in the network for a time with the purpose of learning from other parties and still be able to manage their own affairs⁴⁰⁶. For Brummer, however, the above-mentioned explanations based on the rationality of soft law⁴⁰⁷ or the convergence of the policy among a group of experts⁴⁰⁸ fall short to explain the wider acceptance of voluntary standards in transnational financial regulation⁴⁰⁹. They do so because, even when technocratic convergence is possible, different countries have divergent views over regulatory philosophies (i.e., the form of government intervention in the markets), they differ about the role markets should play (i.e., whether they are mainly instruments for increasing wealth or they also have a public function like incentivising the domestic industry); or they have diverse ideas about the acceptable risks that the industry might take (i.e. some regulators are more risk-averse than others)⁴¹⁰.

These restrictions create a negotiation in two different levels, like Robert Putnam's proposed model of bilateral agreements⁴¹¹. On the one hand, the BCBS' members have to negotiate with their counterparties in the Committee in terms of the best possible solution for a given cross-border banking problem. On the other, however, they need to get consensus by their home relevant actors (e.g. political parties, other

⁴⁰⁵ Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67).

⁴⁰⁶ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

⁴⁰⁷ Keneth W Abbott, Duncan Snidal, 'Hard and Soft Law in International Governance' (n 62).

⁴⁰⁸ Anne-Marie Slaughter, *A New World Order* (n 49), Pierre Hugues Verdier, 'Transnational Regulatory Networks and Their Limits' (n 2).

⁴⁰⁹ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

⁴¹⁰ *ibid*, loc. 3636.

⁴¹¹ Robert Putnam, 'Diplomacy and Domestic Politics: The Logic of Two-Level Games.' (1988) *International Organization* 42, 427-460.

regulatory agencies, relevant political actors, and sectors of the banking industry) to produce a commitment in the Committee.

Brummer identifies two lacunae in the formulation of soft law by international lawyers and international relations theorists. One is thinking that all obligations under hard law are binding and have a reputational cost. The other is not realising that the role of IOs goes beyond the hard law treaties by which they were created. IOs, in fact, also serve a very important role in enforcing soft law instruments by creating novel forms of legitimacy and compliance, even if these forms undermine conventional ideas of accountability⁴¹².

In this vein, Brummer proposes to take a deeper look into the context in which soft law happens and the coordinated role that different actors play in it. He puts forward the idea that states comply with international financial rules pushed by various ‘compliance technologies’⁴¹³ consisting of reputational, market and institutional disciplines. When these mechanisms are activated Brummer argues that international financial regulation is even more coercive than traditional public international law. Accordingly, I will follow Brummer’s description of the interplay of different actors in transnational financial regulation but I flesh it out with examples from the BCBS’ case. This narrative highlights that, even in the absence of legally binding obligations, soft law in transnational financial regulation in general and in the BCBS’ standards in particular, can count with mechanisms to enforce soft obligations.

⁴¹² “Furthermore, in corralling different regimes and authorities, these organizations and institutions create new forms of legitimacy and compliance, even when undermining conventional (domestic) conceptions of accountability. These dynamics, which should not (and do not) turn on whether an instrument is soft or hard law, need to be integrated into existing legal theory.” Chris Brummer, *Soft Law and the Global Financial System* (n 355), loc 3765.

⁴¹³ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

Softer regulation of transnational finance ordinarily works based on market discipline. The case of the BCBS is no exception. Market discipline refers to the rules that send signals to markets regarding a firm probable performance. Brummer highlights those regulations that mandate information disclosure by firms (banks or other types of financial institutions). When the regulations are effective and credible they create a better valuation of the relevant firms by markets. The contrary is also true, when transparency on a firm is sub-optimal, the markets might react negatively towards that firm's exposures (e.g., shares, bonds, securities, etc.)⁴¹⁴.

In the case of the BCBS, Basel I provides a good example of the incentives that markets can create for complying with the Committee's standards. Back in the 1980s, the Japanese negotiated a less strict application of the Basel I standards regarding the percentage of equity capital that banks should have (i.e. a version in which shares and disclosed reserves might be used). Nevertheless, by the 1990s the Japanese banking sector was suffering a severe financial crisis due in part to the lower level of capitalisation that its banks had⁴¹⁵. From that moment onwards a higher level of capitalisation was a positive signal to send to the markets. Thus, markets can reinforce those standards that signal virtuous cycles in the industry by allocating higher prices and value to those products, services, or firms that comply with stricter obligations. Another example is the wider adoption that Basel I had among countries of the developing world. Although the Committee made clear that Basel I was designed to fit the needs of developed countries with complex financial systems, many developing countries implemented the accord regardless of that caveat⁴¹⁶. The dynamics behind this trend

⁴¹⁴ *ibid*, loc. 3897.

⁴¹⁵ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65).

⁴¹⁶ Duncan R Wood, *Governing Global Banking: The Basel Committee and the Politics of Financial Globalisation* n 361, Wolfgang H Reinicke, *Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980-1990* (n 180).

were based in part on the good signal that the adoption of Basel I sent to markets. In these cases, markets reinforced the adoption of the Committee's standards⁴¹⁷.

In relation to the role of market discipline as an incentive to comply with the BCBS' standards and best practices, there is also a link in the other direction, i.e., regulatory outcomes reinforcing market discipline. This happens when the standards published by the Committee flesh out the attributes that investors should seek in firms and banks alike. For example, the "Principles for enhancing corporate governance in Banks" released by the Committee in 2010⁴¹⁸, fleshed out the concrete conducts and rules that investors should be looking for in banks' corporate governance if they wanted to assess the banks' soundness in this area. Before that publication investors might agree that corporate governance was a good quality to look for in a bank, but the BCBS' publication fleshed out the concrete elements of that practice. Consequently, market discipline and the Committee's standards reinforced each other⁴¹⁹.

Additionally to the mechanisms linked to market discipline, the BCBS as other financial TRNs use institutional disciplining mechanisms too. These are typically interventions from other TRNs or IOs in their own jurisdiction that reinforce the standards of the BCBS. In chapter 3 I briefly touched upon them; now it is the time to take a deeper look. Some IOs like the IMF and the World Bank use the practice of conditional lending to those parties that show compliance with the standards of the financial TRNs. The IMF and the World Bank use the 'Financial Sector Assessment Program (sic)' which, among other standards, contains the ones from the BCBS⁴²⁰. As

⁴¹⁷ Higher capital would entail a lower risk and a higher valuation. Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

⁴¹⁸ BCBS (2010) *Principles for Enhancing Corporate Governance in Banks*, see: <http://www.bis.org/publ/bcbs176.pdf>

⁴¹⁹ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

⁴²⁰ IMF (2016) *Factsheet: Financial Sector Assessment Program*, see: <https://www.imf.org/external/np/exr/facts/pdf/fsap.pdf>

Brummer points out⁴²¹ this instrument is slightly more powerful in the case of countries that heavily rely on loans from the IMF or the World Bank. Richer countries, which do not need them, can easily dismiss IMF or World Bank's conditions. In either case there are limitations to this mechanism as the incentives for reform end when the disbursement is complete. In the BCBS' case, the

Network efficiencies are also present at the BCBS' work and are partly the cause of the wider application of its standards. In economic theory, network efficiencies happen when members of the network hold certain advantages against non-members, creating incentives for more new comers in the network⁴²². Because the BCBS' membership concentrates nearly 80% of the world's gross domestic product (GDP)⁴²³, other countries' banks willing to deal with banks in the BCBS' countries have the very powerful incentive to use the same standards, thus widening the application of those standards in turn⁴²⁴. The network effect of the BCBS' membership might explain why non-member countries chose to enforce Basel I in their jurisdictions.

An additional form for enhancing compliance with the BCBS' standards is through monitoring mechanisms. In the case of the BCBS, informal peer review is a powerful tool for monitoring enforcement of the Committee's standards. Before the negotiating process of Basel II, some members of the BCBS had the opportunity to share their opinions about the seriousness with which other counterparties took the enforcement of Basel I:

⁴²¹ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

⁴²² In networked industries this is clearer. For instance the owner of the bigger network of mobile phones has clear advantages against its competitors. If this firm offers its clients a lower 'on-net' tariff for calls to numbers that are also in the network, it creates incentives for other network's consumers to migrate to the bigger firm's one. See, Tirole and Laffont, Telecommunication's regulation.

⁴²³ 'The G20 Economies Explained in 12 Charts' *The Conversation* (Boston, 11 November 2014), see: <<http://theconversation.com/the-g20-economies-explained-in-12-charts-33887>> Accessed 25 March 2015.

⁴²⁴ David Knoke, *Economic Networks* (Polity 2012).

Soon after publishing the Basel I Accord, the committee established a mechanism for addressing interpretive questions arising from the accord itself or from the creation of new financial instruments. This mechanism was explicitly designed to avoid significant competitive inequalities (...). However, the discussions preceding the publication of an agreed interpretation would also give the supervisors considerable insight into the practices and thinking of their peers.⁴²⁵

Another form of monitoring is carried out by private actors like NGOs, academic papers, and the banks themselves. They gather the public information available and analyse it to get the degree of compliance of each country to the relevant standards. In the case of the BCBS, associations like the International Institute for Finance (IIF)⁴²⁶ or Oxford Analytica⁴²⁷ have offered reports over the progress in the implementation of Basel III. From the academia, Barr and Miller have explained the potholes and obstacles of Basel II implementation process⁴²⁸, and Young has explained the disparities in Basel III implementation between the US and the EU⁴²⁹. Although these private reports are not as detailed and complete as those that emanate from the peer review process, they give a good account of the BCBS' efforts towards implementing a particular standard⁴³⁰.

Finally, Brummer highlights a very influential mechanism that incentivises the compliance with TRNs' standards in general and the BCBS' ones in particular. The author adds that, at least in the case of transnational financial regulation, soft law comes with an extra reputational cost for defection in their peers' eyes. In other words, Brummer argues that without these reputational costs attached to defection, parties at

⁴²⁵ Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177), Loc. 4624.

⁴²⁶ IIF (2011) *Banks Continue to Implement Risk Management Reforms Following the Crisis*, see: <www.iif.com/publication/regulatory-report/banks-continue-implement-risk-management-reforms-following-crisis> Accessed 10 February 2016.

⁴²⁷ Oxford Analytica (4 February 2011) *United Kingdom: Banks' power dampens regulatory reform*, see: <https://www.oxan.com/display.aspx?ItemID=DB165986>; Chris Brummer, *Soft Law and the Global Financial System* (n 355).

⁴²⁸ Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67).

⁴²⁹ Kevin Young, 'Tying hands and cutting ties: Explaining the divergence between the EU and the US in global banking reform since the crisis' (2016) *17 Journal of Banking Regulation*.

⁴³⁰ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

the financial TRNs would not comply with the standards that they earlier agreed on, particularly if the cost for compliance is high⁴³¹.

While both contractualist and network theories are applicable to the BCBS, it is Brummer's insight about reputational costs that stands out⁴³². The members of the BCBS have strong incentives to stand by the standards they create together because to do otherwise would have a reputational cost at the professional level. This characteristic helps us to understand why the Basel II process took so long. While the representatives at the BCBS wanted to reach an agreement that would lead to an accord, they first had to get the political leverage at home needed to secure a real commitment. In the US, for example, that commitment had to bring on board both some political factions in the Senate and part of the banking industry (i.e., smaller banks)⁴³³.

Additionally, the final outcome of the BCBS had to be acceptable in the professional community's eyes. This means that the final version of a given standard gets its legitimacy from a wider consensus among the relevant professional community. This in turn might also explain the paradox between the wider acceptance of Basel I and the problematic implementation of Basel II. While the latter had included participatory processes to enhance transparency, the former was completely negotiated behind closed doors among the G-10 representatives at the BCBS⁴³⁴. Basel I, however, had a clear stamp of approval among the relevant professional community and this is what enhanced its influence, even among non BCBS members⁴³⁵.

⁴³¹ *ibid.*

⁴³² *ibid.*

⁴³³ Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67).

⁴³⁴ Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

⁴³⁵ Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65).

Financial TRNs like the BCBS are composed by officials that belong to a professional community – that of banking supervisors⁴³⁶. I argue that banking regulation is a technical type of regulation due to the independence it possesses from politics in many countries that are members of the BCBS. This independence creates a type of ‘natural jurisdiction’ for the banking regulatory community over issues related to cross-border banking and global financial systemic risk. In the next paragraphs I develop this idea by explaining the political and technical independence that the agencies represented at the BCBS have.

Like many other areas of regulation, domestic banking supervision is carried out by specialised agencies with a specific mandate. Additionally, these agencies possess a certain degree of independence from political actors and decisions. Independence can be also an opportunity for an enhancement of the power of a regulatory agency. That independence has been summarised with the word ‘deference’ from political institutions. The word stems from an influential decision by the US courts in the 1980s where a judge decided that specialized agencies should be the only ones with the ultimate power to make decision about matters that lie within their area of expertise⁴³⁷. The rationale behind this decision and the common practice in most countries⁴³⁸ is that technical knowledge is needed to understand and design regulation. On the contrary, other parts of government without that technical knowledge are ill-equipped to deal with such specialised matters. Sector based regulation (e.g., telecommunications, energy, antitrust, environmental, and aerospace regulations) stems from this principle.

⁴³⁶ Chris Brummer, *Soft Law and the Global Financial System* (n 355).

⁴³⁷ Sidney Shapiro, Elizabeth Fisher, ‘Chevron and the Legitimacy of “Expert” Public Administration’ (2013) 22 *William & Mary Bill of Rights Journal* 2.

⁴³⁸ Charles A E Goodhart, *The Changing Role of Central Banks* (LSE 2010).

Agencies that are members of the BCBS have technical and in some cases also political independence from the government and other branches of the state (i.e., legislatures and courts). First, central banks follow a long tradition of independence in many countries. Not only can the central government not influence central bank's decisions, but also their officials follow an institutional career, which specialises in matters like macroeconomic stability, interests and foreign exchange rates, and prudential regulation of banks and other financial institutions⁴³⁹. The same is true for most of the banks' supervisory agencies, although in this case they may not possess political independence⁴⁴⁰.

In this vein, Shapiro and Fisher argue that expertise's role is central for the work of bureaucracies. The definition of expertise, however, is contested. By analyzing the Chevron doctrine in the United States, they argue that there are two types of expertise. Firstly the 'rational-instrumental' (RI) expertise focuses on the democratic governance and control on the regulatory agencies exercised by the Legislature. This paradigm understands that the autonomy of experts in regulatory agencies comes from a political delegation by the Congress. Likewise, RI's main emphasis is the administrative procedure set out by legislation (i.e. the mechanisms of control that legislation mandates). Secondly, the 'deliberative-constitutive' (DC) paradigm understands expertise as a social construct from a community of experts. Most significantly, however, they 'conceptualize expertise and accountability differently because each is

⁴³⁹ Neil Irwin, *The Alchemists: Inside the Secret World of Central Bankers* (Headline Publishing Group 2013).

⁴⁴⁰ In countries like Germany, France, Mexico or Brazil, the prudential regulator of banks is indeed a branch of government and its head is appointed by secretary or minister of finance.

based on a different institutional perspective of behaviour within public administration.’⁴⁴¹

While the two models complement each other, they underline different rationales for decision-making. The first one heavily relies on the institutionalized mechanisms of control of the state (e.g. legislation, statutes, courts, ombudsmen, administrative sanctions, etc.). In contrast to the second paradigm is based on the internal conversation of a professional or epistemic community to which the personnel of a regulatory agency belongs to. I will come back to this theme in the following chapters when I put forward the idea of communicative accountability and the centrality of the professional community to this notion of communicative accountability.

In the case of the BCBS the only relevant model is the one that Shapiro and Fisher call ‘deliberative-constitutive’ and this is linked directly to the role of the professional community as the forum within which the regulatory decisions of the Committee and of its member agencies are confronted. I argue that the ‘inner conversation’ of the professional community of banking regulators mediates the work of the Committee. Therefore, defection from decisions taken by the Committee’s members can be punished through reduction in professional standing and status among the community of banking regulators.

In sum, even without a public mandate based on international law, the BCBS produces soft regulation. According to some authors⁴⁴², the BCBS’ soft standards make sense given the complexity of the matters the Committee deals with (e.g., global financial regulation) and the very high sovereignty costs that states would have to pay in

⁴⁴¹ Sidney Shapiro, Elizabeth Fisher, ‘Chevron and the Legitimacy of “Expert” Public Administration’ (n 437).

⁴⁴² Kenneth W. Abbott and Duncan Snidal ‘The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State’ (n 358).

order to create an IO under public international law. Besides, the expert community behind the BCBS provides technical knowledge that eases the convergence upon common solutions to the complex problems of financial globalization. More importantly, however, the BCBS has a powerful incentive for compliance. That incentive is intrinsically related to the professional community, to which the Committee's members belong to, which, in turn, attaches higher reputational costs given the case there is defection from any of the Committee's members or their institutions⁴⁴³.

This means that the governance of the Committee, even when lacking a public mandate from a treaty, is not haphazard. I argue comes from the professional community to which the BCBS belongs to. The reason for this is that the Committee deals with complex problems and needs a special kind of expertise to do so. The specialisation of the BCBS stems from that of its members' agencies that, at least from the middle of the past century, have been technically autonomous⁴⁴⁴.

The way the BCBS regulates has been very influential and – at least according to some authors⁴⁴⁵ – a necessary part for global financial regulation. This form of soft regulation, however, has also clear accountability deficits. From the public international perspective there is a lack of clarity regarding which actors or institutions could hold the BCBS accountable. Additionally, from the democratic governance field, institutions like the BCBS lack enough representativeness. While the Committee affects many countries, banks, firms, and potentially people through the various mechanisms that I have explained in this chapter, the BCBS' representation is limited to regulatory agencies and

⁴⁴³ Andrew Abbot, *The System of Professions* (n 383).

⁴⁴⁴ Michael McCubbins, Roger G Noll, Barry R Weingast, 'Administrative Procedures as Instruments of Political Control' (1987) 3 *Journal of Law, Economics and Organization*, 848.

⁴⁴⁵ Howard Davies, David Green *Global Financial Regulation: The Essential Guide* (n 327); Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

central banks from 27 countries. Additionally, not only the people at the BCBS are unelected officials, but also they tend to take their decisions without transparency and a clear delegation of powers from their home legislatures. In the next and last section of this chapter I discuss these accountability deficits.

4. Conclusion: The challenge of the BCBS' accountability

In this chapter I have explained that the BCBS exercises regulatory power because it shapes its regulatees' conduct by mechanisms of standard-setting, information-gathering, and behaviour-modification. I have emphasized that the Committee is more than a mere coordination forum for banking regulatory authorities because, although domestic regulatory agencies have a seat at the BCBS, the decisions taken are different than those that each agency would have taken individually. In a sense member countries delegate in a soft manner the authority to set plausible avenues for solving transnational banking issues.

Additionally, the problem of cross-border banking can only be tackled at the transnational level. In this vein, since the 2008 financial crisis the BCBS has increased its visibility to global media, both specialised in finance and not, which in turn has increased the pressure on the Committee to efficiently provide workable standards.

This chapter has explained that, without a public mandate, the BCBS exercises regulatory power through soft law. Given the context of transnational governance in which the Committee works, however, there are particular mechanisms that incentivise the adoption of its standards. These are market discipline, institutional discipline, peer informal reports, and most importantly the reputational cost of defection in the eyes of

the professional community of banking regulators and supervisors. Accordingly, I argue that one of the most important drivers for compliance – both by countries and by banks – is the endorsement that the standards and best practices of the Committee have from the relevant professional community of banking regulators.

I explained that according to Fisher and Shapiro the work of expert regulatory agencies (both at the domestic and at the transnational level) has two dimensions which are the ‘rational-instrumental’ and the ‘deliberative-conventional.’⁴⁴⁶ The BCBS is not an exception to this analysis. In the Committee’s case, the ‘deliberative-conventional’ dimension corresponds to the internal conversation within the community of banking regulators and supervisors and has its own ways of endorsing a decision from the BCBS and legitimating it. At the same time, the ‘rational-instrumental’ dimension of the BCBS’ work is more uncertain because the Committee lacks a clear and accepted source of legitimacy.

The dynamics of financial TRNs like the BCBS move away from legalization.

Abbot and Snidal understand legalization as:

...a specific form of discourse requiring justification and persuasion in terms of applicable rules and pertinent facts, and emphasizing factors such as text, precedents, analogies, and practice. Legal discourse largely disqualifies arguments based solely on interests and preferences. The nature of this discourse affords legal professionals a prominent role. When authority is delegated to adjudicative institutions, proceedings can be highly formalized. Even without strong delegation, however, this discourse imposes some constraint on state action: governments will incur reputational costs within the legal community, and often beyond, if they act without a defensible position or without reasonable efforts to justify their conduct in legal terms.⁴⁴⁷

⁴⁴⁶ Sidney Shapiro, Elizabeth Fisher, ‘Chevron and the Legitimacy of “Expert” Public Administration’ (n 437).

⁴⁴⁷ Abbott, Duncan Snidal, ‘Hard and Soft Law in International Governance’ (n 62), 423.

Chapter 1 introduced the idea that as more problems in current times become transnational, the ability of *legalised* national law to structure and make sense of these matters diminishes. In this guise, some authors have coined the concept of ‘post-national law’⁴⁴⁸ in which the ‘classical distinction between the domestic and international spheres that had sustained them is increasingly blurred, with a multitude of formal and informal connections taking the place of what once were relatively clear rules and categories.’⁴⁴⁹ Post national law acknowledges that the role of national states is still relevant; however, states no longer can be the principal locus for both national and international governance⁴⁵⁰. This development is clearly the case of the BCBS and the governance structures that uphold its work.

The challenge for post-national governance is to find or construct legitimating categories that help us make sense of these novel mechanisms such as TRNs. So far their legitimacy comes – and as long as this is possible – from the better outcomes that TRNs bring, particularly in comparison with their alternatives (e.g., domestic agencies and IOs). Two challenges are highly important, however, first the democratic governance of TRNs and that their work is based on the rule of law⁴⁵¹.

Both discussions are necessarily embedded in the post-Westphalian order that dominated the Western world since 1648 and, by extension, the complete system of international law. Accordingly, it is hard to leave those political and legal categories that have dominated the world for the past three centuries⁴⁵². Perhaps it is early to understand the changes undergoing as we speak, however, in the meanwhile some have proposed alternative models to make sense of post-national governance.

⁴⁴⁸ Jurgen Habermas, *The Postnational Constellation* (n 89).

⁴⁴⁹ Niko Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68), loc. 578.

⁴⁵⁰ *ibid*, loc. 578

⁴⁵¹ *ibid*, loc. 4673

⁴⁵² Randall Lesaffer, *European Legal History* (n 401).

The lack of a centralized hierarchy in transnational governance has made it harder, if not impossible, to apply the principal-agent model that is so common to explain the delegation of authority in national states⁴⁵³. In this guise, Kingsbury argues that this absence of principals and agents creates ‘anomalous’ administrative law⁴⁵⁴ which in the context of the European Union, Sabel and Zeitlin call ‘experimentalist governance’⁴⁵⁵. Experimentalist governance is based on a constructive process of trial and error over time that cannot be traced back to a single locus of power. The work of the BCBS is similar to this trend that Krisch, Kingsbury, and Sabel and Zeitlin spell out⁴⁵⁶. The Committee provides standards to tackle cross-border banking problems but without a clear public mandate or a well identified ‘principal.’

In this chapter I have explained some soft law mechanisms by which the Committee enforces its standards. In the following chapters I will continue with my quest for an analysis of innovative forms of accountability of the Committee itself. It is clear that accountability of the BCBS is nowhere to be found in the universe of institutions that belong to public international law or in the constitutional framework of the states.

The accountability of the BCBS will hardly resemble the action of a democratically elected legislature that sets objectives and delegates authority to an administrative branch, which in turn is periodically reviewed by the legislature to find if

⁴⁵³ Mark Thatcher, David Cohen, ‘Reshaping European Regulatory Space: An Evolutionary Analysis’ (n 80).

⁴⁵⁴ Benedict Kingsbury, Nico Krisch, Richard B Stewart ‘The Emergence of Global Administrative Law’ (n 87).

⁴⁵⁵ Charles F Sabel, Johathan Zeitlin, *Experimentalist Governance in the EU: Towards a New Architecture* (OUP 2010).

⁴⁵⁶ The European Union is perhaps a context where these novel structures of post-national governance are better established See also: Adrienne Heritier, Dirk Lehmkuhl ‘The Shadow of Hierarchy and New modes of Governance’ (n 374); Mark Thatcher, David Cohen, ‘Reshaping European Regulatory Space: An Evolutionary Analysis’ (n 80).

it complied with the goals that legislators set out⁴⁵⁷. Those accountability mechanisms in the work of the BCBS, however should be able to render the Committee accountable in the context of ‘anomalous’ administrative law⁴⁵⁸.

The next chapters develop a socio-legal perspective to find accountability mechanisms for transnational governance in a global context. I seek especially to transfer democratic accountability into a context where it is impossible to create ‘state-like’ structures to legitimise or hold accountable the work of TRN’s like the BCBS. A socio-legal approach towards the work of TRNs might provide qualitative evidence about alternative accountability mechanisms in relation to the work of this type of networks⁴⁵⁹.

As it is no longer plausible to turn back to the legal and political structures of the state for inspiration I suggest – from a socio-legal point of view – to focus on the current international practice that surrounds the BCBS and other financial TRNs to understand how they are actually held ‘accountable’ in innovative ways by banking regulators and to find ways in which they could enhance their accountability.

⁴⁵⁷ Charles F Sabel, Johathan Zeitlin, *Experimentalist Governance in the EU: Towards a New Architecture*, (n 455), 10.

⁴⁵⁸ *ibid.*

⁴⁵⁹ Cecilia J Flores Elizondo, *Reflexive international economic law: balancing economic and social goals in the construction of law*, in Amanda Perry-Kessaris (ed.) *Socio-Legal Approaches to International Economic Law: Text, Context, Subtext* (Routledge 2013).

Chapter 5. The quest for a definition of public accountability beyond the state: a working concept of accountability

1. Introduction: the challenges of understanding accountability

This thesis aims at exploring accountability in transnational banking regulation. As I discussed in chapter 4, global banking standards and their enforcement are a form of regulation. Therefore I ask whether the lack of formal mechanisms of accountability should be taken as an absolute absence of accountability. In order to answer these questions I need a minimal notion of accountability that could apply to unsettled polities.

The minimal definition of accountability that is at the centre of my working concept of accountability seeks to be, on the one hand, wide enough to cover and identify accountability phenomena in different contexts, outside the state and other settled polities⁴⁶⁰, and in settings with high ambiguity. On the other hand, it is narrow enough to define those core accountability processes that set them apart from other phenomena that, although related to accountability, should not be confused with it (e.g., transparency, responsibility, good governance, legitimacy, etc.).

Chapter 1 explained that accountability is a ‘buzzword’ often mentioned in the regulatory and political discourse⁴⁶¹. Mulgan, among others, has highlighted that the concept of accountability encompasses too many phenomena⁴⁶². For him, accountability should remain in the realms of a ‘linguistically conservative end of this spectrum which

⁴⁶⁰ Johann Olsen, ‘Accountability and Ambiguity’ in Mark Bovens, Robert E Goodin, Thomas Schillemans (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

⁴⁶¹ Political science and regulatory studies are not the only disciplines that have discussed accountability. International Relations, Social Psychology, Constitutional Law and Business Administration have also dealt with the concept. Mark Bovens, ‘Introduction’ in Mark, Bovens, Thomas Schillemans and Goodin (2014) *the Oxford Handbook of Public Accountability* (OUP 2014).

⁴⁶² Richard Mulgan, ‘Accountability: An Ever-Expanding Concept?’ (2000) 78 *Public Administration* 3.

restricts “accountability” to its assumed core and places particular emphasis on holding the powerful to account through political and legal channels of external scrutiny and sanctions.’⁴⁶³ Accountability, however and contrary to what one would assume by its wide usage, does not have a unique sense⁴⁶⁴.

In public administration and regulation, accountability is used most of the times as a feature of good government, and an attribute that should shape the exercise of public powers by regulators and political institutions alike⁴⁶⁵. But lacking a concrete meaning has not deterred politicians and regulators alike from mentioning the word multiple times. On other occasions accountability is used as synonymous to transparency, legitimacy and good governance.

If we accept, with Mulgan, that accountability should stay very close to its assumed core and we notice that its limits and concrete definition, however, are mostly vague in their usage, then it would be convenient to define the core of accountability. This chapter’s goal is thus to delineate a minimal concept of accountability – the working definition – to muddle through the ambiguity that seems to be at the centre of debates about accountability.

The working definition is also conceived as a tool for the research that I have conducted. The elements of the working definition of accountability are useful to understand the core elements of the concept, but they also serve as an empirical tool for identifying accountability processes, especially in those contexts where the observer has to be open to find innovative ways of portraying accountability. As I explained in chapter 2, transnational governance is one of these contexts of increased ambiguity

⁴⁶³ *ibid*, 591

⁴⁶⁴ Mark Bovens ‘Public Accountability’ in E Ferlie, L Lynne, C Pollitt (eds.) *The Oxford Handbook of Public Management* (OUP 2005), 182; Andreas Schedler *¿Qué es la Rendición de Cuentas?* (IFAI 2004), 13.

⁴⁶⁵ Robert Baldwin, Martin Cave, Martin Lodge, *Understanding Regulation* (n 164).

because, among other reasons, there is little presence of the state. This is important because not all accountability mechanisms resemble those accountability processes that occur in the context of the state (i.e., those mechanisms typical of liberal democracies and that I explained in chapter 1). While it is true that parliamentary hearings, judicial review, elections or bureaucratic procedures are known mechanisms for accountability processes, it is also true that such mechanisms do not by themselves encompass all possible accountability mechanisms (e.g., social, professional, commercial, etc.).

There is a nascent – but robust – scholarship that has analysed the dynamics of accountability in various contexts and has listed those features that make the concept – and the political phenomena the concept applies to – distinctive⁴⁶⁶. I use some ideas and models developed by this academic literature to narrow down a concept of accountability that is applicable to the complex and ambiguous environment of transnational regulation.

The chapter discusses whether it is possible to find a concept of accountability applicable to the idiosyncrasies of transnational regulation that I have put forward in chapter 1. In the specialized literature about accountability, however there are three main problems: 1) accountability seems to be a cultural keyword; 2) most of the literature portrays accountability in the context of settled polities; and 3) the specialized literature speaks only marginally and always in a fragmented way, this means that there are various – sometimes contradictory – concepts of accountability that do not converge in a unified discussion. The second half of the chapter sets out to identify what are the essential features of an accountability mechanism. An analysis of these accountability mechanisms forms an important aspect of delineating a concept of accountability in

⁴⁶⁶ Mark Bovens, Robert E. Goodin, and Thomas Schillemans *The Oxford Handbook of Public Accountability* (OUP 2014).

order to develop the working concept of accountability and the notion of communicative accountability of chapter 7. Furthermore, I distinguish this working concept of accountability from a form of participation, political activism, or application of the rule of law. The goal of the second part of the chapter is to develop a methodological tool – the working concept of accountability – to identify accountability mechanisms both in settled polities⁴⁶⁷ such as the ones of nation states (which include courts, parliaments, as well as bureaucracies) and in unsettled polities (such as countries with limited democratic institutions or transnational governance in the context of globalisation).

The chapter concludes by putting forward the working definition of accountability. For the purpose of this working concept, accountability is the process, by which one or more external claims are issued requesting and obtaining a justification or explanation from a person or organization that exercises regulatory power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow. I argue that the justification in any accountability process always resonates with a forum that takes the form of an epistemic or professional community.

The next chapter develops a specific idea of communicative accountability as a way of explaining the unity, success as well as failure of accountability mechanisms in the context of transnational regulation. As the reader will see in chapter 7 of this thesis, both the working concept of accountability and the idea of communicative accountability are instrumental to the research conducted during the DPhil. While the working concept of accountability identifies the minimal elements of an accountability

⁴⁶⁷ Johann Olsen, ‘Accountability and Ambiguity’ (n 460).

process, the concept of communicative accountability applies a Luhmannian framework to identify these elements in communication chains.

2. The quest for accountability

Despite accountability's omnipresence in political and regulatory discourse, a clear definition is not always provided. While that definition should not be simple to obtain, one would assume that, at least most of the actors that use the term agree on what being accountable means. As I explain in this chapter's introduction, such unity of thought is however more difficult to find than it would appear at first sight. Inconsistencies and disparities rise when analysing the usage of the word 'accountable' and 'accountability' attached to public policies and the exercise of public powers by various organizations .

An explanation of the ambiguity surrounding accountability might be that the word is a key cultural concept and, as such, it touches several realms and disciplines. A cultural concept is a key word that defines a culture or a social change⁴⁶⁸. According to Dubnick accountability has ceased to be only an element of the toolbox for good government and it provides legitimacy to everything it touches as well. Like other cultural concepts, the problem with this perspective is that accountability runs the risk of becoming a mere buzzword⁴⁶⁹.

This chapter argues, however, that accountability is indeed an essential characteristic of a successful policy and a concept of accountability is very relevant for the current discussion of both global and domestic governance. Accountability has a

⁴⁶⁸ Melvin Dubnick, 'Accountability as a Cultural Keyword' in Mark Bovens, Robert E Goodin, Thomas Schillemans (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

⁴⁶⁹ Christopher Pollit, Peter Hupe 'Talking about Government: The Role of Magic Concepts' (2011) 13 *Public Management Review* 5; Sina Odugbemi, Timothy Lee, *Accountability through Public Opinion: From Inertia to Public Action* (n 13).

distinctive identity, both in theory and in practice. It is a relevant component of the ‘arsenal’ of good government too⁴⁷⁰.

Mark Bovens acknowledges that there is a temptation to speak about accountability from the scratch every time an author finds that that concept relates to his/her area of expertise⁴⁷¹: a temptation to ‘reinvent the wheel’ in each scholarly article, book, or publication, thus creating a fragmented discussion about accountability. That is, and following Bovens, Schillemans, and Goodin⁴⁷², that accountability has a different meaning and different implications in the context of social psychology⁴⁷³, accountancy⁴⁷⁴, public policy and public management⁴⁷⁵, political science⁴⁷⁶, or international relations⁴⁷⁷. Therefore, to find common ground between the different languages and models used to speak about accountability has proved difficult.

This section sets out to review the relevant literature on accountability in order to define a working concept. The next section identifies and explains the most relevant characteristics of accountability. Both sections intend to flesh out the working concept of accountability, which is summarized in the last part of this chapter. As has been said in the introductory section of the chapter, the working concept has two objectives: first,

⁴⁷⁰ Mark Bovens, Thomas Schillemans, Paul ‘T Hart, ‘Does Public Accountability Work? An Assessment Tool’ (2008) 86 *Public Administration* 1, 225-242.

⁴⁷¹ Mark Bovens, ‘Two Concepts of Accountability: Accountability as a Virtue and as Mechanism’ (2010) 33 *West European Politics* 5.

⁴⁷² Mark Bovens, Thomas Schillemans, Robert E Goodin ‘Public Accountability’ in Mark Bovens, Thomas Schillemans, Robert Ee Goodin (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

⁴⁷³ Philip E Tetlock, Jae Il Kim, ‘Accountability and Judgment Processes in a Personality Prediction Task’ (1987) 52 *Journal of Personality and Social Psychology* 4, 700

⁴⁷⁴ Martin Messner, ‘The limits of accountability’ (2009) 34 *Accounting, Organizations and Society* 8, 918-938; Michael Power *The Audit Society: Rituals of Verification* (OUP 1997).

⁴⁷⁵ Patricia Day and Rudolf Klein, *Accountabilities: Five Public Services* (n 14); Barbara S Romzek, Melvin J Dubnick, ‘Accountability in the Public Sector: Lessons from the Challenger Tragedy’ (n 14);

⁴⁷⁶ Sean Gailmard, ‘Accountability and Principal-Agent Theory’ in Mark Bovens, Thomas Schillemans, Robert E Goodin (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

⁴⁷⁷ Jan Klabbers *An Introduction to International Institutional Law*, (Cambridge University Press 2002); Robert Keohane ‘Global Governance and Democratic Accountability’ (n 53)); Robert Keohane, ‘The Concept of Accountability in World Politics and the Use of Force’ (2003) 24 *Michigan Journal of International Law* 11; Enrique Carrasco, Alison K Guersnsey, ‘The World Bank Inspection Panel: Promoting True Accountability through Arbitration’ (2006) *Cornell International Law Journal* 41; Philipp Dann, ‘Accountability in Development Aid Law: the World Bank, UNDP, and Emerging Structures of Transnational Oversight’, (2006) *Archiv des Völkerrechts* 44, 381-404.

to pin down what I mean by ‘accountability’ for the purposes of this thesis, and second, to provide a heuristic for identifying instances of accountability processes through the qualitative data.

a) Accountability as a key cultural concept

A reason why there is not a unified notion of accountability might be because the concept is not univocal. Accountability means different things to different people and in different contexts. With Dubnick⁴⁷⁸, I agree that accountability is a cultural phenomenon and its understanding exceeds a simple definition. For the author, accountability is embedded in the cultural categories with which we portray our political systems and our societies. This means that accountability’s definition in stricter terms needs a cultural context without which it cannot be understood. This also means that accountability is a descriptive as well as a normative concept. It is descriptive because it defines a real phenomenon in society⁴⁷⁹, but it is also a normative concept because it defines how society and governance should be.

When policy makers and regulators use the word accountability they might refer to particular mechanisms to review the performance of political institutions or, in contrast, they could be speaking more broadly about a quality of public life. Thus, increasing accountability could either mean increasing the virtuous outcome of government or putting in place or improving the mechanisms for controlling a particular branch of government.

⁴⁷⁸ Melvin Dubnick, ‘Accountability as a Cultural Keyword’ (n 468).

⁴⁷⁹ The Oxford English Dictionary defines accountability as “The quality of being accountable; liability to account for an answer for one’s conduct, performance of duties, etc. (in modern use often with regard to parliamentary, corporate, or financial liability to the public, shareholders, etc.); responsibility.”

This dichotomy of accountability as a mechanism and accountability as a virtue – or a good quality of governance – has been explained by Bovens⁴⁸⁰ who argues that accountability tends to mean a particular mechanism in the European context and a virtue in the United States⁴⁸¹. For Bovens, accountability is sometimes a way of speaking about a set of standards that lift up political life, and one or more mechanisms which control public officials and institutions; regardless of whether they improve the ethical exercise of power or, on the contrary, may even worsen it.

But additionally to the dichotomy explained by Bovens⁴⁸², accountability as a cultural keyword also means that the concept gets its meaning from a diversity of contexts that multiply the potential nuances of accountability. These adjectives are linked to particular areas of professional knowledge or public life, thus, for example, corporate accountability is different from financial, democratic, or organizational accountability⁴⁸³.

For Dubnick, the concept of accountability can no longer be defined with reference to dictionaries, to its etymology, or to its usage in past times (i.e., before the 1980s)⁴⁸⁴. On the contrary, accountability has evolved in practice as a concept that encompasses a range of other related phenomena. This happens when accountability is taken to refer to transparency, legitimacy, good governance, or responsibility too. These phenomena are intrinsically linked to accountability but should not be taken as synonymous words. This confusion is exemplified when a journalistic piece complained about the lack of legal consequences for any member of the banking community for the losses caused by the financial crisis of 2007-2008 and demanded that someone should

⁴⁸⁰ Mark Bovens, 'Two Concepts of Accountability: Accountability as a Virtue and as Mechanism' (n 471).

⁴⁸¹ For instance, the General Accountability Office of the U.S. mentions 'accountability' as one of its core values. See: <www.gao.gov/about/index.html> Accessed 1 March 2015.

⁴⁸² Mark Bovens, 'Two Concepts of Accountability: Accountability as a Virtue and as Mechanism' (n 471).

⁴⁸³ Melvin Dubnick, 'Accountability as a Cultural Keyword' (n 468).

⁴⁸⁴ *ibid.*

be rendered accountable⁴⁸⁵. In this example the word ‘accountability’ is being used as meaning legal liability. But I suggest that the words, though related, are not exact synonyms.

On the other hand the meaning of accountability is not univocal because it can mean different things in different contexts. To recognize this is an important aspect of this thesis’ theoretical framework because it sheds light on the fact that accountability is highly dependent upon the context within which it operates.

One element of this context is precisely the common understandings and expectations shared among an epistemic community. The fact that accountability is nuanced by a community’s common understandings highlights the need for a *minimal* notion of accountability capable of applying across various epistemic communities (i.e. specialised in politics, human rights, public administration, and banking regulation, to name a few). Accountability’s diversity, however, should be based on a robust concept that allows the observer to identify the phenomenon even when different milieus modify the contexts. The next section explains the challenge of structuring a working concept of accountability that applies to global or transnational governance and to transnational banking regulation in particular.

b) Accountability dependence on the context of the nation-state

The scholarly literature about accountability is lopsided in favour of the nation-State. This comes as no surprise because most governments in particular in the Northern hemisphere for the past two or three hundred years (in Europe since the peace of

⁴⁸⁵ See: Tatiana Siegel ‘Brad Pitt Wants Justice for Victims of Financial Collapse...’ *The Hollywood Reporter*, (Los Angeles 12 February 2015), see: <www.hollywoodreporter.com/news/brad-pitt-lack-accountability-financial-844588> Accessed 17 March 2015.

Westphalia) have been centred on sovereign nation-States⁴⁸⁶. Nevertheless the political and sociological categories upon which the state is built run the risk of contaminating the concept of accountability so much so it is no longer feasible to apply it to other forms of governance that loom in the shadow of the State⁴⁸⁷.

When studying accountability some authors have stressed the role that the principal-agent relationship plays⁴⁸⁸. Principal-agent theory is a construct of rational choice theory which seeks to explain those relationships where one party commands and the other obeys. Under the umbrella of rational choice, authors like Niskanen⁴⁸⁹; Tullock, Seldon, and Brady⁴⁹⁰; as well as Tullock and Buchanan⁴⁹¹ have theorized ways by which public servants in bureaucracies have the incentives to disclose the information they have – and their principals do not – and to behave in the best interest of their principals⁴⁹².

The existence of principals and agents, however, correlates nicely with one of the foundational assumptions of the modern-state: the sovereignty of ‘the People’ (the capital letter is intentional here). As it is widely known, political philosophers like Francisco Suarez⁴⁹³, Thomas Hobbes⁴⁹⁴ and Jean Jacques Rousseau⁴⁹⁵ were highly influential in creating the philosophical foundation of liberal states. In one way or another, they based their theories on the people as a whole as the original source of

⁴⁸⁶ Randal Lesaffer, *European Legal History* n 368.

⁴⁸⁷ Gordon Tullock, James Buchanan, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (n 370).

⁴⁸⁸ Gailmard, Sean (2014) ‘Accountability and Principal-Agent Theory’ (n 476).

⁴⁸⁹ Niskanen, William ‘The Peculiar Economics of Bureaucracy’ (1968) 58 *The American Economic Review* 2, 293-305.

⁴⁹⁰ Gordon Tullock, Arthur Seldon, Gordon Brady, *Government: Whose Obedient Servant?*, (Institute of Economic Affairs 2000).

⁴⁹¹ Gordon Tullock, James Buchanan, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (n 370).

⁴⁹² Michael McCubbins, Roger G Noll, Barry R Weingast, ‘Administrative Procedures as Instruments of Political Control’ (n 444).

⁴⁹³ Francisco Suarez, *Las Leyes* (First published 1612, Centro de Estudios Constitucionales de Madrid 1967).

⁴⁹⁴ Thomas Hobbes, *The Leviathan* (First published 1651, Penguin 2000).

⁴⁹⁵ Jean Jacques Rousseau *The Social Contract* (First published 1762, Penguin 2003).

sovereignty and the ones entitled with the right to rule themselves, which in turn they delegate to the government (the King, a Commonwealth or the State). The correlative obligation of the rulers – and the very motive why they rule – is to seek the *common good* of the people or, according to the more modern thinkers, to protect their individual liberties⁴⁹⁶.

But in other settings (i.e., unsettled polities like the context of transnational governance) it is harder to find a clear distinction between principals and agents and, in those cases where that relationship is not clear, the status of principal or agent might not be permanent. In these alternative settings it is also harder to make sense of a clear mandate from an imaginary (and not at all coherent) *demos* which delegates power to the officials in charge of transnational regulation.

Delegation from the people to the government is a key assumption for understanding the philosophical foundations and the workings of the State. In this context it is natural to stress the element of control in accountability and those elements which are naturally found in States: democratic elections, democratic mandates, division of powers, constitutions, servants and masters, etc. These concepts are often referred to discuss accountability.

First, there is a common association of accountability with democracy: “Discourses on democracies reflect an assumption that some form of accountability to the public is among the defining features of political systems that warrant that label. An accountable government is more often than not understood to be democratic, and vice versa.”⁴⁹⁷ Second, in other contributions to the literature about accountability, elections are a major mechanism for accountability because they prize or punish the performance

⁴⁹⁶ JG Merquior, *Rousseau and Weber, Two studies in the theory of legitimacy*, (Routledge & Kegan Paul 1980); Paschalis Kitromilides ‘Enlightenment and Legitimacy’, in Athanasios Moulakis (ed.) *Legitimacy/Legitimé* (Walter de Gruyter 1986).

⁴⁹⁷ Melvin Dubnick, ‘Accountability as a Cultural Keyword’ (n 468), 32.

of governments⁴⁹⁸. And third, constitutions seem to play a very important role in structuring accountability in the state⁴⁹⁹.

As I explained in chapter 1, however, it is difficult – if not impossible – to find a state-like hierarchy in transnational regulation. The temptation is to assume that, because it lacks any resemblance with the structure of the state, transnational regulation should transform itself in the image of the state’s institutions and create elections, delegation of powers, constitutions and so on⁵⁰⁰. But, even if it were feasible, there is a need to study the empirical workings of accountability in transnational regulation first, which might not chime with the political categories embedded in the state.

That is why our minimal notion of accountability needs to be independent of the political categories of the state. While these categories are indeed important, they might also limit the quest for accountability in global financial regulation because they closely relate to political realities – those that belong to the state – that are different or inexistent in transnational regulation. In the next section I discuss ambiguity of the concept of accountability as a third problem for developing a working definition of accountability.

c) Accountability in the context of ambiguity

In terms of Max Weber’s⁵⁰¹ classic notion of social action, ambiguity means that one actor does not have a clear idea of how other actors might react to his/her behaviour. In organizational terms, this means, in addition, that decision making in a given organization is not the outcome of a linear process in which the result is foreseeable

⁴⁹⁸ Adam Przeworski, S. C. Stokes, B. Manin, *Democracy, Accountability, and Representation*, (Cambridge University Press 1999).

⁴⁹⁹ Carol Harlow ‘Accountability and Constitutional Law’ in Mark Bovens, Robert E Goodin, Thomas Schillemans (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

⁵⁰⁰ Though some authors try a version of scaling up the state’s institutions into transnational governance. See: James Bohman ‘From Demos to Demoi: Democracy Across Borders’ (n 94); Jurgen Habermas, *The Postnational Constellation* (n 89).

⁵⁰¹ *ibid.*

from the beginning. Perfect rationality in decision-making would entail that the consideration of all possible outcomes and all possible consequences is viable. On the contrary, however, and as Herbert Simon puts it, humans and therefore organizations act in accordance with bounded rationality⁵⁰². Hence, it is impossible to know all probable outcomes and their repercussions at any given time.

March and Olsen followed Simon's and other author's⁵⁰³ ideas and developed a model of decision-making based on experience rather than perfect rationality⁵⁰⁴. For these authors, routines follow from processes of trial and error in which past experience is paramount. Ambiguity is typically reduced when there is a known course of action among a group of actors with legitimacy, so there is more certainty about which process to follow and/or the expected outcome.

In this vein, there are various and sometimes conflicting accountability risks to individuals or organisations that might arise as a result of a given course of action⁵⁰⁵. Accountability risks are the different possibilities of being held accountable from different accountability regimes. The literature about accountability, however, tends to explore the phenomenon in settings with limited uncertainty, leaving aside what Olsen calls 'unsettled polities' which lack 'well-entrenched institutions staffed by experienced, well-socialized people performing socially standardized activities'⁵⁰⁶. In contrast to this, 'unsettled polities' have 'weak or competing institutions, staffed by inexperienced personnel doing novel things.'⁵⁰⁷ Whereas ambiguity is a consequence of life and it is

⁵⁰² Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (The free press 1997); Herbert Simon 'A Behavioral Model of Rational Choice' (1955) 69 *The Quarterly Journal of Economics* 1, 99-118.

⁵⁰³ Richard Cyert and James G. March *A Behavioral Theory of the Firm* (Prentice Hall 1963 1992)

⁵⁰⁴ James G March, Johann Olsen, 'The Uncertainty of the Past: Organizational Learning Under Ambiguity' (1975) *European Journal of Political Research* 3 147-171.

⁵⁰⁵ Gerry Mashaw 'Accountability and Institutional Design: Some Thoughts on the Grammar of Governance' in Michael W Dowdle, Ed. *Public Accountability, Designs, Dilemmas and Experiences* (2006 Cambridge University Press).

⁵⁰⁶ Johann Olsen, 'Accountability and Ambiguity' (n 460), 143.

⁵⁰⁷ *idem*.

impossible to get rid of it entirely, ‘settled polities’ are able to reduce ambiguity by institutionalising social processes and thus establishing some barriers to keep it at bay⁵⁰⁸.

The problem of not addressing ambiguity in accountability properly is a variant of the dominant narrative of accountability which foregrounds the state, described in the previous section, but it is not strictly the same. Nation-states – often referred to as ‘Western liberal democracies’ – are a source of most of the examples that we come across in the scholarly literature about accountability. Besides, most Western countries are societies with a high level of institutionalization and thus less ambiguity.

Additionally though, other political subunits and other forms of social organisation (e.g., companies, NGOs, international organisations, universities, etc.) are ‘settled polities’ as well, which share with well-developed liberal democracies the characteristic of less ambiguity when dealing with the allocation of blame and sanctions. Their rich institutional life creates a diverse toolbox of processes and mechanisms to hold the powerful to account.

Although it is necessary to study accountability in the context of institutionally developed polities⁵⁰⁹, its analysis should not be limited to those contexts alone, as this thesis argues. The literature about accountability, however, has only marginally explored unsettled polities that possess greater ambiguity⁵¹⁰ than highly institutionalized organizations and states.

Unlike Western liberal democracies and other highly institutionalised forms of organisation, the BCBS and other financial TRNs are surrounded by a context of great complexity and ambiguity. In the Basel Committee’s case ambiguity may result from

⁵⁰⁸ *idem*.

⁵⁰⁹ Chapter 1 has already mentioned that liberal democracies and domestic jurisdictions also have an accountability gap created by those political relationships that do not resemble the principal-agent model.

⁵¹⁰ Robert Keohane (2003) ‘Global Governance and Democratic Accountability’ (n 53).

the high complexity that banking and financial practice has, as well as from the particular status that the BCBS possesses as an informal TRN. As earlier chapters of the thesis have argued, the Committee emerged as an instrument to tackle cross-border banking and coordinate its regulation. With time, however, and as chapters 2 and 3 explained, it has become more than a coordination mechanism controlled by its members and has turned into something similar to a transnational regulatory agency.

Nevertheless, unlike other IOs that must deal with ambiguity too, the BCBS lacks a public mandate that provides certainty to its work. Paradoxically, instead of being an opportunity, the lack of accountability in the BCBS' work may come as a disadvantage. Because there is not a clear source of its powers, the Committee faces more accountability risks coming from diverse perspectives (e.g., the legal national and international system, the political system, the professional system, NGOs etc.). The academic literature specialised on accountability has coined this problem as 'the problem of many eyes' which typically happens when public organisations that exercise power are subject to different accountability forums, and each one of them – at least potentially – can render diverse judgements on the accountee⁵¹¹. The BCBS has experienced at least three different types of accountability claims that come from different perspectives. First, social accountability has come the Committee's way in the form of criticism from non specialists in financial regulation. Due to the catastrophic consequences of the 2007-2008 financial crisis on ordinary people's assets, the reputation of banks, bankers and banking regulators (including the Committee) has waned⁵¹². Second, some comments on the BCBS's work have come from economists who criticise the consequences Basel III had for the global economy or for the economy

⁵¹¹ Mark Bovens 'Analysing and Assessing Public Accountability. A Conceptual Framework' (2006) *European Governance Papers No. C-06-01*; Mark Bovens, Thomas Schillemans and Paul 'T Hart' 'Does Public Accountability Work? An Assessment Tool' (n 470).

⁵¹² N+1 *The Problem are The Banks: Letters to Wallstreet* (n 6)

of a particular country⁵¹³. Finally, several comments revolve around the good and evils of the BCBS' work judged against the regulatory objectives of banking regulation⁵¹⁴. As chapter 7 will argue, the BCBS tends to engage in conversations that are framed in the specialised language of banking regulation while leaving other accountability claims unanswered.

To transition from high ambiguity of unsettled polities to a settled polity, TRNs like the BCBS need to create structures of expectation. For Luhmann these structures emerge with time and aim at fulfilling the expectations of a particular accountability regime⁵¹⁵. To do so, however, the BCBS needs first to increase certainty about which particular perspective (e.g. the legal, political, banking, economic, or social) will be the relevant framework for holding the Committee accountable. Second, it needs to set the expectations by which others would hold it accountable. Finally, while doing so, it should avoid accountability overloads or what Koppell calls 'Multiple Accountability Disorder.'⁵¹⁶

The process by which an organization like the BCBS manages expectations⁵¹⁷ can be explained by Luhmann's theoretical framework. For the author organizations create 'decision premises' in order to reduce complexity. They set out the organizational ends and the means to get them. For Luhmann, the reference for decisions in the

⁵¹³ Chapter 7 will explain Mr. Jamie Dimon's remarks criticising Basel III for damaging the US' economy.

⁵¹⁴ Chapter 7 will put forward four examples of these criticisms. These examples revolve around minimum capital requirements for SMEs' lending, Basel III complexity, the delay in the implementation of Basel III, and how adequate were the minimum capital standards of Basel II.

⁵¹⁵ Luhmann speaks about 'alter's expectations are fulfilled by ego.' Niklas Luhmann, *Social Systems* (n 100), 308.

⁵¹⁶ Johathan G S Koppell, 'Pathologies of Accountability: ICANN and the Challenge of "Multiple Accountabilities Disorder"'(2005) 65 *Public Administration Review* 1, 94-107; Mark Bovens, Thomas Schillemans 'The Challenge of Multiple Accountability' in Melvin Dubnick, George Frederickson (eds.) *Accountable Governance: Problems and Promises* (n 14).

⁵¹⁷ Dubnick Melvin, Barbara S Romzek, 'Accountability and the Centrality of Expectations in American Public Administration' (1993) 2 *Research in Public Administration* 2, 37.

organization is the organization itself⁵¹⁸. How and what has been decided in the past and how and what is expected to be decided in the future is central for how and what is decided in the present. Luhmann says that the organization decides because a decision has already taken place or to trigger a future decision⁵¹⁹.

Tradition and expectations are greatly influential in the organization's decision making. Tradition means the organization's understanding of past decisions that normally comes as routines; expectations are the assumed decisions the organization plans to take in the future. Expectations also include the decision's outcomes and consequences⁵²⁰. Organizations create routines and directives to avoid uncertainty. While routines are part of tradition (i.e., the processes that an organization has followed in the past), directives belong to expectations. They mandate the *expected* behavior of the organization's units and personnel.

Uncertainty and ambiguity are provoked by complexity. While the modern organization must take decisions within a time limit, it must increase rationality and participation. At the same time that decisions are made during a particular time frame, the rationality and participation is expected to be high. Luhmann explains that rationality is the amount of information that needs to be analysed in order to come up with the best decision among alternatives⁵²¹. Participation grows the social network of the decision relations.⁵²² Both rationality and participation increase the organization's size and complexity. Time, though, limits the amount of rationality and participation

⁵¹⁸ Or, in other words, the organization's past decisions. In complex organizations, past decisions are printed in minutes, emails, circulars, etc. and referred to when a new relevant decision is made.

⁵¹⁹ Luhmann, Niklas *Organización y decisión. Autopoiesis, acción y entendimiento comunicativo*, (UIA-Anthropos 1997), 20. I have translated from the Spanish '...se decide porque se ha decidido o para que se decida'

⁵²⁰ 'El mecanismo que trataremos primera y básicamente, toma en cuenta la particularidad de que no hay otros elementos, salvo decisiones, pero que ninguna decisión puede asegurar todas las otras decisiones con las que ella se relaciona y mediante las cuales se constituye la situación.' *ibid*, 44.

⁵²¹ *ibid*, 27.

⁵²² *ibid*, 28.

that the organization can invest into a decision. But the three variables (time, rationality, and participation) provoke more uncertainty.

Luhmann explains that the organization's decisions are the transition from uncertainty to risk. Uncertainty is present before deciding, when facing multiple alternatives. Risk exists when a decision has already been made and one still does not know what consequences will follow. For Luhmann, the presence of risk or uncertainty is unavoidable. The decision changes uncertainty to risk, but it does not entirely extinguish them – either as risk or uncertainty.

Organizations can decrease uncertainty and risk, however, by creating decision premises⁵²³. To do so, they have four choices according to Luhmann⁵²⁴: 1) past decisions and assets for repetitive use are *stored* for present decisions⁵²⁵; 2) *excuses are prepared* by bringing a past decision to the present or by putting off to the future some of the decision's parts – or the whole decision itself; 3) other people get involved in the decision making process to share responsibility; and 4) who has known what and when is identified in case the public opinion questions the decision. These four choices come up as decision premises because they set the tone both for deciding and for reducing risk or uncertainty⁵²⁶.

For Luhmann, the organization faces a paradox when taking a decision. It must choose among alternatives that are, in principle, equally valid. They are, according to Luhmann, 'undecidable decisions;' choices that cannot be selected without further

⁵²³ Luhmann borrows this concept from James March, Herbert Simon *Organizations* (Wiley 1958); Herbert Simon *Models of bounded rationality* (MIT 1982).

⁵²⁴ Luhmann, Niklas *Organización y decisión. Autopoiesis, acción y entendimiento comunicativo* (n 519), 83.

⁵²⁵ The necessity of organizational routines and standards for future decisión is a characteristic that many authors from the field of Organization Theory highlight. See Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (n 502).

⁵²⁶ Although not the main object of this thesis, it is worth noting that one of the greatest risk or uncertainties that organizations face is the risk of being held accountable with detrimental consequences for the organization.

reference to other deciding rules⁵²⁷. If an alternative stands out by itself, to take it would be the obvious choice at the outset⁵²⁸, and no one would have to choose other alternative. Decision premises are the form organizations have to cope with uncertainty when choosing an apparently equally valid set of alternatives.

Organizations' main general purpose is to reduce uncertainty. They do so by 'avoiding' it⁵²⁹ rather than confront it directly. As explained above, Luhmann thinks that time presses a decision which has to be taken amid uncertainty. It is uncertain whether one decision is better than its alternatives. It is also uncertain whether its consequences will be positive, negative, or neutral. It is finally uncertain the way a decision's consequences will play out with other decisions.⁵³⁰ The organization needs to reduce uncertainty by creating a system of decision-making for those cases where one of the alternatives does not stand out as an obvious choice.

'Decision premises' are 'pre-decisions'⁵³¹, or the decisions that the organization takes about the requirements of future decisions. According to Luhmann, they split into three types. First, decisions about *programming* plan how to decide in the future. They include decisions about the organization's *goals* and what Luhmann calls *conditional programming*. *Goals* decisions set the organization's ends (profit, regulation, a public utility, the military defense, a charity, etc.); *conditional programming* defines the way to proceed in future decisions. It mandates how to decide in the presence of certain events (i.e., *if A then B*). Second, decision premises include choosing the right

⁵²⁷ Which are decisions that the organization has already taken, too.

⁵²⁸ Luhmann calls such a paradox 'undecidable decisions'; See Niklas Luhmann, *Social Systems* (n 100);

⁵²⁹ The idea of avoiding uncertainty rather than eliminating it comes also from Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (n 502).

⁵³⁰ This is particularly clear in the case of the BCBS. With regards to regulatory capital, the Committee had the choice of enforcing it according to a fix rule, or to put in place risk measurements that could be more apt for discriminating each case, or, finally they could design a system based on the market reputation. Instead, the BCBS did the three of them ('the 3 pillars'), and received the criticism of being a system 'too complex'.

⁵³¹ David Seidl, *Luhmann's Theory of Autopoietic Systems* (n 102), 17.

personnel, essential for knowing who is in charge of making a decision at a particular time (and who is responsible too). Third, decision premises define *communication channels*. These are the ways to ‘organize the organization.’⁵³² Hierarchy, for example, is one of these ways, i.e., the expectation that all communication must go vertically, from the inferior to the superior, and not horizontally, across sections or departments. Another example of a communication channel is to mandate that financial matters must be discussed by a committee with a certain quorum and people from the accounts, marketing and human resources department. Finally, a fourth type of decision premise is not intentional; it is rather a result of the organization’s decisions as a whole. Luhmann calls it the ‘undecidable premise’ and it is equivalent to what other authors call organizational culture⁵³³.

Without avoiding uncertainty, decision premises minimize uncertainty’s consequences for the organization. Using decision premises, the organization decides how to take the best decision. Similarly to what Herbert Simon⁵³⁴ proposed, this does not mean that the decision taken is actually the best *objective* choice among other alternatives. Decision premises assure, however, that the decision was taken according to the rules. They also assure that, if the decision’s effects are not quite what was expected, at least the organization can issue a justification saying that it decided following ‘standard’ procedure. The justification may add that the procedure will change in view of current events⁵³⁵.

⁵³² *ibid*, 18.

⁵³³ Seidl puts the example of a sequence of decisions that hire only men in an organization. Even without a decision to hire only men, future decisions may follow the same trend. David Seidl, *Luhmann’s Theory of Autopoietic Systems* (n 102), 18. See also Douglas North, *Institutions, Institutional Change, and Economic Performance* (University of Cambridge Press 1990); Richard Scott, *Institutions and Organizations* (Sage 2001).

⁵³⁴ Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (n 502).

⁵³⁵ Bridget Hutter, Michael Power, *Organizational Encounters with Risk*, (Cambridge University Press 2008).

Decision premises are the result of the interactions between system – i.e. the BCBS – and environment. Henceforth, they emerge as a result of experience over time. Thanks to what the organization portrays as past shocks and failures, routines are set in place to ‘anticipate’ solutions or justifications to uncertain future events. It is important to note that organizational understanding of an event as a shock is the result of the interaction between the organization and the environment (what Luhmann calls structural coupling, as chapter 6 later explains). Therefore both the expectations and the relevant accountability standards that become more certain over time necessarily relate to three features: first, the internal communication of the BCBS that makes sense of the ‘irritations’ that the environment creates; second, the selection of an accountability forum as the relevant professional community that the BCBS responds to; and third, the standards against which to judge the Committee’s actions and justification, which come as a result of the internal conversation and plurality of the professional community.

In this vein, the portrayal of the BCBS as only a ‘think tank’ for banking regulators – as some officials and other regulators that take part in the Committee have put it – might be a strategy to cope with the multiple accountability risk that the BCBS face (i.e., to be accountable to the professional community of bankers and banking regulators and, at the same time, to avoid legal or political accountability). Likewise, the publication of the Basel Committee’s Charter and the normalized practice of consultation processes could be the result of a strategy to increase participation and manage expectations.

This thesis aims at exploring accountability in transnational banking regulation. As I discussed in chapter 4, global banking standards and their enforcement are a form of regulation. In this thesis I ask whether transnational banking regulation is subject to accountability processes and I explore the mechanisms of accountability in the work of

the BCBS. Therefore, the minimal notion of accountability needs to take into account the problems of uncertainty and ambiguity in unsettled politics.

To sum up, the working concept of accountability must be wide enough to apply to phenomena across different contexts (problem 1), outside the context of strong state institutions (problem 2), and identify accountability processes in a context of ambiguity (problem 3). In the next section I highlight those core elements of accountability that keep the identity of the concept but, at the same time, are adequate building blocks for a working concept of accountability that is capable of capturing the complexity of accountability processes in transnational regulation.

3. The building blocks of the working concept of accountability

In the following subsections I discuss these three core features which, in turn, are the building blocks for the working definition of accountability. These three characteristics define accountability. On the one hand, without any of them there would not be an accountability process, arrangement or regime. On the other hand, additional attributes of accountability do not change the identity of the process, because they only modify it⁵³⁶.

a) The idea of justification to others at the centre of accountability

Tetlock and Boettger say that accountability is the ‘pressure to justify one’s views and actions to others’⁵³⁷. Justification in this sense means explaining one’s views, actions or

⁵³⁶ Those additional attributes are different modes of accountability: horizontal or vertical accountability; professional, market, legal, and political accountability; accountability deficits or overloads; etc.

⁵³⁷ Philip Tetlock, Richard Boettger, ‘Accountability: A Social Magnifier of the Dilution Effect’ (1989) *Journal of Personality and Social Psychology* 57, 388.

omissions⁵³⁸. A justification has three main implications. First, it is external. It is an interaction between one entity (individual or corporate) and other different entities (individual or institutional, e.g. a court, a branch of the public administration). Second, it is an explanation of views, conducts, or decisions that are in one or another way thought to be the responsibility of the justifying subject. And thirdly, the justification provides information and/or arguments that pinpoint the goodness of the views, conducts, or decisions taken. I will develop these three implications of justifications in the next paragraphs.

i) A justification needs to be public

First, a justification implies the presence of another individual, corporation or forum to which the justification is addressed. The whole idea of ‘public accountability’⁵³⁹ in liberal democracies is that officials should answer to the public for their conduct. Feelings of blame and shame are important for accountability but, as long as the process remains within the conscience of an individual, it is difficult to speak about public accountability⁵⁴⁰. The analysis of justifications can be individual, organizational, and social.

At the individual level, Tetlock and other authors have studied the individual dimension of accountability. In their studies individuals provide justifications to explain why they have taken a particular decision⁵⁴¹. The authors devised a series of

⁵³⁸ Andreas Schedler *¿Qué es la Rendición de Cuentas?* (n 464), 14.

⁵³⁹ *idem.*

⁵⁴⁰ It seems that the presence of a real or hypothetical external *accountor* is also a ubiquitous tenet of human behaviour not only in the context of liberal democracy. Tugendhat explains how shame can be present in solitude. Ernst Tugendhat, *Selbstbewusstsein und Selbstbestimmung* (Suhrkamp 1979).

⁵⁴¹ Philip Tetlock, ‘Accountability and Complexity of Thought’ (1983) *Journal of Personality and Social Psychology* 45; Philip Tetlock, Linda Skitka, Richard Boettger, ‘Social and Cognitive Strategies for Coping With Accountability: Conformity, Complexity, and Bolstering’ (1989) *Journal of Personality and Social Psychology* 4; Philip E Tetlock, Jae Il Kim, ‘Accountability and Judgment Processes in a Personality Prediction Task’ (n 473); Philip Tetlock, Randall Peterson, Charles McGuie, Shi-jie Chang,

experiments where subjects assumed that their decisions will be assessed by others, and therefore they need to provide the reasons that moved them to take a particular decision. As the authors explain⁵⁴², the need for justification would be inexistent if a real or probable accountor is not present.

At the organizational level, accountability is a process between corporate entities (i.e., organizations) and other individuals or groups. In this case, the focus of accountability is not individual behaviour but organizational patterns and values that enable decision-making. Dubnick and Romzek discuss⁵⁴³, for example, the assessment of other agencies and congressional committees of the work of the US' National Aeronautics and Space Administration (NASA) triggered by the Challenger shuttle accident. They argued that the assessment of the accountors analysed the procedures in place to ensure the safety of the mission and its members.

In another incident, the Bhopal Working Group⁵⁴⁴ reviewed the catastrophe of Bhopal, India. A plant belonging to Union Carbide released a very toxic substance that killed thousands of people. The report concluded that the accident was caused by the inability to enforce standard operating practices and engineering controls, the disinvestment in the facility, poor training, lack of communication and surveillance and too much 'red tape' by the Indian government⁵⁴⁵.

The report established that the disaster's causes went beyond individual responsibility. They were complex and vested in the faulty way the organization worked.

Peter Feld, 'Assessing Political Group Dynamics: A Test of the Groupthink Model' (1992) 63 *Journal of Personality and Social Psychology* 3.

⁵⁴² Philip Tetlock, Richard Boettger, 'Accountability: A Social Magnifier of the Dilution Effect' (n 537).

⁵⁴³ Barbara S Romzek, Melvin J Dubnick, 'Accountability in the Public Sector: Lessons from the Challenger Tragedy' (n 14).

⁵⁴⁴ Bhopal Working Group, 'The Public Health Implications of the Bhopal Disaster' (1987) 77 *American Journal of Public Health* 2, 230-236.

⁵⁴⁵ *ibid.*

A third example of accountability at the organisational level is the report on the Financial Services Authority (FSA) and the financial crisis of 2008-2009⁵⁴⁶. The findings of this report pointed at the way the FSA overviewed the compliance of banking organizations with their regulatory principles. The common feature of cases like these is an external agent that assesses each organization's patterns of behaviour and values, and not only individual behaviour.

At the level of social groups (e.g., professions) accountability is identifiable too. The particularity of social groups is that their worldviews and beliefs go beyond a particular organization: they are shared among individuals and organizations. These social groups are also specialized and, therefore, they possess a particular perspective of the world and knowledge that enables them to solve a set of problems for which they specialize. As I explained in chapter 4, the professional community of banking regulators is connected to the work of the BCBS. Just as the BCBS might be accountable

The publicity of justifications means, finally, that they must reach the accountant and other interested parties in the process so that they can *hear* them, assess them and decide which consequences should follow. Publicity, however, should not be taken for granted. It depends indeed on the accountee's will to utter the justification, but whether or not it is successful or not depends upon the way the justification is published, which media it uses, the arguments it advances and the language (technical or lay) that it contains. This will be further discussed in the next chapter when explaining the role of communication in accountability.

⁵⁴⁶ Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (FSA 2009). See: < http://www.fsa.gov.uk/pubs/other/turner_review.pdf > Accessed 25 July 2015.

ii) The justification of the account comes from someone that is allegedly responsible

The second implication is that accountability is a justification of a set of views, conducts, or decisions that allegedly are the responsibility of the individual or organization held accountable. As Bovens puts it '[b]eing accountable means being responsible, which, in turn, means having to bear the blame'⁵⁴⁷. Public accountability's *raison de etre* is to hold the powerful to account. Responsibility, therefore, comes as a consequence of the exercise of power.

The responsibility of the accountee is related with the problem of overlapping jurisdictions, in certain contexts where power is scattered among many authorities that either need to coordinate their efforts⁵⁴⁸. If the jurisdiction of a given authority is shared with others, justifications can take the form of a way to avoid blame rather than explain the accountees' views or conduct. This can also be understood as 'shared regulatory space'⁵⁴⁹.

Second, when the accountee provides a justification it implies that he/she feels compelled to do so due to a legal or softer obligation. There should be a previous need that provokes the justification on behalf of the accountee. But that need is not necessarily triggered by a legal or formal obligation. In 'unsettled polities' that need might come as a product of persuasion rather than a legal sanction, and, as chapter 6 explains, it might come as a result of particular accountability claims that are formulated using a certain language. I will come back to the nature of the obligation that triggers a justification in chapter 6.

⁵⁴⁷ Mark Bovens 'Public Accountability' (n 464), 189.

⁵⁴⁸ Elinor Ostrom, Vincent Ostrom, 'Public Goods and Public Choices' in E S Savas (ed.) *Delivering Public Services: Toward Improved Performance* (Westview 1977).

⁵⁴⁹ Jody Freeman and Jim Rossi, 'Agency Coordination in Shared Regulatory Space' (n 80) 1134.

iii) The justification influences the audience that takes part in the accountability process

Finally, a justification uses information and/or arguments to defend the position of the accountee⁵⁵⁰. As I will explain in the next chapter, the form in which the arguments and the information are presented may affect the success of the justification. Additionally, the justification structure in terms of information and arguments might also chime with certain groups and exclude others. As I will explain in the following chapter, by framing his/her justification in a particular language, the accountee can select the relevant epistemic community for the discussion (e.g., if the BCBS answers a claim that uses the language of transparency it might ‘call’ the specialised community on that topic).

The possibility of being held accountable might change the ways in which we justify in advance depending on the forum we expect will judge us. Boettger, Skitka, and Tetlock studied the degree to which accountability affects what people think or what people say they think depending on whether they could expect a judgment on their opinions or not⁵⁵¹. In their study, the participants needed to ‘pre-commit’ about their opinion on sensitive topics (e.g., affirmative action, death penalty, or nuclear freeze). They then asked the participants to justify their views on four scenarios: in the first the participant knew that his/her opinion would not be reviewed; in the second scenario, the subject would be judged by an audience of which he/she did not know its opinion; in the third one the participant knew that her/his opinion would be judged by a progressive audience; and in the fourth scenario, the opinion would be reviewed by a conservative one.

⁵⁵⁰ Andreas Schedler ; *Qué es la Rendición de Cuentas?* (n 464), 114.

⁵⁵¹ Philip Tetlock, Linda Skitka, Richard Boettger, ‘Social and Cognitive Strategies for Coping With Accountability: Conformity, Complexity, and Bolstering’ (n 541).

The experiment found that the combination of scenarios first led ‘subjects accountable to an audience with known views to give more careful consideration to that perspective and to shift their public stands in that direction as well.’⁵⁵² It also found that the same pre-commitment led those ‘subjects accountable to an unknown audience to anticipate counterarguments that critics from either side of the political spectrum might raise and to incorporate those positions into balanced, middle-ground policy stands.’⁵⁵³

Additionally, the experiment found that people that pre-commit to liberal views at the outset are more prone to stick to their views even if the accountor – the person they have to justify to – is conservative. The authors hypothesize that this might be caused by the pervasiveness of the liberal views among the participants in the study (i.e., in the University of California at Berkeley). Interestingly, the hypothesis means that the social or organizational context impacts the way people – or organizations and groups – justify.

This hypothesis has important ramifications. The fact that there might be a link between the way justifications are built (i.e., the manner in which the arguments and/or information is presented) and the ideas that are more dominant in one context, chimes with what I explain the Luhmannian concept of communication in chapter 4.

Justification is thus an essential building block for the concept of accountability. Without it accountability loses its identity and becomes something else (e.g., governance, participation, or public discussion). In the next two subsections I explain the second and third element of the working definition of accountability.

⁵⁵² *ibid.*, 639-640.

⁵⁵³ *ibid.*

b) The necessity of standards for accountability

Standards are necessary for accountability processes. Davies argues that they are a constitutive part of the process of accountability⁵⁵⁴. Mashaw, in turn, considers the standards as one of the six features that any accountability process possesses⁵⁵⁵. They are mentioned by most of the authors in the academic discussion about accountability because the accountee's behaviour and justification are judged against standards.

Standards can take many forms. Lerner and Tetlock mention the possibility of 'outcome accountability' against 'process accountability.'⁵⁵⁶ In the first case, accountability assesses the end result of the accountee's decision. In the second case, accountability's focus is whether the process had the proper stages in accordance with the standards⁵⁵⁷. Accountability can take the form of a relationship, an arrangement, or a regime⁵⁵⁸. The difference between each form of accountability is based on its permanence and continuity. While relationships are ephemeral, regimes last the longest. Additionally, regimes have a greater degree of institutionalization than arrangements and relationships.

The type of standard may be related to the type of accountability regime and the community behind it. For Mashaw⁵⁵⁹ there are three principal accountability regimes which rely on politico-administrative, market, social standards. The politico-administrative regime subdivides into the political, bureaucratic, and legal. Mashaw

⁵⁵⁴ Anne Davies *Public Accountability*, (Oxford University Press 2001), 84.

⁵⁵⁵ Who?, to whom?, about what?, with which standards?, with which procedures?, and with what consequences? Gerry Mashaw 'Accountability and Institutional Design: Some Thoughts on the Grammar of Governance' (n 505).

⁵⁵⁶ Jennifer Lerner, Philip Tetlock, 'Accounting for the Effects of Accountability' (1999) 125 *Psychological Bulletin* 2; see also Mark Bovens 'A framework for the analysis and assessment of accountability arrangements in the public domain' in E Ferlie, L Lynne, C Pollitt (eds.), *The Oxford Handbook of Public Management*, (Oxford University Press 2005).

⁵⁵⁷ Jennifer Lerner, Philip Tetlock, 'Accounting for the Effects of Accountability' n 552, 258.

⁵⁵⁸ Mark Bovens 'Analysing and Assessing Public Accountability. A Conceptual Framework' (n 511).

⁵⁵⁹ Gerry Mashaw 'Accountability and Institutional Design: Some Thoughts on the Grammar of Governance' (n 505).

acknowledges that each accountability regime has different standards: ‘These sorts of choices do not make actors accountable or unaccountable. Instead, they institute regime changes. Whether we have gained or lost by shifting from one accountability regime to another depends upon who we want to be accountable, to whom, about what, through what processes, judged by what criteria, and with what effects.’⁵⁶⁰

Mashaw argues that each one of the elements of an accountability regime is dependent upon every other one. This means that a change from politico-administrative standards brings along a change in the relevant forum, the process, the conduct being judged and the effects that the accountability process might bring to the accountee. Therefore, standards are a good indicator of the relevant accountability regime at play. For instance, if standards of one regime are the firm’s financial performance chances are the whole regime is ruled by markets and that sanctions are also economic⁵⁶¹. If standards belong to a professional community, the process might be based on the rules of peer review.

Standards are central for accountability processes because they point out which regime is at play. Therefore, a minimal definition of accountability needs to contain the standards against which the accoutee’s conduct and justification are judged. Thus, along with the justification, standards are an additional building block to the working definition of accountability. In the next subsection I explain that accountability is an interaction between accountant and accountee in the form of a process and this is another essential characteristic of the concept.

⁵⁶⁰ Gerry Mashaw ‘Accountability and Institutional Design: Some Thoughts on the Grammar of Governance’ (n 505), 128

⁵⁶¹ See Albert Hirschmann, *Exit, Voice, and Loyalty* (Harvard University Press 1970).

c) The third building block of the working concept of accountability: accountability as a result of an interaction between accountor and accountee in the form of a process

Accountability needs to be a process that proceeds in different stages so that the justification – a central feature of accountability – makes sense. Accountability is an interaction between an accountor and an accountee that follows certain stages so that the justification is being asked and being judged. If none of these two stages occur, then accountability is not complete. As I explained previously, however, accountability is deeply anchored in the context of liberal democratic states.

Public lawyers tend to portray the processes involved in accountability using the mechanisms of liberal democracies. For instance, Scott describes accountability as ‘the formal duties of public bodies to account for their actions to ministers, Parliament, and to courts’⁵⁶². This definition is deeply anchored in the notion of the modern state and liberal democracy. In this context of hierarchies and checks and balances is easier to depict accountability as a public legal process.

In public administration, accountability might embody one or more bureaucratic processes by which a higher official reviews the conduct of a lower ranking employee⁵⁶³. If the context moves to the legislature, parliamentary or congressional committees come to mind. The process would have a protocol to summon the relevant officers, gather germane information, and question all interested parties. The parliamentary regulations often mandate how to deliberate and reach a conclusion. Finally, if one centres one’s attention on the judiciary, accountability can take the form

⁵⁶² Colin Scott, ‘Accountability in the Regulatory State’ (n 31), 40.

⁵⁶³ Michael McCubbins, Roger G Noll, Barry R Weingast, ‘Administrative Procedures as Instruments of Political Control’ (n 444).

of judicial review before the courts. Each one of these examples has distinct procedures that embody accountability processes.

On a more abstract level, however, accountability processes tend to split into at least three stages and one consequence. In this vein, Bovens describes the basic elements of an accountability process: ‘there should be an actor, either an official or an institution, who provides information about his or her conduct to a forum; there should also be explanation and justification of conduct — and not propaganda, or the provision of information or instructions to the general public. The explanation should be directed at a specific forum — and not be given at random. The actor must feel obliged to come forward — instead of being at liberty to provide any account whatsoever. Finally, there must be a possibility for debate and judgment by the forum, and the possibility of formal or informal sanctions or rewards —and not a monologue without engagement’.⁵⁶⁴

Bovens description is very similar to the list that Anne Davies provides⁵⁶⁵. Davies argues that any accountability process has four main stages: (1) the asking of the account; (2) getting the account; (3) judging the account against a set of standards; and (4) deciding which consequences, if any, should follow⁵⁶⁶.

I argue that these more abstract steps that compose accountability processes are present in any accountability mechanism, both in settled or unsettled polities. In the case for instance, of Equitable Life, Inc., the parliamentary ombudsman in the United Kingdom issued a report on the government’s performance when trying to solve the bankruptcy of the insurance company that went bankrupt at the end of the 1990s. Equitable Life left many of their clients defenceless as it decided to cancel its obligation to pay them unilaterally. To fill the report, the parliamentary ombudsman summoned

⁵⁶⁴ Mark Bovens, ‘New Forms of Accountability and EU-Governance’ (2007) *Comparative European Politics* 5: 107.

⁵⁶⁵ Anne Davies *Public Accountability* (n 554).

⁵⁶⁶ *ibid*, 84.

and questioned officials from past and present administrations (i.e., asking and getting the account), judged their justification in light of the evidence that it collected from diverse sources, and assessed the government's performance according to the laws and rules relevant to the case (i.e., judging it according to a set of standards) and decided that the government should implement a scheme to repay the clients of equitable life, because it had failed to implement efficient regulation to avoid the company's behaviour (i.e. deciding which consequences should follow)⁵⁶⁷.

Accountability is the interaction in the form of a process with stages between one or more accountors and the accountee. The stages are typically asking the justification, getting it, judging it and deciding which consequences should follow. This third building block is the final component of the three main elements of the working definition of accountability. Any accountability mechanism must revolve around a justification, that is judged against a set of standards, and that takes the form of a process with distinct stages (i.e., asking the justification, getting it, judging it, and deciding the consequences – positive or negative – that follow).

The working definition of accountability needs thus to have the core elements we have discussed in this section. Additionally it needs to be minimal enough to describe and identify accountability mechanisms in a context of high ambiguity like transnational regulation's, outside the traditional categories that make up the body politic of the state, and capable of embracing the diversity of different milieus and professional communities. In the next section I put forward the working concept of accountability which is a combination of the core features of accountability that I've outlined above.

⁵⁶⁷ Parliamentary Ombudsman *Equitable life: A decade of regulatory failure* (2011).

4. The working concept of accountability

As I stated at the beginning of this chapter, the minimal definition of accountability that is at the centre of the working concept put forth at the end of the chapter is, on the one hand, wide enough to cover and identify accountability phenomena in different contexts, outside the state and other settled polities⁵⁶⁸, and in settings with high ambiguity. On the other hand, it is narrow enough to define those core accountability processes that set them apart from other phenomena that, although related to accountability, should not be confused with it (e.g., transparency, responsibility, good governance, legitimacy, etc.).

The main elements of the working definition of accountability are: (1) a justification, (2) assessed against a set of standards, (3) that takes the form of a process with at least three distinct stages: (a) demanding the justification, (b) obtaining the justification, and (c) judging the justification; and (4) that produces consequences for the accountee as a result of the process.

The working concept of accountability includes *the process* by which one or more external claims are issued, including requesting and obtaining a justification or explanation from a person or organization that exercises power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow. The working definition, following Davies⁵⁶⁹, delineates three stages: there is an accountability claim at the beginning of the process; next, the accountee answers the claim and issues a justification; and finally, the justification is judged according to a set of standards and it is decided which consequences, if any, should follow.

⁵⁶⁸ Johann Olsen, 'Accountability and Ambiguity' (n 460).

⁵⁶⁹ Anne Davies *Public Accountability* (n 554).

If any of the elements listed above is missing, the chances are we are facing a different phenomenon and not an accountability process. As the reader would note now, the working definition does not refer to actors. In other words, it does not mention who asks for the justification, who gives the justification, and who judges it. This is an intentional choice and the reason for it is that both in settled and unsettled polities it is possible to identify accountability processes without referring to the accountor or the accountee. Additionally, in unsettled polities like transnational regulation what is being argued is more important than who says what. Chiming with the language and expectations of the banking regulatory community in the case of the BCBS is more important than the status of the accountor. I explain this feature in chapter 6 in a deeper way.

The main purpose of the working concept of accountability, as I mentioned at the beginning of this chapter, is to be a tool for analysing and finding accountability processes in the qualitative data set of communicative events linked to the work of the Basel Committee on Banking Supervision (BCBS). With this objective in mind, the working concept of accountability serves two ends. First, it provides a description of accountability that is useful to identify the phenomenon distinctively and set it apart from other similar socio-political concepts. Second, the working definition should be useful to identify accountability processes in contexts where the state or its institutions are not necessarily present (i.e., global governance).

In this vein, it is possible to identify the components of an accountability process that lacks formality by finding out whether the elements of the process: 1) are sequential (i.e., they follow a logical order); and 2) make reference to each other. Additionally, any accountability process – but especially in unsettled polities with low institutionalization

– finds cohesion if it chimes with the expectations of one or more professional communities.

For Bovens⁵⁷⁰, accountability processes are interactions between accountees and forums where a justification is judged by the forum, and it also decides which consequences should follow. Bovens portrayal of accountability is insightful because it recognizes the existence of a plurality of accountors with homogeneous features that result in a forum. At the same time, Bovens concept is incomplete because he understand a forum as though it was a part of the process. In this thesis' view a forum mediates through the many interactions between an accountee an his or her accountors.

The reason why a forum cannot be an accountor is because a forum is not an actor. It is rather a more abstract entity that is present through the language that structures the process and the expectations (i.e., the standards) against which the accountor judges the accountee's behaviour and/or values.

I argue that an accountability process is a sequential interaction between one or more accountors and one accountee. The forum is nonetheless present too, and very important for that matter. But I argue that instead of being an actor, the forum acts as a backdrop that 'observes' the process. In this vein the role of expectations is essential to: 1) make sense of the accountability process; and 2) align the accountee's standards with those of the forum.

I argue that professional communities are relevant fora for accountability, especially in those contexts of transnational financial regulation like the one of the BCBS. I also argue that there is a learning process that is necessary to stabilize the forum's expectations among potential accountees. In other words, in ambiguous settings, there might be a plethora of potential accountors. All of them may issue

⁵⁷⁰ Mark Bovens, 'Two Concepts of Accountability: Accountability as a Virtue and as Mechanism' (n 471).

accountability claims to get a justification from the accountee at one point or another. Nevertheless, only those claims that resonate with the forum (i.e., the epistemic community) would be successful in getting a justification and establishing an accountability relationship with the accountee. I argue in the next section that chiming with the forum is equal to chiming with the forum's expectations.

5. The managing of expectations and the role that a professional community plays in accountability processes

Expectations are an important feature of public administration, so much so that they might condition the decision making of public officials⁵⁷¹. Some expectations come from formal rules (e.g., judicial decisions, laws, regulations, etc.) or hierarchical relationships, but accumulated experience based on previous decisions and social informal relationships⁵⁷² can be another source.

Tetlock and Boetger's⁵⁷³ advance the idea that the way in which an individual expresses and justifies her or his views is different if he or she foresees that an accountability agent will review them, and, furthermore, if he or she knows what the opinions of an accountant or an accountability forum are:

When people expect to justify their views to an audience with unknown opinions and learn of being so accountable prior to exposure to the relevant evidence, they often engage in "pre-emptive self-criticism" (...) they analyse the evidence especially carefully and pay particular attention to inconsistent information. In effect, people try to prepare themselves for potential objections that a well-informed audience might raise to the stands that they have taken.⁵⁷⁴

⁵⁷¹ Dubnick Melvin, Barbara S Romzek, 'Accountability and the Centrality of Expectations in American Public Administration' (n 517).

⁵⁷² Richard Cyert and James G. March *A Behavioral Theory of the Firm* (n 503), Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (n 502).

⁵⁷³ Philip Tetlock, Richard Boettger, 'Accountability: A Social Magnifier of the Dilution Effect' (n 537).

⁵⁷⁴ *ibid*, 388.

The more stable and known the expectations are the more certainty there exists in a given regulatory context. Bovens argues that there is an evolutionary progression of accountability. In its weaker forms accountability processes take the form of relationships. If ambiguity is reduced, accountability processes might progress towards one or more accountability arrangements, which are more stable and certain frameworks for accountability mechanisms. Finally, in the presence of more certainty, accountability processes form accountability regimes⁵⁷⁵.

In this vein accountability overloads and accountability deficits are equally harmful. In both scenarios the accountee does not have certainty about what the mechanisms of accountability and the standards by which their conduct will be judged are. Therefore, he or she cannot foresee a course of action and conduct themselves according to the standards. In accountability overloads and accountability deficits, however, there is a higher risk of being held accountable for conducts that the accountee did not expect to be judged and with standards that he/she did not know when taking the decision.

For these reasons the general opinion that politicians and public servers are unwilling to agree upon standards and mechanisms for accountability is incorrect. In an environment without clear and *ex ante* accountability mechanisms in place, people and organizations with power face the risk of being held accountable by anyone and about anything. Thus, it is to the politicians' benefit to have certainty about the mechanisms and the standards by which they can be held accountable.

Surprisingly, a similar situation exists with accountability overloads. When multiple, and sometimes contradictory, accountability processes with diverse standards are set in place, a decision maker faces the dilemma of deciding by which standards to

⁵⁷⁵ Mark Bovens 'Analysing and Assessing Public Accountability. A Conceptual Framework' (n 511).

abide to. Nevertheless, embracing one type of standards with their accountability forum does not lower the risk of being held accountable by other competing standards and fora. It is only natural that both people and organizations with power thrive for clarity about the expectations by which their work will be judged.

Dubnick and Romzek⁵⁷⁶ argue that multiple expectations are relevant for decision makers. For the authors those expectations influence decision making on multiple levels: ‘the nature of the agency’s tasks (technical level accountability); the management strategy adopted by those heading the agency (management level accountability); and the institutional context of agency operations (institutional level accountability)’⁵⁷⁷. They use the example of the NASA in the context of the accident of the Challenger Shuttle. The authors point out that NASA had diverse expectations that came from the institutional and political context of the time in the US.

It is evident that accountability deficits and overloads create complexity and ambiguity. To cope with them powerful officials and organizations need to manage expectations. This means that they need to ponder in advance whether they are going to be judged and, in case they are, by which standards and accountability mechanisms. The following paragraphs I explain three features that result from the complexity in decision making when the potential accountee is faced with future accountability mechanisms: (1) the creation of routines and internal regulations for decision making; (2) the strategy of blame avoidance; and (3) the managing of expectations through time in the form of learning through trial and error.

Firstly, when presented with the possibility of being held accountable, organizations might create routines and internal regulation for decision making. Niklas Luhmann argues that organizations create general rules for decision making.

⁵⁷⁶ Barbara S Romzek, Melvin J Dubnick, ‘Accountability in the Public Sector: Lessons from the Challenger Tragedy’ (n 14).

⁵⁷⁷ *ibid*, 230.

Organizations use these rules to justify their behaviour when the outcome of their decision-making is harmful (e.g. that they followed standard procedure and that the harmful outcome was impossible to foresee). For Luhmann there is not a link between the process and the outcome, due to the inherent complexity of organizations. Regardless of how strictly decision makers follow the process, the risk of failure is always present. Luhmann explains this by the inherent condition of complexity. This chimes with other authors' argument that the risk of failure exists because of the lack of perfect rationality that creates uncertainty⁵⁷⁸. Both Herbert Simon⁵⁷⁹ and Luhmann⁵⁸⁰ acknowledge that a decision must be taken under the stress of time.

For Luhmann not only do the rules and routines provide guidance for a better decision, but also –and perhaps mainly – provide a source of justification if the decision goes wrong⁵⁸¹. The fact that organizations deal with uncertainty and complexity (i.e., the risk of failure) combined with the need to decide under stress, might create, according to Luhmann the need to deal with expectations in the ways that this chapter's section 2 has explained⁵⁸²:

- (1) The pressure to decide leads to store past decisions and decision's elements in routines for repetitive use. This possibility chimes with other authors'

⁵⁷⁸ Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (n 502); Richard Cyert and James G. March *A Behavioral Theory of the Firm* (n 503); James G March, Johann Olsen, 'The Uncertainty of the Past: Organizational Learning Under Ambiguity' (n 504).

⁵⁷⁹ Herbert Simon *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (n 502).

⁵⁸⁰ Niklas Luhmann, *Ecological communication* (Polity 1989).

⁵⁸¹ *ibid*, 84.

⁵⁸² Luhmann, Niklas *Organización y decisión. Autopoiesis, acción y entendimiento comunicativo* (n 519), 83-84.

explanations for the existence of routines in organizations⁵⁸³. It particularly chimes with Cohen, March and Olsen's⁵⁸⁴ model of the 'garbage can'⁵⁸⁵;

- (2) The pressure to decide makes it easier to bring the decision back to the past or bring it forward to the future. Decision-making is this way avoided because it is assumed that either the decision (or part of it) has been taken in the past or will be made in the future. 'One should not totally discard the suspicion that bureaucracy needs a great deal of planning in excuses' preparation.'⁵⁸⁶
- (3) A third possible way to deal with expectations is to incorporate third parties into the decision making process. 'Others are proactively involved partly to prevent criticism, partly to narrow down our own decision scope, partly to decide, if not about the matter of decision, at least about other's participation in case someone asks.'⁵⁸⁷
- (4) Finally, the pressure to decide puts in place a sort of 'politics' around the organization. In case an accountability process happens – even if it is hypothetical – it is important to find out whom has known what and when. In politics it is common that higher echelons of an organization avoid knowing information about some very sensitive decisions. In this way they do not have to respond to accountability claims and thus avoid the blame⁵⁸⁸.

⁵⁸³ Richard Cyert and James G. March *A Behavioral Theory of the Firm* (n 503), James G March, Johann Olsen, 'The Uncertainty of the Past: Organizational Learning Under Ambiguity' (n 504).

⁵⁸⁴ Michael D Cohen, James G March, Johan P Olsen, 'A Garbage Can Model of Organizational Choice' (1972) 17 *Administrative Science Quarterly* 1; James G March, Johann Olsen, 'The Uncertainty of the Past: Organizational Learning Under Ambiguity' (n 505).

⁵⁸⁵ The 'garbage can' model explains that problems in organizations are not searching for solutions, but paradoxically, it works the other way around: past solutions (recycled in a sort of rubbish bin) are seeking for problems to solve. Michael D Cohen, James G March, Johan P Olsen, 'A Garbage Can Model of Organizational Choice' n 580.

⁵⁸⁶ Luhmann, Niklas *Organización y decisión. Autopoiesis, acción y entendimiento comunicativo* (n 519), 84.

⁵⁸⁷ *ibid.*

⁵⁸⁸ The fact that happens does not mean that this behaviour is convenient or good. The defence in trials of violations against human rights, for instance, often claim that their clients weren't aware of the violations and that those crimes were committed by subordinates.

Thus, according to Luhmann's hypothesis, organizations deal with expectations by: 1) creating routines, 2) planning excuses, 3) increasing participation, and 4) dispersing the blame throughout the organization.

The second feature that results from complexity in decision making is blame avoidance. Just like complexity and ambiguity, blame avoidance is omnipresent in social life in general and in public or private organizations in particular. Blame avoidance is deeply coupled with the existing routines and rules, which as I argued above, organizations often use to justify themselves or to shift the blame into other agents or causes.

Hood puts an example from everyday life:

'You're riding on a city bus in the middle of a heat wave following a cold snap. To everyone's extreme discomfort, the bus has its heating turned full on. You go to the obvious point of contact –the bus driver – to express your anger at this absurd state of affairs and ask the heating to be shut off immediately. But you find the bus driver claims not to be to blame and says many of the buses in the city still have their heating on, because only the company mechanics can alter the heat settings on the buses. If you have the time and patience to pursue the matter further, you may find that the mechanics deny all blame as well, and tell you their labor union blames the company for not hiring enough mechanics to service the buses properly. But then you find the bus company managers blame the city's transport licensing authority for setting the fares for riders at a level that doesn't allow the company to hire more than a few mechanics. And the licensing authority says...' ⁵⁸⁹

Hood then explains a number of strategies that are used for avoiding blame: (1) presentational strategies, that work with the information and perception to avoid blame; (2) agency strategies, that try to convince the claimers that the cause for the blame is elsewhere; and (3) policy strategies, that focus on the structure of public policy and organizations to steer the public's attention to an structural cause ⁵⁹⁰.

Hood focuses his attention on the blame game of individuals (politicians, public administrators, and public servants) that face a particularly acute risk: reputational

⁵⁸⁹ Christopher Hood, *Blame Game: Spin, Bureaucracy and Self-Preservation in Government*, (Princeton University Press 2010), 3

⁵⁹⁰ *ibid*, 15.

risk⁵⁹¹. This type of risk implies the existence of a forum which opinion is relevant for the public servant. The forum finally decides whether the official is a blame maker – and thus, has avoided the strike – or is a blame taker – the one that must bear the blame upon his or her shoulders. Blame attribution and blame avoidance are relevant components of the increasing interest that many quarters of society place in accountability⁵⁹². And like accountability, blame attribution suffers the extra difficulty of the diverse camps from which accountability claims are issued. Each one of those camps have their own accountability mechanisms and standards. Therefore, dodging the blame from one accountability type (e.g., political accountability) does not necessarily mean that the risk that claims from other types of accountability (e.g., professional) are successful ceases to exist.

This takes us to the third feature that results from the complexity in decision making when the potential accountee faces future accountability mechanisms: the learning process and the eventual rise of coherent accountability regimes. This time we come back to the organizational and social context and leave individual actors aside. Unlike individual politicians and public servants, organizations are more resilient to accountability and blaming claims.

Through a process of trial and error organizations might manage expectations by: (1) cementing an accountability relationship with accountors that belong to one distinct forum (i.e. professional community) instead of facing multiple and contradictory accountability claims from various forums; and (2) building consensus upon the set of standards that will be used to hold the organization accountable. Jerry Mashaw emphasizes the role that time plays in accountability:

⁵⁹¹ *ibid*, 4.

⁵⁹² Christopher Hood, 'Accountability and blame Avoidance' in Mark Bovens, Thomas Schillemans, Richard E Goodin (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014).

‘...time is a crucial consideration in the design of accountable institutions. But it also claims that while time adds to uncertainty, complexity, and normative ambiguity in decision-making, time does not defeat accountability even in extreme cases such as accountability for historic injustices and responsibility for intergenerational equity.’⁵⁹³

Organizations are interested in diminishing the risk of failure of their decisions and what Hood calls ‘reputational risk’⁵⁹⁴. Therefore they tend to stick with those decisions that have been successful and to avoid those other ones that resulted on a failure or the organization taking the blame. On the long run, this trial and error process might turn down the level of uncertainty towards both the accountability mechanisms that should apply and the set of standards by which the organizational behaviour should abide to.

6. Conclusion: a working concept of accountability for unsettled polities

The working concept of accountability is important to identify accountability phenomena in ambiguous contexts like transnational regulation. While the working concept is wide enough to apply to unsettled polities, it is narrow enough to identify accountability processes and set them apart from other related concepts that should not be confused with accountability, such as legitimacy, transparency, responsibility, or good governance.

Through the working concept of accountability, this thesis, however, intends to not only identify single accountability processes in the work of the BCBS, but also to find out why those processes exist and whether or not they affect the Committee’s

⁵⁹³ Jerry Mashaw, ‘Accountability and time’ in Mark Bovens, Thomas Schillemans, Richard E Goodin (eds.) *The Oxford Handbook of Public Accountability* (OUP 2014), 574.

⁵⁹⁴ Christopher Hood, *Blame Game: Spin, Bureaucracy and Self-Preservation in Government* (n 589).

future behaviour. To do so I focus my attention in the management of expectations that engaging in accountability processes entails.

Through managing expectations, accountability refers to the creation of standards, the avoidance of blame or minimizing the risk of being blamed, and over time and through learning might strengthen the accountability relationship of a financial TRN like the BCBS with the professional community of banking regulators that also constitutes a forum and build a clearer set of standards by which a TRN can be held accountable.

Most importantly, I argue that the accountant and the accountee are not the only actors in an accountability process. In addition to them we can find a professional or epistemic community which is relevant for the management of the accountee's reputational risk. That forum or professional community, I argue, provides a backdrop to each accountability process.

The working concept of accountability captures *the process* by which one or more external claims are being issued requesting and obtaining a justification or explanation from a person or organization that exercises power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow. Accountability claims, the justification and the judgment of the justifications resonate with that professional forum and through that shared meaning a unified accountability process might be in place.

The next chapter explains Niklas Luhmann's understanding of communication which leads to the idea of communicative accountability. This idea takes the working concept of accountability a further step and introduces some elements that help to understand the role of a professional or epistemic community in accountability

processes. Chapter 7 argues that professional communities mediate each stage of the process and shape the accountee's relevant expectations.

Chapter 6. Theorizing accountability through the lens of communication: Applying Luhmannian ideas to the working concept of accountability

1. Introduction: the relevance of the consequences of accountability processes

Accountability is a process that occurs between an accountor and an accountee. The accountor asks the account, judges it, and decides which consequences should follow. The accountee gives the account⁵⁹⁵. Additionally, for the purposes of this thesis and according to the working concept of accountability that I put forward in chapter 5, accountability is the process, by which one or more external claims are issued requesting and obtaining a justification or explanation from a person or organization that exercises regulatory power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow.

In this vein, Bovens defines accountability as ‘the relationship between an actor and a forum, in which the actor is obliged to explain and justify his conduct, the forum can pose questions, pass judgment and the actor may face consequences.’⁵⁹⁶ Bovens stresses that without an obligation between the accountor and the accountee, and potential consequences for the accountee, the process is not accountability. Put in other words, if the justification from the accountee comes without anyone with enough power for getting a justification, then the phenomenon is not accountability. The same happens when the process lacks potential or real consequences for the accountee. In that case, such processes are not accountability, but can be a form of responsiveness, transparency or simply good governance.

⁵⁹⁵ This definition is provided by Anne Davies *Public Accountability* (n 554), 84.

⁵⁹⁶ Mark Bovens, *Analysing and Assessing Public Accountability: A conceptual framework*, (Eurogob No. C-06-01, 12 2006).

As I pointed out in chapter 4, international law lacks enough binding power to recreate accountability mechanisms based on a principal-agent relationship. Transnational regulation thus, operates in a context of greater ambiguity where it is difficult, if not impossible, to recreate the accountability arrangements and regimes mirroring those of states.

There are some interactions between TRNs and their stakeholders that resemble an accountability process. In chapter 7 I will identify 5 interactions between the Basel Committee and some of its stakeholders that resemble the stages of an accountability process. TRNs like the BCBS lack however, a legal or political obligation to justify. If Bovens is right, these interactions – which I describe as chains of communication – might not be accountability processes but part of the governance of the committee.

Nevertheless, I argue that they can indeed be thought of as accountability processes. To do so I consider the possibility of accountability processes outside the law of the state. In this vein, Moore sets out the idea of accountability in the court of public opinion where ‘accountability agents’ who may or may not have a legal basis to press their claims think of themselves as authorized to demand an explanation from powerful organizations⁵⁹⁷. Moore explains that ‘accountability agents’ might use the legal mechanisms for accountability but, more often than not, ‘[t]he set of demands for accountability that lack legal sanction constitute a sort of anarchic penumbra of extra-legal accountability demands.’⁵⁹⁸ These claims, however, are effective and provoke a response of public officials and private organizations alike, when external pressure that is brought to bear on them gets ‘traction’ in the court of public opinion.⁵⁹⁹ Thus, public

⁵⁹⁷ Mark H Moore, ‘Accountability, Legitimacy, and the Court of Public Opinion’ (n 13), 2

⁵⁹⁸ *ibid*, 4

⁵⁹⁹ *ibid*, 4

opinion can be a powerful instrument to call the powerful to account when the laws of the state are ineffective or absent.

The question is, however, why. Why would a powerful public or private entity respond to an extra-legal accountability claim that would in some way legitimize the demand, and also the ‘accountability agent’ that is pressing it Moore advances the idea that there is in the accountee a need to respond that resonates with the public opinion⁶⁰⁰:

...the reality seems to be that the leaders of organizations *do* feel vulnerable to these demands for accountability. They feel obligated to hear and respond to demands made in the court of public opinion. Organizational leaders in both public and private organizations know that those who may not have legal standing or practical force in one social forum may find traction in others. Corporate executives know that such accountability agents may turn their efforts to trying to persuade customers, investors, and workers that they should not buy from, invest in, or work for a company that harms people or natural environments. (...) Given the practical threat that some accountability agents pose, leaders might wisely respond to the extra-legal demand as though they had some legal responsibility to meet it.⁶⁰¹

While the concept of public opinion can be appealing to explain the effectiveness of extra-legal accountability claims⁶⁰², it does not explain how this type of accountability might work. In contrast, Shapiro and Fisher⁶⁰³ argue that the role of expertise is central to the work of bureaucracies. The definition of expertise, however, is contested. By analyzing the *Chevron* doctrine in the United States, they argue that there are two types of expertise⁶⁰⁴. Firstly the ‘rational-instrumental’ (RI) expertise focuses on the democratic governance and control of regulatory agencies exercised by the legislature. This paradigm understands that the autonomy of experts in regulatory

⁶⁰⁰ Moore does not use the framework of Luhmann system theory, however, as it will be explained later in this chapter, the accountee’s justification responses to a need to keep the system’s integrity and stability of expectations.

⁶⁰¹ Mark H Moore, ‘Accountability, Legitimacy, and the Court of Public Opinion’ (n 13), 5.

⁶⁰² Extra-legal does not mean illegal. On the contrary it means that the process stands on the margins of the law.

⁶⁰³ Sidney Shapiro, Elizabeth Fisher, ‘Chevron and the Legitimacy of “Expert” Public Administration’ (n 437).

⁶⁰⁴ See also Elizabeth Fisher, *Risk Regulation and Administrative Constitutionalism* (Hart 2007).

agencies comes from a delegation by the Congress. Likewise, RI's main emphasis is on the administrative procedure set out by legislation (i.e. the mechanisms of control that legislation mandates)⁶⁰⁵. Secondly, the 'deliberative-constitutive' (DC) paradigm understands expertise as a social construct from a community of experts. Most significantly, however, they 'conceptualize expertise and accountability differently because each is based on a different institutional perspective of behavior within public administration.'⁶⁰⁶ While the two models complement each other, they underline different rationales for both decision-making and accountability⁶⁰⁷. The first one heavily relies on the institutionalized mechanisms of control of the state (e.g. legislation, statutes, courts, ombudsmen, administrative sanctions, etc.); the second paradigm, however, highlights the internal conversation of a professional or epistemic community to which the personnel of a regulatory agency belongs to.

I take Shapiro and Fisher's deliberative-constructive paradigm to advance the idea that, in TRNs such as the BCBS, the language, topics, and discussion of a professional community is very important for getting justifications from these types of transnational governance mechanisms. In this vein, Haas advances the idea that, in transnational governance, external expectations and standards are set by epistemic communities. An epistemic community is for Haas a group with shared expectations:

'Epistemic communities are networks – often transnational – of knowledge-based experts with an authoritative claim to policy relevant knowledge within their domain of expertise. Their members share knowledge about the causation of social or

⁶⁰⁵ Michael McCubbins, Roger G Noll, Barry R Weingast, 'Administrative Procedures as Instruments of Political Control' (n 444).

⁶⁰⁶ Sidney Shapiro, Elizabeth Fisher, 'Chevron and the Legitimacy of "Expert" Public Administration' (n 437).

⁶⁰⁷ The link between decision making and accountability has also been noted by Luhmann. It is interesting to highlight that, in theory, there are at least two understandings as to how to account a public service: an outside-in (the RI paradigm) and an inside-out one (the DC paradigm), *ibid*.

physical phenomena in an area for which they have a reputation for competence, and a common set of normative beliefs about what actions will benefit human welfare in such a domain. Members are experts with professional training who enjoy social authority based on their reputation for impartial expertise.’⁶⁰⁸

The question that guides this chapter is therefore why the Basel Committee responded to some claims but not others. The concept of communicative accountability helps to answer this question by explaining the relationship between the accountant, the accountee, and a professional community that is relevant for both accountant and accountee. The concept of communicative accountability is instrumental to map not only the sequences of communicative events that form an accountability process in the case of the BCBS, but also how those accountability processes resonate with one or more professional communities.

Communicative accountability, however, is not only a useful methodological tool to map accountability processes ‘on the margins of the state’⁶⁰⁹. It is also an understanding of accountability as a recursive process among a community of experts. As I will explain in this chapter, the community of financial professionals exercises peer pressure on the officials of the BCBS and might affect – positively or negatively – the standing of the Committee and its officials before the same professional community. I argue that reputation and standing are powerful incentives to motivate justifications from the BCBS to one or more accountability claims. Yet prestige and standing are judged against the technical expertise and accuracy of the Committee’s decisions against the backdrop of the epistemic community of bankers and financial regulators.

⁶⁰⁸ Peter Haas ‘Introduction: Epistemic Communities and International Policy Coordination’ (n 383), 3.

⁶⁰⁹ Graff-Peter Calliess and Peer Zumbansen, *Rough Consensus and Running Code: A Theory of Transnational Private Law* (n 1).

Communicative accountability draws on Niklas Luhmann's concept of communication. As I advanced in the thesis' introduction, Luhmann understands communication as a sequential chain of communicative events; each event with three selections. Departing from the more generalized understanding of communication as the transmission of information between two points, Luhmann explains that communication is a selection of communicative events that chime with each other because they share a common theme and a common understanding⁶¹⁰.

Communicative accountability hence adds a third element to my working definition of accountability. Instead of the traditional two-way relationship between accountant and accountee, communicative accountability also requires a professional or epistemic community, which mediates each step of the process of accounting⁶¹¹. Likewise, the epistemic community creates a 'network of meaning' that first, eases communication at each stage of the accountability process; and second, gives unity and some coherence to the process. Moreover, the 'network of meaning' provides a 'forum' for accountability that plays the role of an 'expert public opinion' that assesses each stage of the accountability process (i.e. the accountability claim, the justification, and the judgment of this justification).

⁶¹⁰ Luhmann argues that the shared understanding is a professional system that is functionally differentiated from other social systems (i.e., it is specialized in legal, economic, scientific, financial, artistic, or religious matters, among others). The social system of financial regulation is very relevant for the work of the BCBS and, as I will explain, for fleshing out the expectations that are brought to bear upon the Committee's work "From the perspective of the dynamics of development, boundaries are performances that can be intensified. We have indicated this aspect with the concept of system *differentiation*." (the emphasis is in the original version) Niklas Luhmann, *Social Systems* (n 100), 30; Differentiation is the way of recognizing plurality or uniformity in society's sub-systems, see also Barry Buzan, Albert Mathias, 'Differentiation: a sociological approach to international relations theory' (2010) 16 *European journal of international relations* 3, 315-337.

⁶¹¹ An attempt to make sense of the accountability of TRNs and to include a professional community has been done by Dreirde Curtin and Linn Senden 'Public Accountability of Transnational Private Regulation' (*Amsterdam Centre for European Law and Governance*, 2011); accountability for the authors is not a two way relationship, but a triple process that involves the accountant, the accountee, and an accountability forum of experts.

In a context of uncertainty and complexity, communicative accountability explains through the peer pressure of the epistemic community both a TRN's sense of obligation to respond to certain claims and the potential or real consequences that it may face as a result of being held accountable. In this process the use of expert language is central. Without it, neither the TRN nor other members of the professional community would 'hear' or 'understand' the relevance of a given accountability claim. A quote from one of my exploratory interviews is eloquent. For instance, one former official of the BCBS referred to the 'occupy' movement that had organized a demonstration in front of the BIS offices at Basle, where the Committee is also headquartered. He explained to me that they were sympathetic to the movement's demands, but they 'did not understand them.' He added that the BCBS was a technical body that, unfortunately, could not do anything to address the demonstrators' political demands.

To construct the concept of communicative accountability I first explain Luhmann's concept of communication in the context of Luhmann's systems theory. Second, I explain the concept of communicative accountability and I flesh it out with the analysis of the qualitative data set about the BCBS. I argue that each element of the accountability process (i.e., the communication chain) has three selections: information, medium, and understanding. While the first selection (i.e., *information*) is relevant because it indicates the link between each communicative event and the next one, the third selection (i.e., *understanding*) is relevant because it connects each communicative event with a network of meaning. In the case of the work of the BCBS, the network of meaning is the community of national bankers, financial professionals, and financial regulators.

I conclude by summarizing the key features of the concept of communicative accountability and by explaining why the BCBS is obliged to explain and justify itself

when a claim chimes with the language and expectations of the financial regulatory community. I seek to show that communicative accountability complies with the requirements of an accountability process that Bovens sets forth in his definition. Likewise, the concept of communicative accountability is a way to make sense and identify accountability processes in the transnational court of *expert public opinion*.

2. Luhmann's system theory and his understanding of communication

Luhmann's concept of communication is particularly apt for understanding accountability in transnational governance because it portrays communication as an anarchic, decentralized process. First, it emphasizes the common understanding of past and present communication. And second, Luhmann's model of communication better than other accounts of accountability describes the environment of anarchy and uncertainty present in global governance processes. For Luhmann, communication organizes itself by a series of unplanned selections. He calls this way of organization *autopoiesis* (i.e., self-reference).

In the following subsection I briefly explain some of the elements of Luhmann's theory that constitute the context for his understanding of communication. This introduction is necessary to get a better idea of Luhmann's theory of communication which is the basis of this thesis' concept of communicative accountability and which next section explains.

a) Luhmann's understanding of social phenomena: a short introduction to his thought as a context for his idea of communication

Niklas Luhmann's systems theory is based on the concept of *autopoiesis* developed by the Chilean biologists Maturana and Varela⁶¹². These authors explained biological organisms differ from non-living ones in that the former have the ability to reproduce themselves. In other words, they meant that each living individual has the ability to produce the structures for its own reproduction. *Autopoiesis* is the name they gave to self-reproduction⁶¹³. Non-living entities are *allo-poietic*, where 'allo' means other in Greek, because they need an external agent to modify them (rain, wind, gravity, etc.)⁶¹⁴.

Autopoietic organisms do not need an external agent to reproduce:

Consider for example the case of a cell: it is a network of reactions which produce molecules such that (i) through their interaction [they] generate and participate recursively in the same network of reaction which produced them, and (ii) realize the cell as a material unity.⁶¹⁵

According to Maturana and Varela, *autopoietic* systems are *operatively closed* and *interactively open*. By being operatively closed, nothing different from the system operates inside the system: the system creates its own elements for operating. Nevertheless, *operative closure* does not mean that the system is altogether closed to external input. The system responds to the environment but according to its own operations, upon which the environment has no influence whatsoever (*interactive openness*). A cactus, for example, develops the elements it needs for its production and reproduction (spines, roots, water storing tissue, flowers, etc.). In the cactus' case, no other organisms reproduce those structures that constitute the cactus plant (i.e.,

⁶¹² Maturana, Humberto and Francisco Varela, *De Máquinas y Seres Vivos. Autopoiesis: la organización de la vivo*, (Editorial Universitaria 1974).

⁶¹³ Contrary to 'allo-poiesis' (from Greek 'allos': other) David Seidl *Luhmann's theory of autopoietic social systems* (n 102).

⁶¹⁴ *ibid.*

⁶¹⁵ Maturana, Humberto and Francisco Varela, *De Máquinas y Seres Vivos. Autopoiesis: la organización de la vivo* (n 612), 188, in David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 2.

operative closure). At the same time, a cactus can grow in the Sonora or Arizona deserts, or in other humid and rainy climates like Britain. In both scenarios the cactus will have different access to water, nutrients, sunlight, etc. In both locations the plant regulates the amount needed of these elements, according to its own structure (i.e., *interactive openness*). The only way a living system interacts with its environment (*interactive openness*) is according to its independent (*auto-poietic*) operations (*operative closure*).

For Maturana and Varela *operational closeness* and *interactive openness* are directly linked to cognitive processes⁶¹⁶. Organisms transform stimuli from the environment into information. The temperature goes up or down, the wind blows strongly or mildly, the light varies its frequency, and the pitch of the sound waves can be higher or lower. Not all autopoietic organisms, however, perceive all these changes in the same way. Dogs, for instance, hear higher pitches than humans; but humans can see wider frequencies of light and thus perceive colour, which dogs cannot. For Maturana and Varela – and for Luhmann too – stimuli are only irritations that the autopoietic organism transforms into information according to its own operations⁶¹⁷.

The system may adapt to the environment, or not. The concept of *structural coupling* captures the relation between a system and its environment. The environment triggers a diversity of reactions in the system, but those reactions follow the internal structure of the system. A *structurally coupled* system is well adapted to its environment. This means that *important* stimuli in the environment trigger adequate responses in the system. The system that is structurally coupled with its environment copes with the environment in a better way than non-structurally coupled systems. If a

⁶¹⁶ Maturana, Humberto and Francisco Varela, *De Máquinas y Seres Vivos. Autopoiesis: la organización de la vivo* (n 612), 188, in David Seidl *Luhmann's theory of autopoietic social systems* (n 102).

⁶¹⁷ *ibid.*

cactus lives in the Sonora desert, the plant is structurally coupled to live in the conditions of lack of rain and extreme heat. If the cactus is moved to a rain forest, the survival of the organism is in jeopardy because the internal operations of the plant are not originally adapted to cope with that environment. This is similar to what happens to other organisms or other systems (e.g., social or psychic). A structurally coupled system adapts well to the environment.

The conclusions from Maturana and Varela have been applied directly to social science with mixed results⁶¹⁸. Luhmann, on the contrary, first attempted to make a general theory of autopoietic systems that included both living and non living systems. Luhmann's general systems theory⁶¹⁹ is abstract for this reason. It also modifies Maturana and Varela's remarks so that the theory is apt to social and psychic systems (i.e., human beings):

Against the backdrop of categorisation of analytical levels the transformation of the original autopoiesis concept to the social domain becomes clear. Instead of just transferring the concept from the field of biology into the field of sociology, it is first abstracted to a general concept on a trans-disciplinary level, before being re-specified into social autopoiesis and the autopoiesis of particular types of social systems.⁶²⁰

Therefore, if someone would apply Luhmann's theory to living, biological organisms, the theory would have to be modified appropriately again⁶²¹. Luhmann's theory is often described as a type of 'grand theory' that cannot be tested or applied to empirical projects: an abstract explanation of social reality⁶²². But Luhmann's theory is not altogether abstract. It has three levels of analysis, each one with a greater degree of concreteness⁶²³. The first one is the general systems theory, the more general and

⁶¹⁸ *ibid.*

⁶¹⁹ Luhmann, Niklas *Social Systems* (n 100).

⁶²⁰ David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 6.

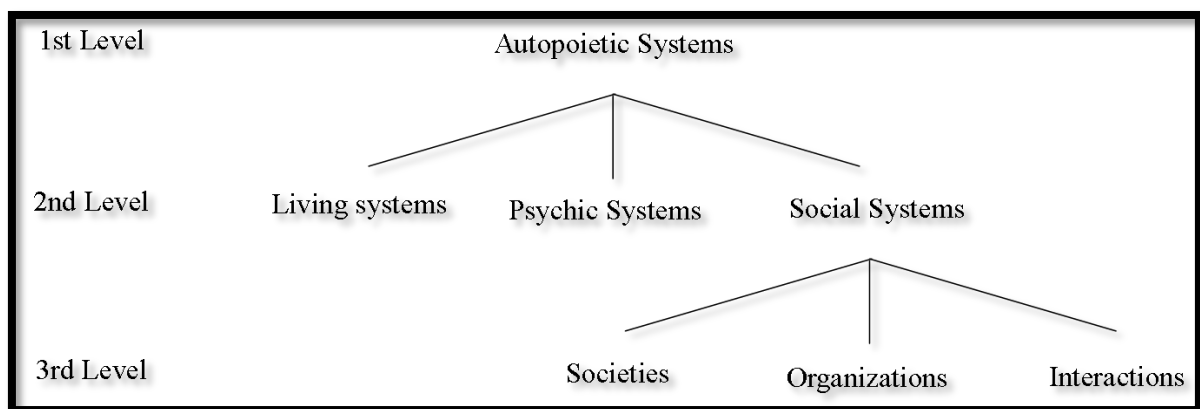
⁶²¹ *ibid.*, 6-7.

⁶²² Alan Bryman *Social Research Methods* (OUP 2012), 21.

⁶²³ David Seidl *Luhmann's theory of autopoietic social systems* (n 102).

abstract of them. The second one includes the types of possible autopoietic systems⁶²⁴. For Luhmann, social and psychic systems are autopoietic systems too, along with living organisms. While living systems operate on biological exchanges between their inner structures, social systems operate on communication, and psychic systems operate on thoughts or consciousness⁶²⁵. This level is less abstract than the previous one, but its descriptions are still fairly general. The last level of analysis is a subcategory of social systems. On this last level, Luhmann divides social systems in three types: society, organizations and interactions⁶²⁶.

Fig. 6.0. Levels of analysis in Luhmann's theory⁶²⁷



Society is the social system *par excellence*⁶²⁸. For Luhmann, it comprises all possible communication, and therefore there is only one society: the world society⁶²⁹.

⁶²⁴ i.e., where the system's reproductive elements are consequence of the same system's operation.

⁶²⁵ Luhmann 1995, David Seidl *Luhmann's theory of autopoietic social systems* (n 102). While is harder to use the more abstract version of Luhmann's theory for empirical social research, some of the concepts described in the more concrete levels of analysis are useful for social research. Luhmann's remarks on societies, organizations and interactions are indeed capable of guiding empirical research, as this thesis shows and this chapter later explains.

⁶²⁶ Luhmann, Niklas *Organización y decisión. Autopoiesis, acción y entendimiento comunicativo* (n 519).

⁶²⁷ David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 5.

⁶²⁸ Niklas Luhmann, *Social Systems* (n 100), 408-409.

⁶²⁹ *ibid*; for a critique of Luhmann's concept of a world society see David Rodríguez Mancilla, Gerardo Torres Nafarrete, 'Estudio Introductorio' in Niklas Luhman *La Sociedad de la Sociedad*, (Universidad Iberoamericana 2001); See also G Leite Goncalves 'El Post-Colonialismo y la teoría de sistemas: apuntes para una agenda de investigación sobre el derecho en los países periféricos' in Estrada Saavedra, M. and René Millán (eds.) *La Teoría de los Sistemas de Niklas Luhmann a prueba*, El Colegio De México-UNAM 2012); Fernando Carballo 'Niklas Luhmann y la barbarie: consideraciones sobre la inclusión y

The difference between society and the environment is based on the premise that the environment cannot communicate, it can only be the object of communication. Everything that is not communication is the environment⁶³⁰; everything that is not communication is not part of society.

Luhmann's holistic, global concept of society, however, is not uniform, as it does allow some plurality or differentiation⁶³¹. Society has parts or, using Luhmann's words, it has subsystems. Society has differentiated in the past in various forms⁶³². One of them has been *segmentation* or the differentiation into equal subsystems, like clans, tribes, or families. A second form of differentiation has followed the logic of *centre-periphery*, distinguishing between the metropolis and the rest of society. A third form of differentiation is *stratification*, dividing society into a hierarchy of subsystems and categories. Finally, a fourth form of differentiation has been *functional*, following society's need for specialization according to function (arts, science, economics, law, etc.).⁶³³

According to Luhmann, we live now in a world society, which is composed by different sub-systems, which differ from each other by the function they have⁶³⁴. The

exclusión planetaria' in Estrada Saavedra, M. and René Millán (eds.) *La Teoría de los Sistemas de Niklas Luhmann a prueba*, El Colegio De México-UNAM 2012).

⁶³⁰ Luhmann, Niklas, *Ecological Communication* (n 580).

⁶³¹ "From the perspective of the dynamics of development, boundaries are performances that can be intensified. We have indicated this aspect with the concept of system *differentiation*." (the emphasis is in the original version) Niklas Luhmann, *Social Systems* (n 100). 30; Differentiation is the way of recognizing plurality or uniformity in society's sub-systems, see also Barry Buzan, Albert Mathias, 'Differentiation: a sociological approach to international relations theory' (n 610).

⁶³² Some authors have criticized Luhmann's view of a 'world society' and his division of history. They struggle with his mainly western-centred point of view. But, while Luhmann's division of history is controversial, the typologies of social differentiation can be useful and are indeed based on classic authors like Max Weber, Emile Durkheim or Talcott Parsons. Max Weber, *Economy and Society: An Outline of Interpretative Sociology* n 359; Emile Durkheim *The division of labour in society* (Palgrave Macmillan 2013); Talcot Parsons, *The Social System* (Routledge 1991); David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 13.

⁶³³ David Seidl *Luhmann's theory of autopoietic social systems* (n 102).

⁶³⁴ Luhmann does not suggest that these forms of differentiation are the only ones, nor does he says that there is an evolution *à la Comte* where one newer type of differentiation is better than the others. See

type of differentiation that follows the logic of function is the most relevant to Luhmann⁶³⁵. Although society's sub-systems are now primarily products of *functional differentiation*, secondarily, they can contain other sub-systems that follow a different logic. Secondary sub-systems (i.e., the sub-system's sub-system) might be differentiated using *segmentation*, *stratification*, or following the *centre-periphery* logic⁶³⁶.

Each sub-system has a unique perspective to look at the environment. Such a perspective is precisely the source of its differentiation. Luhmann calls each sub-system's particular perspective 'coding.'⁶³⁷ Coding constitutes both each system's particular perspective and a product of its specialization. Among other systems, law, economics, or science have a different world perspective that autopoietically chooses what is relevant to each profession (i.e., each system) and what is left outside. The law, focuses in everything that is *legal*, leaving aside everything else. This creates a *binary code* that selects communication inside and outside the system (i.e., *legal-notlegal*).

Likewise, economics and science have *binary codes*. For economics the binary code is *have-not have*, and Luhmann defines sciences code as *true-false*. Interestingly, what is legal might not be true, nor what is true means a good or service (in economic terms). As a consequences of coding, those events not coded using the relevant system's code become irrelevant to a system: 'Events must be distinguished as coded and uncoded. Coded events operate as information in the communication process, uncoded ones as disturbance (noise).'⁶³⁸

David Rodríguez Mancilla, 'Nota a la version en Español' in Niklas Luhmann, *Organization y Decisión. Autopoiesis, acción y entendimiento comunicativo* (n 592).

⁶³⁵ David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 14.

⁶³⁶ Teubner argues that the financial system (a sub-system) follows the logic of *function* but is secondarily differentiated by a logic of *centre-periphery* (being London, New York City, Frankfurt, Zürich and Hong Kong the centres) and tertiary, within each centre, following a logic of *stratification*. Gunter Teubner, 'Introduction' n 332.

⁶³⁷ Niklas Luhmann, *Ecological communication* (n 580), 142.

⁶³⁸ *ibid.*

Uncoded events are noise because they fall outside the system's expectations and remain outside the system's autopoietic communication. Luhmann uses the analogy of a conversation to which a passerby is not addressed. In such a situation, the passerby is not expected to join in. Even if she does, it is unlikely that she understands the conversation going on in its entirety⁶³⁹. Systems, similarly, are specialized to understand the environment from a particular perspective contained in their code. Un-coded events are disturbances because they do not chime with the system's functional specialization.

Luhmann's theory is more diverse and complex than the short introduction of this subsection could capture. For the purposes of the thesis, however, I only explained those concepts that are central to understanding Luhmann's idea of communication. The next subsection further develops an account of the ideas that are central to Luhmann's theory and which constitute the theoretical foundation for the concept of communicative accountability that the thesis puts forward.

b) Luhmann's understanding of communication

At the core of Luhmann's theory is his concept of communication. Luhmann's idea of communication, however, departs from the metaphor of transmission that authors like Habermas⁶⁴⁰, Eco⁶⁴¹, and Castells⁶⁴² develop. The idea of transmission assumes that there are two or more points or terminals in any communication process, one that

⁶³⁹ *ibid* 142-143.

⁶⁴⁰ Jürgen Habermas *The theory of Communicative Action; v. 2 Lifeworlds and Systems: a critique of functionalist reason*, (Beacon Press 1978).

⁶⁴¹ Umberto Eco *A Theory of Semiotics* (Indiana University Press 1979).

⁶⁴² Manuel Castells, *Communication Power* (n 81).

transmits and others that receive information⁶⁴³. On the contrary, Luhmann finds the transmission metaphor limited. When transmitted, information does not ‘travel’ or ‘leave’ one point to another⁶⁴⁴. For Luhmann, communication is not a ‘thing’ but a connection⁶⁴⁵. The idea of transmission also assumes that there is a two way process between transmitting and receiving. In communication, however, meaning is also essential to the process⁶⁴⁶. An example is in order.

A person swimming in the sea waves her hand and screams. She wants help because the current is pulling her off the shore. Another person sees her but understands the waving as a form of greeting. The passerby does not *understand* the swimmer’s gesture as a SOS and she simply waves back. Eventually, a third person sees the swimmer too and finally understands the waving of hands as a request for help. It is then when the third person helps the swimmer. A transmission can go back and forth, but it is only effective when a shared meaning is present. Communication is therefore more than transmission.

For Luhmann, selection is at the core of his concept of communication. Communication is a chain of communicative events. Each event links with each other by selecting each other. Communication is the sequential selection of events that forms meaning⁶⁴⁷. Let us suppose that, in our example, it is not the first time the sea pulls someone away from the shore. Due to many people that have swam in that beach and

⁶⁴³ Shannon and Weaver first set out the metaphor of transmission. Although Luhmann draws on some of these author’s concepts (like the selections of information, media, and appeal), he dismisses their claim that communication is a transmission of information. See Claude E Shannon, ‘A Mathematical Theory of Communication’ (n 99).

⁶⁴⁴ *ibid.* Perhaps this is understandable because Shannon and Weaver explain communication as a transmission of signals that ‘travel’ from one point to the other. They refer to radio signals that need a transmitter and a receiver. When communication is social, however, the metaphor of transmission is no longer useful.

⁶⁴⁵ ‘The metaphor of transmission locates what is essential about communication in the act of transmission, in the utterance. It directs attention and demands for skillfulness onto the one who makes the utterance. But the utterance is nothing more than a selection proposal, a suggestion. Communication emerges only to the extent that this suggestion is picked up, that its stimulation is processed.’ Niklas Luhmann, *Social Systems* (n 100), 139.

⁶⁴⁶ *ibid.*, 140.

⁶⁴⁷ David Seidl *Luhmann’s theory of autopoietic social systems* (n 102), 7.

suffered from its jarring currents, the community decided to make a system to avoid misunderstandings. Our swimmer, a frequent visitor to that beach, knows that the gesture to ask for help is to wave both hands in intervals of 10-15 seconds. The passerby, a member of that community, knows the gesture too. This time the meaning is clear, there is less uncertainty, and the help is quickly on its way. This time there is a shared meaning about the different gestures to greet and to ask for help. In my example the second person helps the swimmer because both attach a common meaning to the waving of hands. But, for Luhmann, behind that agreement there is a sequence of events that were selected through trial and error.

Communication is a chain of sequential communicative events. While each one is a unity – e.g., the waving of the hands – each one is able, however, to be analyzed as the product of three selections: presentation, expression, and appeal⁶⁴⁸. Luhmann also calls them *information*, *utterance*, and *understanding*. I explain the three selections in the following paragraphs.

The first selection is information. It is a decision to communicate something specific among other options: *what* is chosen among other alternatives. From the universe of possibilities that *alter* would like to communicate to *ego*, *alter* selects only one⁶⁴⁹. The second selection is *utterance*. This is the channel and the reason chosen to communicate information: *why* and *how* something is communicated (e.g., a particular newspaper, an editorial, a report, a personal letter, a statement, etc.). Finally, the third selection consists of *understanding* – also called *appeal*, which is the selection of the meaning that is communicated among all possible alternative meanings.

The third selection, *understanding*, is central for Luhmann's concept of communication. For the author, *understanding* is the distinction between *information*

⁶⁴⁸ Niklas Luhmann, *Ecological Communication* (n 580), 142.

⁶⁴⁹ David Rodríguez Mancilla, Javier Torres Nafarrete, *Introducción a la Teoría de la Sociedad de Niklas Luhmann* (Herder-UIA 2008), 70.

and *utterance*. This means that, in order to understand a communicative event, one must distinguish between what is communicated from how and why it is communicated. To distinguish between what the swimmer communicates ('I'm drowning') from the medium and reason why she is communicating (waving her hands to get help, and not waving her hands to greet the passersby or to be let alone).⁶⁵⁰

Understanding is the selection of the expectation of success. Likewise, understanding is the intentionality of communication⁶⁵¹. But contrary to what other theories of communication explain, the intention of the issuer is not relevant. Rather, Luhmann explains that communication's intentionality means the way a communicative event will be understood in the context of past communication and future expectations⁶⁵².

A communicative event is successful if it chimes with a relevant system of understanding. The relevant question is then how the network of communications understands the new communication. The question is not how the receiver understands the communicative event, but how society or a community creates meaning through a network of communicative events.

When moving away from the metaphor of transmission, communication becomes a multi-centered complex process. It is no longer a 'dialogue' between an issuer and a receiver – hence, the metaphor of transmission is less germane – but a

⁶⁵⁰ Seidl puts another example: 'if alter says to ego: 'I am tired', ego has to distinguish the information ('I am tired' and not e.g.: 'I am very energetic') from the utterance (the words alter is using and the reason why alter is saying it: e.g. alter wants to indicate that ego should leave him alone; he is not saying it in order to get any advice on what to do about his tiredness).' David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 7.

⁶⁵¹ For Luhmann intentionality is the way previous communication understands a new communicative event. Niklas Luhmann, *Social Systems* (n 100).

⁶⁵² *ibid*, 71.

complex network *shared* among many issuers that somehow builds meaning as a result of the process⁶⁵³.

When moving away from the metaphor of transmission, communication does not become the result of what someone understands⁶⁵⁴, but it is the result of what a wider community *understands*. This understanding is external to all those who intervene in the process in that not a single one can control the outcome. For Luhmann, someone understands something *because* she is a member of a community of understanding. Communication is in this sense *autopoietic*, it has life of its own. Thus, once the communication process starts, the outcome of the process is uncertain to all participants.

Meaning makes a crucial addition to the equation of information and utterance. In our example, the swimmer can repeat the gesture of moving her hands simultaneously for intervals of 10-15 seconds in another beach. But unless people at this second beach understand the gesture in the same way as in the first location, no one would take her gesture as a call for help. Even more, the gesture could mean something else in this hypothetical second resort (e.g., a greeting, a way of complaining, or a display of joy). Meaning depends ultimately on the other two previous selections – information and utterance. But meaning is so important that the form information and utterance take is at the end irrelevant, as long as the desired meaning is conveyed.

Luhmann understands the acknowledgement of a given communicative event by a future one as a fourth selection. *Alter* can either accept or reject the communication from *ego*, in the same way that a student can understand the phrase ‘do your homework’ from his teacher but reply ‘no, I won’t’⁶⁵⁵. In this case *alter* is acknowledging *ego*’s

⁶⁵³ Manuel Castells, *Communication Power* (n 81). The author tresses the fact that TV is a system of communication, however, this thesis undersntand that TV is just the media. The system contains different meaning or understanding.

⁶⁵⁴ Luhmann calls that ‘someone’ as ‘alter’. Luhmann describes the interactions between two entities as *alter* and *ego*. Niklas Luhmann, *Social Systems* (n 100).

⁶⁵⁵ David Seidl *Luhmann’s theory of autopoietic social systems* (n 102), 17.

communicative event, even when *alter* rejects it. But it is also possible that *alter* does not acknowledge *ego's* communicative event. This could happen because of two reasons: First, *alter* does not perceive it (i.e., the communicative event does not reach *alter's* attention); or second, because *alter* does not *understand* it (i.e., the communicative event is phrased in a language that *alter* does not understand).

In conclusion, communication for Luhmann is a sequence of communicative events which can be analyzed as a triple selection process of *information* (i.e., what is being said), *utterance* (i.e., by which media or channel it is being said) and *appeal* (i.e., with what meaning it is being said). Most significantly, the third selection – meaning – is key to understand Luhmann's system theory. Similarly, it is very important for this thesis because it connects each element of a communicative accountability process with each other, and with the language and conversation of a wider professional community. In the next subsection I seek to apply Luhmann's concept of communication to the case of the BCBS.

3. A concept of communicative accountability

The introduction to Luhmann's concept of communication and the review of how the academic literature about accountability understands epistemic communities is useful to introduce the concept of communicative accountability. The concept of communicative accountability that I develop in this chapter uses Luhmann's understanding of communication to map accountability processes in the case of the BCBS. It takes the working definition of accountability and complements it with Luhmann's concept of communication explained above.

According to my working definition, accountability is the process by which one or more external claims are issued requesting and obtaining a justification or explanation from a person or organization that exercises power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow. The working definition, following Davies⁶⁵⁶, delineates three stages: there is an accountability claim at the beginning of the process; next, the accountee answers the claim and issues a justification; and finally, the justification is judged according to a set of standards and it is decided which consequences, if any, should follow.

Communicative accountability is the particular process by which a sequence of connected communicative events takes the form of the working definition of accountability. A communicative event can be an article in the comment section of a newspaper, a television interview, a comment in a social network (*facebook, twitter, etc.*), a justification in a press release, or a journalistic article in the media. For Luhmann a communicative event is a point in the communication process⁶⁵⁷.

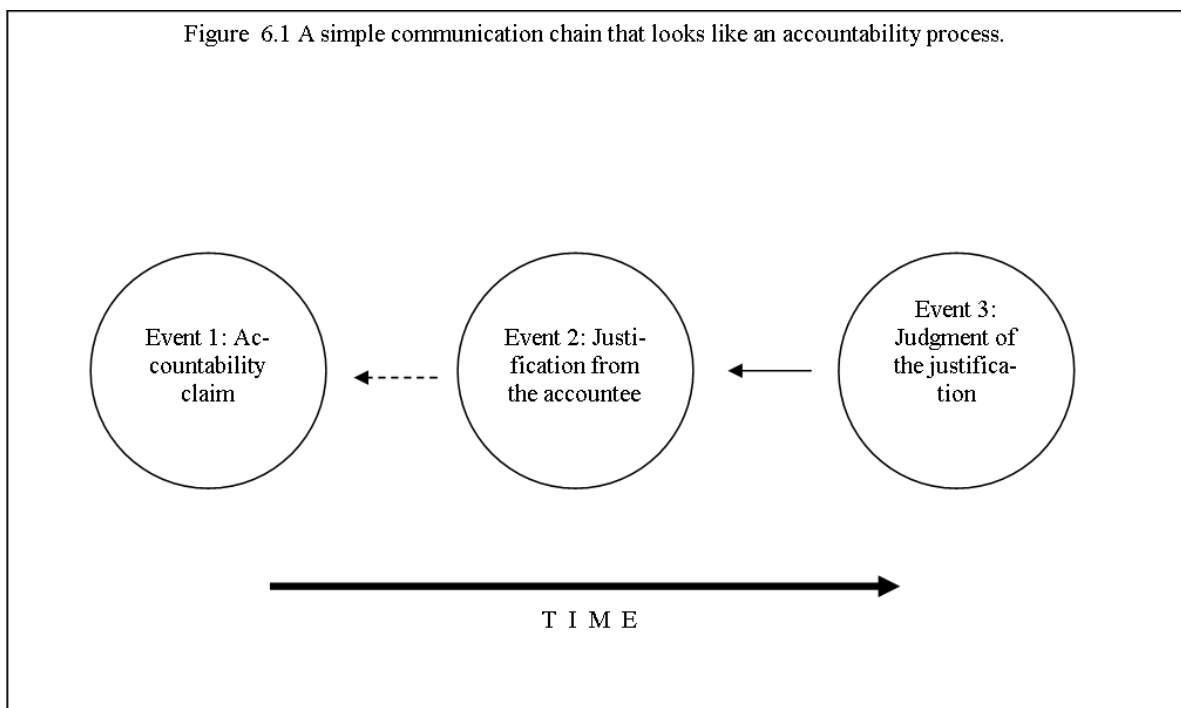
The interconnection of different communicative events that look like accountability processes happens at three levels (i.e., the same three levels of Luhmann's concept of communication). Firstly, the events that form the three-stage process that looks like accountability (i.e., the accountability claims, the justifications, and the judgments of those justifications) mention the same theme (e.g., they all speak about the internal based risk approaches, the implications of Basel II for small and medium-sized enterprises, or the over-complexity of Basel III). Not only do they have the same theme, however, but also those events make reference to each other. This means, for instance, that using the first level of analysis (i.e., Luhmann's *information*)

⁶⁵⁶ Anne Davies, *Public Accountability* (n 554).

⁶⁵⁷ Niklas Luhmann, *Social Systems* (n 100), 81.

there is a communicative event that has the form of a judgment and that explicitly refers to another communicative event that takes the form of a justification from the accountee. This communicative event refers in turn to another one that takes the form of an accountability claim. Figure one explains this connection. In it, each circle symbolizes one communicative event and each arrow, the explicit reference that one event makes to another. This reference happens when a future event ‘speaks about’ or ‘mentions’ a past communicative event. Arrows show what Luhmann describes as selections between communicative events at the *information* level.

The arrows in figure 6.1 are continuous or discontinuous; which represents that one communicative event refers to another explicitly or implicitly. The reference is implicit when one event does not ‘speak about’ another by expressly identifying it but instead uses its language and theme. In chapter 1 I reproduced a very similar figure to introduce the concept of communicative accountability.



First, chains of communication are formed by communicative events that connect to one another by implicit or explicit references. Additionally, they are

connected by the topic they talk about and the ‘perspective’ from which they argue. This perspective is the third Luhmannian selection of *meaning*.

A chain of communication may have three or more events shaped in the form of an accountability process that refer to the same theme. Only if the sequence shares the same language and resonates with the same perspective there is coherence in the chain of communication. Most significantly, Luhmann’s third selection (i.e., *meaning*) gives a common perspective.

As I will explain in chapter 7, the discussion about the effects of the Basel II accord on small and medium-sized enterprises (SMEs) is eloquent. The topic of many communicative events in this discussion was the impact that attaching a higher risk on exposures to SMEs would have on the level of loans available to small and medium-sized enterprises. Mainly because of Germany’s fierce opposition to the measure, the BCBS decided to relax the rule so that SMEs would not be affected. Nevertheless, the perspective from which the problem was viewed was diverse. When the BCBS decided to relax the rule on SMEs’ exposures, there were two different perspectives that assessed the Committee’s decision. Firstly, there were some communicative events that focused on the effects – positive or negative – that the new rule would bring for SMEs. Some comments mainly from the German press praised the final decision as a sensible one and highlighted its benefits on SMEs⁶⁵⁸. Others argued that the changes were not enough and more efforts were needed⁶⁵⁹.

⁶⁵⁸ *Financial Times Deutschland*, 4 July 2002, ‘Deutschland drückt Mittelstands-Interessen bei Basel II durch’; *Reuters-Nachrichten auf Deutsch*, 3 July 2002, ‘Fokus1-Schröder-Basel II wird Mittelstands-Forderungen gerecht’; Szent-Ivanyi, Timot, ‘Kreditvergabe an Mittelstand gesichert – Kompromiss bei “Basel II” – Verhandlungen’, *Berliner Zeitung*, 4 July 2002; RTR, ‘Basel II wird Forderungen des Mittelstands gerecht’, *General Anzeiger*, 4 July 2002; Wanner, Claudia, ‘Baseler Ausschuss formuliert Kompromiss’, *Financial Times Deutschland*, 11 July 2002; see also ‘Western Europe – SMEs – SMEs Mind the Financing Gap’, *The Banker*, 1 October 2002

⁶⁵⁹ *European Report*, ‘Financial services – MEPs lead Criticism of Basel II Accord over SME capital adequacy’, 6 September 2003

Secondly, however, the European Shadow Financial Regulatory Committee (ESFRC) issued an accountability claim criticizing that the change of the rule regarding SMEs exposures was based on political grounds. They argued that, any change should have been based on a technical discussion from the financial point of view⁶⁶⁰.

In this example, the Committee, through a conference of its Chairman in the European Parliament, justified the claims coming from both perspectives⁶⁶¹. On the one hand, Mr. Caruana said that the BCBS was committed to assure that Basel II effects on SMEs were positive. On the other, he argued that the changes approved were based on financial arguments, and not political ones.

More importantly, what this example shows is that there are two distinctive perspectives talking about the same theme (i.e. SMEs). Each perspective resonates with two different communities. The first perspective, i.e. the one that demanded changes in Basel II for the benefit of SMEs, resonates with advocacy groups and small and medium-sized enterprises' organizations. The second perspective, i.e. the one that criticized that the decision was taken on political grounds rather than on technical ones, resonates with financial and banking regulatory experts.

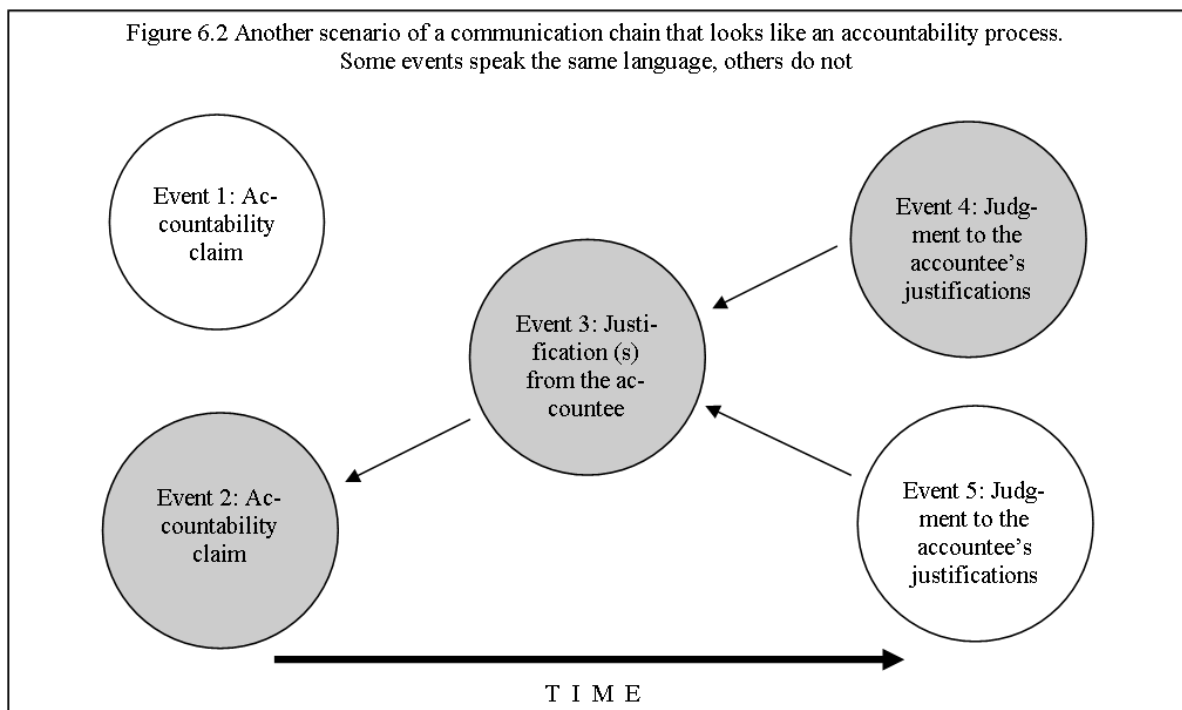
This example also shows that political pressure can sometimes be very effective to change the BCBS' decisions. And finally, that despite of the facts, the Committee is very keen on defending its standing as a technical 'think tank'- as I pointed out in chapter 4 – that is not easily influenced by political manoeuvres (i.e. the pressure from Germany).

Figure 6.2 shows the same process that figure 6.1 depict. This time, however, it adds the third selection of *meaning* (i.e. perspective). Each circle is a communicative

⁶⁶⁰ ESFR Statement No. 16 *Bank Supervisors' Business: Risk Management or Systemic Stability?*, 4, the document was also presented as a comment in the 3rd consultation process of the BCBS. See www.bis.org/bcbs/cp3/eushfireco.pdf.

⁶⁶¹ Address by Mr. Jaime Caruana in the workshop organized by the European Parliament on the Consequences of Basel II for SMEs, 10 July, 2003, at www.bis.org/review/r030714d.pdf?frames=0

event that refers to a past one by an arrow (continuous or discontinuous). In figure 4.3 only those events that, firstly, speak about the same topic; secondly, refer to each other; and thirdly, speak from the same perspective (i.e., speak the same language and chime with the same epistemic community) are part of a coherent accountability process. Those communicative events that share a similar perspective are filled with a solid colour. On the contrary, those others with an alternative perspective are left in blank. These latter events can refer to the same theme but they do not chime with the same set of expectations as those fill with solid colour.



The *meaning* selection of each communicative event can potentially chime with various epistemic and professional communities. If the discussion is about the law, it chimes with the legal community. If it is about the technical merits of certain public policy, it resonates in a scientific or technical community (e.g., if the discussion is about the best way to build a bridge, it chimes with engineers and builders). Finally, if the

discussion is about minimum capital requirements and the measures to guarantee a healthy global financial system, it chimes with the epistemic community of financial professionals, bankers, and banking regulators as it is the case with the accountability chains of communication around the work of the BCBS, as chapter 7 illustrates.

I have set out the elements that will lead my analysis of the qualitative data set and that result in the five examples of chapter 7. By focusing on the selection of *information* and *meaning* it is possible to identify coherent chains of communication that resemble accountability processes: they have a common theme and a common perspective. Likewise, they have the form of accountability claims, justifications, and judgments.

In summary, the concept of communicative accountability enriches the description of accountability. Accountability processes of TRNs would be complex interactions between, on the one hand, many parties that ask the account and judge it and, on the other, the TRN that answers with one or more justifications. The process' cohesion, however, needs to rely on two features: firstly, it happens because of the references that communicative events make to each other (i.e., in the case of accountability, those that judge the justification of the accountee, and the justification that mentions the accountability claim or claims); and secondly, by the language and concepts that each communicative event uses; which draws on the shared perspective of an epistemic and professional community.

When the decision-making of a public organization refers to themes in relation to which epistemic communities claim expertise, and accountability-like discussions come as a consequence of those decisions, the standards and language of one epistemic community stand as a backdrop to the accountability process. Thus, accountability-shaped processes in uncertain contexts such as transnational financial governance of the

BCBS are not only formed by the accountant and the accountee. Additionally, the third selection resonates with the particular language of an epistemic and professional community. I argue that communicative accountability is also useful to map and explain the role of the BCBS expectations in the professional community⁶⁶². I argue that this role creates a relevant conversation in which the BCBS naturally participates and in which it is only reasonable that it justifies its actions and maintains the relevant expectations and the integrity of that particular system.

From a Luhmannian perspective, each epistemic community constitutes a self-referential system which produces its own expectations. This means that each community creates its own standards for decision making (i.e., what is acceptable and what is not). A good example of how expectations of the professional epistemic community work is the discussion about the impacts of Basel II over lending to SMEs. There was a controversy between those who thought that the relaxation of the rules for expositions to SMEs was politically motivated and those who thought that it was justified by a financial point of view.

Before explaining the influence of expectations in processes that might hold the BCBS accountable a clarification is in order. There is a contrarian argument that is worth discussing here. Kapstein⁶⁶³ argues that the international payments system was in complete disarray in the 1980s and that a credible threat by the US and the UK eventually saved it. The threat consisted of negotiating a bilateral agreement to set minimum capital requirements bypassing the Basel Committee. The Anglo-American threat was powerful enough to force the other members of the Committee to eventually

⁶⁶² For Romzek and Dubnick, expectations are normative standards within a professional community. They do not understand them as economists do (i.e. as future events that some agents foresee, like the growth on GDP, or the decrease in the price of petrol). On the contrary, Romzek and Dubnick argue that expectations are normative standards for decision making. Barbara S Romzek, Melvin J Dubnick, 'Accountability in the Public Sector: Lessons from the Challenger Tragedy' (n 14).

⁶⁶³ Ethan Barnaby Kapstein 'Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence' (1992) 46 *International Organization* 265.

converge around a set of standards for cross-border banking regulation that later resulted in the Basel I accord. The author concludes that the minimum capital standard for banks that became a fundamental part of Basel I resulted from a pragmatic assessment as to what was possible at the time, rather than an investigative exercise by the relevant literature on banking regulation. Therefore, Kapstein's conclusion might suggest that, at least in the Basel I case, the epistemic community had little to do with the final result. On the contrary, the decision was grounded in political considerations.

While I share Kapstein's narrative (i.e., that Basel I would have been impossible without the UK and US attempt to negotiate), I nevertheless disagree with his conclusions that central bankers do not form an 'epistemic community'⁶⁶⁴ because the author understands it as a community driven by academic and scientific work. My concept of 'epistemic community' is wider and it includes professional common understandings, whether or not they base their conclusion on academic and scientific work. Additionally, it is worth noting that the Anglo-American threat included two of the foremost centres of finance and banking (i.e. New York and London), where the professional community's best and finest concentrated⁶⁶⁵. Thus, the motivations of the US and the UK to negotiate a bilateral agreement about minimum capital requirements might be based on a common understanding by bankers and banking regulators in those important leading financial centres.

As I will explain in chapter 7, there are wider expectations in the community of financial professionals, bankers, and banking regulators that eventually create consequences for the accountee.

⁶⁶⁴ idem, 266.

⁶⁶⁵ Poul F Kjaer, Gunter Teubner, Alberto Febbrajo, *The Financial Crisis in Constitutional Perspective: the Dark Side of Functional Differentiation* (n 383).

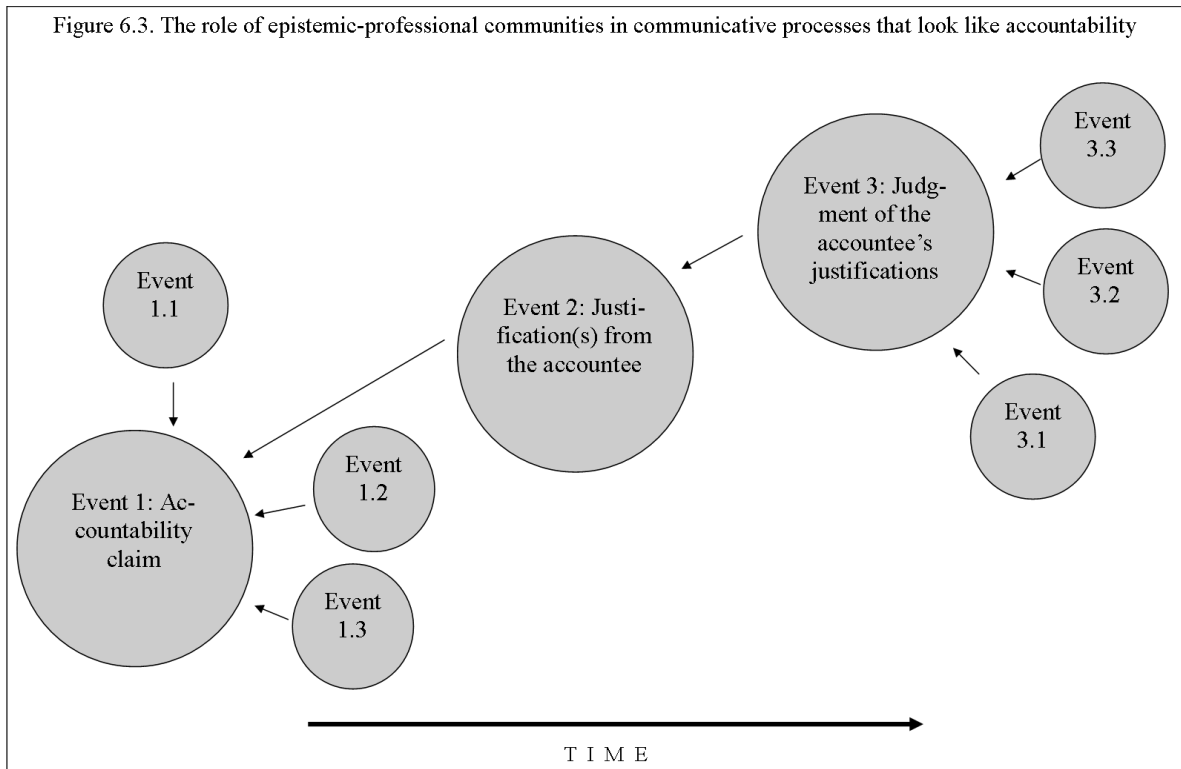
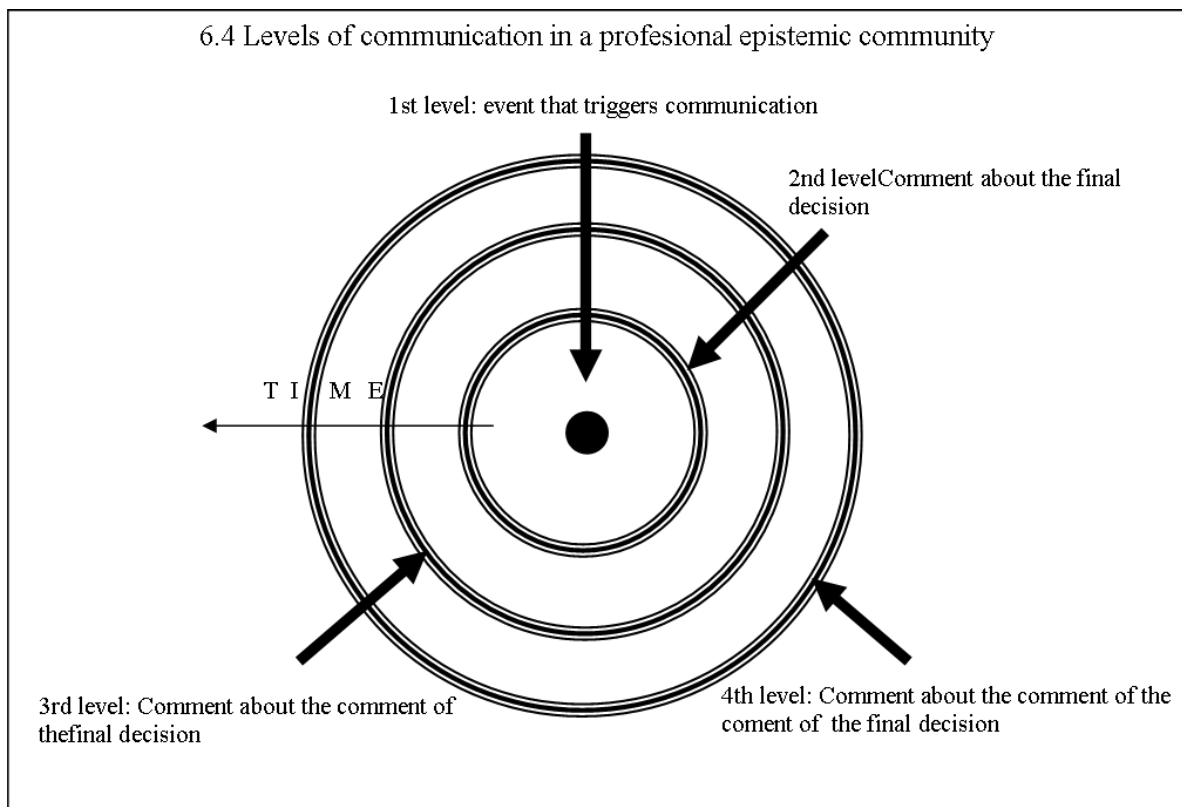


Figure 6.3 explains the interaction between the accountant, the accountee and the professional-epistemic community. In figure 6.3 one can identify the arrows that depict explicit or tacit references from one future event to one or more past ones. Each circle also shows a distinct communicative event. Additionally, figure 6.3 shows events that are not part of the chains of communicative accountability but which nonetheless refer to those ‘primary’ events. These events correspond to numbers 1.1, 1.2, 2.1, 2.2, and so on. There are ‘primary events’ that form part of the accountability chain of communication (i.e. they ask the account, get it, and decide which consequences should follow) and ‘secondary events’ which ‘speak of’ or ‘talk about’ the ‘primary’ ones. The role of the epistemic-professional community is precisely discussing – as a backdrop – the events of the communicative accountability process.

Unlike figure 6.2, figure 6.3 only depicts a process with one epistemic-professional community and where there are at least two events that assess and talk about each communicative event that forms part of the accountability chain of

communication. The process, however, can be much more complex than the one figure 6.3 depicts. Events number 1.1, 1.2, 2.1, 2.2, etc., can be in turn assessed and referred by other events that speak about the same theme from a particular epistemic-professional perspective. Each event has the ability to produce a ripple effect similar to the one a stone thrown in the water causes. Figure 6.4 shows this effect.



In communicative accountability the minimal elements of an accountability process (i.e. the claim, the justification, and the judgement of the justification) are in turn assessed by other communicative events. I argue that all of those events – both the central ones and those which stand at the periphery – chime with each other. Moreover, Luhmann’s triple selection of *information* (i.e. the theme), *utterance* (i.e., the language), and *appeal* (i.e. meaning) is a way of analysing all the events and identify them as elements of an accountability communicative chain.

4. Conclusion: A concept of communicative accountability

Communicative accountability is the sequence of communicative events that take the form of the elements that made up the working definition of accountability (put forward in chapter 5): one or more accountability claims, one or more justifications, and one or more judgments of the justifications. The presence of the epistemic-professional community might provoke in some cases that the accountee issues a justification. Not doing so, or issuing a defective one, would have consequences for the accountee. The presence of the epistemic-professional community thus creates an informal obligation based on the prestige and standing of the accountee in the professional community.

Luhmann's concept of communication provides a framework for identifying events and making sense of how they create meaning. As I explained in this chapter, meaning is highly relevant for the process of communication. But it is not the meaning that a singular event conveys, but rather it is the meaning that a community possesses, and that the event chimes with.

The professional epistemic community acts like an audience for communicative accountability. Put in other words, it stands as a backdrop that oversees the accountability claims, the justifications, and the judgments of these justifications. If an accountability claim does not resonate with the preoccupations and language of the epistemic community, it is less likely that the accountee will answer it with a justification.

The idea of communicative accountability provides guidance to identify and make sense of those chains of communication that resemble an accountability process and that chime with the expectations of a particular epistemic community. The language

that accountability claims use and their resonance into a particular community might be a highly relevant feature to provoke a justification by a TRN. Instead of looking for legally mandated obligations to account – which are very hard to find in the context of transnational financial regulation – I focus on the resonance that accountability claims create among the TRN’s professional-epistemic community. Chapter 7 fleshes out the concept of communicative accountability with the qualitative data set on the BCBS.

Chapter 7. Communicative accountability in and for the BCBS

1. Introduction: accountability for the BCBS

This chapter maps and identifies informal accountability processes in relation to the work of the BCBS. The previous two chapters (chapters 5 and 6) put forward the working concept of accountability and, using Luhmann's framework about communication I constructed the concept of communicative accountability. Accountability is a complex phenomenon that has been discussed in the specialized literature and that sometimes verges on a *buzzword* among politicians and regulators. But as I pointed out in chapter 5, there is not a unified agreement as to what accountability as a concept is and what its limits are. Transparency, legitimacy, and good governance are often – mistakenly – taken as accountability. The quest for accountability in TRNs like the BCBS needs, however, a clear understanding of what is and is not accountability. I provided this understanding in chapter 5 with the working concept of accountability.

The working concept is a 'minimal' definition that *describes* what an accountability process looks like. For the working concept, accountability is the process, by which one or more external claims are issued requesting and obtaining a justification or explanation from a person or organization that exercises power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow.

As argued in chapter 5, however, the working definition is not complete. The literature about accountability stresses that there are some elements without which an accountability process is not an accountability process. These are the necessity to

provide a justification (i.e., to answer an accountability claim) and the real or potential consequences for the accountee⁶⁶⁶. Thus, there are processes that look like accountability but, after a deeper analysis, we find that they are not so.

This chapter focuses on an analysis of a qualitative data set around the work of the BCBS and tries to identify accountability processes in it. The data set is constructed out of a plethora of journalistic and academic articles, press releases, publications by the BCBS, other transnational regulatory networks (TRNs), international organizations (e.g. the World Bank, the IMF), and think tanks. The construction of this data set was further inspired by Niklas Luhmann's ideas by using his concept of communication and thus taking each article, press release, comment, criticism or publication as one communicative event. I analysed more than 5000 communicative events from a universe of ca 28500 items that referred to the work of the Basel Committee. Through coding, I grouped them into different and related categories or themes. I could identify 15 themes that discussed the Committee's work in relation to certain features. Table 7.1 lists those themes, shows the number of items that refer to them, and indicates the years in which those topics were discussed more intensely⁶⁶⁷.

Table 7.1. Main themes identified relating to the work of the Committee

Theme	Items	Year
Internal Ratings	250	2000
Operational Risk	300	2002
Operational Risk Management	63	2002
SMEs and capital	62	2003
Operational Risk	335	2003
SMEs and capital	94	2004

⁶⁶⁶ Mark Bovens, *Analysing and Assessing Public Accountability: A conceptual framework* (n 596). As this chapter later explains, the necessity to account translates into a compelling need to justify, to keep a system's integrity.

⁶⁶⁷ I arrived at these themes through coding and studying the history of the BCBS, which I have explained in chapters 2 and 3. The number of items is the result of searching the words 'Basel Committee' and each one of the themes in the *Factiva* database.

Theme	Items	Year
Basel II implementation delays	91	2004-2007
Basel II implementation costs	199	2004-2008
Implementation of Basel II in the US	198	2002-2007
Liquidity risk	299	2008
Financial Crisis	816	2009
Market Risk	119	2009
Basel II IRB is pro-cyclical	276	2009-2013
Jamie Dimon Basel III is 'anti-American'	221	2011-2013
Basel III is too complex	310	2011-2013
BCBS eases liquidity ratio for Banks	169	2013-2014

Once I identified the themes, the methodology identified communication chains through classifying the items that belonged to each theme into accountability claims, justifications, and judgments of those justifications. Then, I sought to identify the links between different events which shared the same theme by identifying the references that one future event made to other past events⁶⁶⁸. I could not identify complete communication chains that resembled an accountability process in every theme. Moreover, in some of them I could not find items that had the form of an accountability claim. In the cases that I could find events with the form of an accountability claim, a justification by the BCBS or one of its officials, and a judgement of that justification, I was able to link them by the references that each event made to the others.

With those cross-references between events a unified communicative process emerges based on two types of links. In the first type, a future event spoke about another one or more past events by expressly mentioning them (e.g., when the Chairman of the BCBS answers a criticism addressing the person or organisation that made the critical comment); the second type happens when a future event refers to a past one but only tacitly (e.g., when an official of the BCBS answers an accountability

⁶⁶⁸ A similar method has been proposed by Loet Leydesdor and CS Wagner 'Network structure, self-organization, and the growth of international collaboration in science' (2000) 34 Research Policy 1608

claim by using the same words of the claim but without clearly identifying who said it). The second type of link was more difficult to identify because it lacked an explicit reference to the event that it was responding to. As some of the examples that I narrate below will show, those who issue an accountability claim seldom have formal power to bind the BCBS to answer the claim. Moreover, in some cases the claim comes from someone who is actually subject to the BCBS and domestic agencies' regulation (e.g. the case of Jamie Dimon, CEO of JP Morgan Chase). Additionally, the power and clarity of argumentation with which a claim is made can turn an informal accountability claim into an efficient way to get a justification from the Basel Committee even when no hard law is used. By 'informal' I mean a claim that does not use hard law; most of the 'informal' accountability claims I identified were criticisms.

Out of the 15 themes, I found that only some of them had accountability claims. From those conversations I chose the five examples that I put forward in this chapter. The reason underlying the selection is twofold. On the one hand these examples show very relevant themes in the history of the Committee. On the other, I was able to identify accountability claims, justifications from the Committee, judgements of those justifications, and reactions that chimed with the language and expectations of the wider community of banking regulators. As a result, this chapter describes five key examples of linked events referring to the work of the BCBS that look like accountability processes⁶⁶⁹. This means that there are some claims that ask an account of the Basel Committee in relation to its actions; one or more answers that justify the actions of the BCBS and yet other communications that judge that justification. In the second part of

⁶⁶⁹ I looked in the 28500 items for relevant discussions. I found that there were some that were central for the work of the BCBS (i.e. minimum regulatory capital, liquidity coverage ratio, the type of approach to regulate the very complex financial system, etc.). Then I analyzed all those items that spoke about the discussions I identified. I found the five examples that I talk about in this chapter by coding for accountability claims, justifications and judgments.

this chapter I discuss whether or not these processes are accountability processes, i.e., that there is an obligation to justify and that the process may have consequences. For this purpose and for making this evaluation I use the concept of communicative accountability explained in chapter 6.

Hence, in the first part of the chapter I reproduce five different processes in which the BCBS is at the centre of a discussion that looks *like* an accountability process. Then the second part of the chapter analyses whether or not the examples given constitute 'real' accountability mechanisms. The first part of this chapter analyses the five examples using the working definition of accountability that I set out in chapter 5; thus I try here to identify one or more accountability claims, a justification by the BCBS, and one or more judgments of the justification. I have analysed the qualitative data set with reference to the elements of the working definition in order to identify those items that *look like* stages of an accountability process. To assess whether these examples constitute real accountability mechanisms, the second part of this chapter takes on the definition of communicative accountability. This means that they have potential consequences and there the BCBS has an obligation to give a justification.

While analysing the qualitative data set I found that after the Committee makes a final decision (i.e. where there is not more room for further discussion and the decision triggers the implementation process), a discussion follows that criticizes or commends the BCBS' decision. In this chapter the five communication processes start and discuss a decision issued by the BCBS that was final. In the literature about public policy, a decision is final if it closes the design phase and starts the implementation phase of the policy process⁶⁷⁰. This discussion sometimes takes a similar form to accountability.

⁶⁷⁰ Bardach, Eugene *The implementation game* (MIT Press 1977)

At other times, however, I found that the discussion revolving around the work of the BCBS was not accountability-shaped for two reasons. Firstly, because the matter being discussed was not final (i.e., it had not started the implementation process). Similarly to what happens to other financial TRNs, the BCBS makes decisions in an open and participatory way; therefore it is normal that they have inputs from many interested parties. But if the decision is not yet final, such processes are part of the BCBS' governance and I did not classify them as accountability mechanisms.

The second reason why the process might not be an accountability process is that the discussion had a pattern different from accountability (e.g., it did not have an accountability claim but merely a comment). The difference between an accountability claim and a mere comment is, first, the phrasing they use. While an accountability claim is accusatory and normative (i.e., it makes a judgment), a comment is neutral. Second, an accountability claim implies the expectation of getting a justification from an accountee. A suggestion might be followed by another suggestion. An example might be clarifying: expressing that the implementation of Basel II was very costly to banks is clearly an accountability claim even when is phrased in other words (e.g. 'Many firms have spent upwards of US\$100m on their complex and lengthy Basel programmes, and a key question is whether Basel II has been a challenge or burden for banks'⁶⁷¹). A comment in the work of the BCBS consists, for example, on stating that the Committee has a difficult work ahead⁶⁷².

⁶⁷¹ Andre Khoury, *Bumpy ride for Basel II* (Sidney, *Australian Banking & Finance*, 23 May 2008)

⁶⁷² 'A mammoth project to make the capital set aside by banks better reflect risk is well on its way to implementation in 2000 despite proving to be the most complex regulatory change to hit financial markets in decades' Karen Iley, 'Basel II on track for 2006, says BIS's Crockett' (London, *Reuters News* 27 January 2003)

All five examples that I put forward in this chapter share the distinguishing feature that they required a justification by the BCBS. There were, however, other discussions in which, instead of a justification, the Committee simply issued a comment

The fifth example that I put forward, however, involves the criticism that Jamie Dimon directed to the Basel Committee and that took place before the final decision was formally taken. Nevertheless I decided that it is an accountability process based on Lastra and Shams' argument that there are some *ex-ante* accountability processes that take place before the final decision⁶⁷³. Although Bovens argues on the contrary that *ex-ante* mechanisms are rather forms of control⁶⁷⁴, I classified this case as an accountability process for two reasons. Firstly, because it illustrates the central role that language plays in unifying the chains of communication that resemble accountability processes; and secondly, because although the Committee took the formal decision after the discussion had taken place, there was already an informal consensus among the members of the BCBS, a reason why some stakeholders saw the decision as a *fait accompli*.

From the various themes around which the conversation of the Committee has revolved around I selected five. The selection was made because the relevance of each theme (i.e., there were more items in the five examples than in other topics, which means that the work of the Committee had more media exposure in these five themes). The themes that I selected are: 1) the methods to measure regulatory capital in Basel II, 2) the criticism that the Basel III accord is too complex, 3) the treatment that Basel II gave to bank's loans to small and medium-sized enterprises (SMEs), 4) the criticism that Basel III was biased against the interest of the United States of America's banking

⁶⁷³ Lastra, R. M., and H. Shams (2000) 'Accountability: ex ante or scrutiny, ex post or control and transparency' *Conference on Rules, Incentives and Sanctions Enforcement In Financial Regulation, Working Paper*

⁶⁷⁴ Mark Bovens, *Analysing and Assessing Public Accountability: A conceptual framework* (n 596).

and financial system, and finally, 5) the delay in implementing the rules for liquidity in Basel III.

Additionally to the common theme of each of the five examples, what I also show in this chapter is that each communication process has a common perspective. This means that a theme is discussed from the point of view of one epistemic and professional community which is, by the way, the same to the professional community that I have described in chapters 2 and 3: the professionals of finance, banking and banking regulation⁶⁷⁵.

As I have said, the second part of this chapter will flesh out the concept of communicative accountability put forward in chapter 6 with my qualitative data set about the work of the BCBS. There, in the second section of this chapter, I will explain that Luhmann's conceptual framework about communication is useful for both identifying and making sense of communicative processes that resemble accountability and that chime with a particular professional community – in this case that of bankers and banking regulators. I also explain in the second section of the chapter that, just like I describe for the BCBS' members and banks in chapter 4, such a community provides a network of peers that may create in the BCBS a *soft* obligation to justify and provoke real or potential consequences with reference to the prestige and standing of the Committee in the professional community of bankers and banking regulators⁶⁷⁶.

I use some of Luhmann's theoretical components for the analysis of the 5 accountability-like processes in the second section of the chapter. . As I explained in

⁶⁷⁵ Chapter 5 describes this community. It does not only comprises bankers and banking regulators, but also professionals of rating agencies, accountants, lawyers specialised in finance, brokers, dealers, professionals at hedge funds, academics in the fields of financial economics and business schools, and journalists specialized in finance

⁶⁷⁶ Kenneth W Abbott, Duncan Snidal, 'Hard and Soft Law in International Governance' (n 62); Kenneth W. Abbott and Duncan Snidal 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' (n 358).

chapter 6, Luhmann understands communication as a sequence of linked communicative events. The author explains that the sequential events are linked because future events select past ones; which means that the link happens backwards. Each selection, besides, has a triple level of analysis. Firstly one can select the theme that is spoken (i.e., *what* is being selected); secondly, one can select the channel through which the event ‘travels’ (i.e., *how* and *why* it is selected); and thirdly, one can select the meaning of the event. The third selection is the most relevant for Luhmann and for this research too. Meaning means that the event resonates with a community; which in our case is a professional one. A criticism of the work of the BCBS, for instance, can resonate with politicians and civic activists such as those of the *Occupy Wall Street* movement. If this is the case it probably will not chime with the financial, banking and banking regulatory community that works in Basle.

The examples revolve around discussions that are very technical at times and use concepts such as ‘minimum regulatory capital’, ‘liquidity coverage ratio’, ‘internal based risk approach’, etc. I have explained these concepts in chapters 2 and 3. Nevertheless, in this chapter I remind the reader of the meaning of some of these technical concepts.

This chapter is divided into two further subsections. Section 2 explains the five communicative chains that I put forward as ‘accountability-types’ and Section 3 analyses these five chains and discusses them as examples of communicative accountability.

2. The five examples that follow an ‘accountability-shaped’ pattern

In this section I put forward five examples that narrate very topical discussions for the work of the BCBS. The reader will notice that the narrative chimes with the stages of the working definition of accountability (i.e., asking the justification, getting it, and judging it). It is not a coincidence. As I stated in this chapter’s introduction, the analysis of the dataset was precisely done by searching for communicative events that had the function of an accountability claim, a justification from the BCBS, and a judgment of that justification.

In these five narratives, however, I try not to divide the process abruptly. I rather explain it in a continuous way and I use next section to analyse the 5 chains of communication using the Luhmannian conceptual framework that I explained in chapter 6.

a) The discussion about the Internal Risk-Based approach of Basel II

The Internal Risk-Based (IRB) approach was first introduced in the early drafts of Basel II. It was a component of the accord’s ‘first pillar’ (i.e. minimum capital requirements) that measured credit risk. As I explained in chapter 2, it was intended as a method for financial institutions to measure their own internal risk of insolvency and keep regulatory capital at safe levels for the bank’s soundness⁶⁷⁷. The IRB approach included a sub-type called ‘advance IRB’ (A-IRB). Only the biggest and more complex financial

⁶⁷⁷ Regulatory capital is the percentage of assets that the bank should keep at all times and it is measured against the bank’s total assets. Put in other words it is ‘the cushion of capital that regulators demand banks set aside as a last defence against unforeseen losses.’Nielsen, P. (2003) ‘Major global, small retail Banks win from Basel II’, *Reuters News*, 5 May 2003

institutions could use A-IRB, which was a way in which the banks could measure their own internal risk of insolvency by creating their own empirical models⁶⁷⁸.

Both approaches consisted of a way of measuring the risk of default by weighing the risk of the bank's assets in four categories: probability of default (PD), exposure at default (EAD), loss given default (LGD), and maturity (M). Under Basel II, the banks had the task of classifying their assets under these categories and adding up the risk of each asset for the bank's stability⁶⁷⁹.

Both the foundation IRB and the advanced IRB approaches were criticized in the negotiating process of Basel II (prior to 2004). The main arguments were that the IRB approach would be too complex⁶⁸⁰; too costly for the banks to implement⁶⁸¹; and that the approach was not as good as other methodologies to measure the risk of default⁶⁸², such as the 'Cumulative Probability Function'⁶⁸³ or a model that Benink and Benston developed⁶⁸⁴.

The final version of Basel II was finally published in 2004. It reflected the suggestions made during the negotiation phase, mainly about the cost, complexity and

⁶⁷⁸ Although I use the past to refer to IRB and A-IRB, those approaches –with changes– remained in the Basel III accord.

⁶⁷⁹ Basel II provides a catalogue of banks' exposures, each one having a different risk attached. The main types of exposures are: 1) corporate; 2) sovereign; 3) bank; 4) retail; and 5) equity.

⁶⁸⁰ America's Community Bankers, *Letter in the Basel II Consultation Process*, 31-May-2014 'At the same time, the proposal would impose, if adopted in the United States, a disproportionately burdensome and overly complex system of capital regulation on community bank'

⁶⁸¹ American Bankers Association, *Letter in the 2nd Basel II Consultation Process*, 25-June-2014 'Every bank ABA consulted concluded that the proposal would not maintain capital at its current levels but would, in fact, result in an unjustified requirement of higher capital. This will not only disadvantage banking groups but will adversely affect borrowers by raising the cost of credit or limiting its availability.'

⁶⁸² AMSouth Corporation, *Letter in the 2nd Basel II Consultation Process*, 1-May-2014 'We urge the Committee to: (...) permit reliance on internal models from companies that have demonstrated advanced and reliable systems, without superimposing regulatory formulas on such models...'

⁶⁸³ Marrison, C. (2001) *Risk Measurement for Project Finance*, CAPCO: Sweden; the study was also submitted to the 3rd Basel II Consultation Paper, 27-March-2001

⁶⁸⁴ Benink, H.A., G. Benston (2005) 'The future of Banking Regulation in Developed Countries: Lessons from and for Europe', 14 *Financial Markets, Institutions & Instruments* 5, 289

the benefits of other methodologies – but, although modified, Basel II included both the IRB and advanced IRB approaches⁶⁸⁵.

Once the BCBS published the final version of Basel II, various parties with links to the financial industry and banking regulation criticised the accord. A survey made by Accenture among bankers, found that they ‘were less convinced about most of the benefits of adopting Basel II than they were a year ago’⁶⁸⁶. The survey covered 63 of the most important banks in Europe and North America⁶⁸⁷. Some other sectors – mainly from the American financial industry and US House of Representatives – claimed that the big, complex, and global banks would have an unjust competitive advantage when using the A-IRB approach⁶⁸⁸. Others questioned the assumptions and methodology of the IRB approaches. In this vein, one editorial from *The Banker* asked whether ‘the models work and [whether] the regulators have the quality and number of personnel to assess the bank models that will emerge under Basel II’⁶⁸⁹. Finally, a very powerful claim came in the form of a quantitative impact study (also called ‘QIS4’) that some

⁶⁸⁵ BCBS *Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework*, (BCBS 2004), see: <www.bis.org/publ/bcbs107.htm> Accessed 10 February 2016.

⁶⁸⁶ ‘Banks have become less enthusiastic about Basel II as they realise the huge costs involved in introducing new rules on their capital requirements. A survey by Accenture, the consultancy, found banks are less convinced about most of the benefits of adopting Basel II than they were a year ago (...) The survey, which covered 63 leading banks in Europe and North America, comes as banks are investing heavily in adopting the new rules, which are designed to improve their ability to manage risks.’ Thal Larsen, P. ‘Doubts grow over Basel II benefits’, *Financial Times*, 25-VI-2005; the press release by Accenture can be found at: <newsroom.accenture.com/article_print.cfm?article_id=4123> Accessed 15 March 2014.

⁶⁸⁷ Ibid.

⁶⁸⁸ ‘With the usefulness of measurements such as value-at-risk (VAR) questionable, as well as the data supporting most models being both in its infancy and subject to dubious assumptions, it is unclear if the added complexity can be managed.’ ‘Could simpler be better when it comes to Basel II?: Questions are still being asked about the workability of the capital adequacy framework, especially the IRB’, *The Banker*, 1-V-2005; See also, Blount, E. ‘Basel IA heralds change in direction: facing a rising chorus of “whoa” from bankers and Congress, the regulators agree to try to level the Basel II landscape with revisions to Basel I’, *ABA Banking Journal*, 1-I-2006; see also ‘Comment: Schism On Basel II A Possibility As US Ploughs Its Own furrow – Congress’s Insistence On More Time Not Only Threatens The June 2004 Deadline But May Lead To Tandem Versions Of the Accord Appearing’, *The Banker*, 1 April 2004.

⁶⁸⁹ *The Banker* ‘Comment: Could Simpler Be Better When it Comes To Basel II?’ 1 May 2005.

countries, such as Japan, Germany and the USA, independently carried out⁶⁹⁰. The QIS4 stands out among other accountability claims because it summarized them and provides quantitative evidence of the possible application of the IRB approach to banks. Perhaps this was the reason why the Committee decided to answer the claim and justify itself.

The QIS4 attempted to measure the possible effect of the implementation of IRB approaches in Japan, Germany and the USA. The results of the US' study showed that its implementation would have one big unintended consequence; which was that the regulatory capital that big and global banks would need to keep at all times was going to be much less than expected, not only giving those banks a competitive advantage but also showing that the implementation of the IRB methodology could be harmful for the overall financial stability⁶⁹¹. The results of the QIS4 were not altogether coherent⁶⁹², but they implied what some claims have already voiced in different media: that the IRB approach's assumptions could be flawed⁶⁹³.

On a joint statement of 29 April 2005 four US agencies (The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision) announced the delay in implementation of Basel II because of the results of the QIS4⁶⁹⁴.

⁶⁹⁰ Among them the US, Japan, Germany, and South Africa.

⁶⁹¹ For an explanation and scope of the national quantitative impact studies (QIS 4) see: www.bis.org/bcbs/qis/qis4.htm; 'In a statement issued on April 29, the U.S. banking agencies indicated that the minimum regulatory capital changes resulting from QIS4 were more variable across institutions and capital dropped more in the aggregate than the agencies had expected. This was the impetus for deciding to delay issuance of our next round of proposals for Basel II.' *US Fed News*, 'Gov. Bies Comments on Financial Stability Benefits, Implementation Challenges of Basel II', 17 May 2005.

⁶⁹² The BCBS argued that 'these exercises did not represent a joint effort of the Basel Committee on Banking Supervision, and the details varied significantly across countries. Nevertheless, the Committee's working group on Overall Capital and Quantitative Impact Studies prepared templates to support these national exercises, i.e. (i) a questionnaire in the form of an Excel workbook and (ii) corresponding instructions that specified how to complete the questionnaire.' See: www.bis.org/bcbs/qis/qis4.htm Accessed 10 March 2016.

⁶⁹³ Michael Oxley statement at the House of Representatives.

⁶⁹⁴ The joint statement explained that the study's results 'are critical inputs in the assessment of (1) the implications of Basel II for the safety and soundness of the banking system and (2) the competitive effects of adopting the Basel II Framework (...) The statement also argued that there was 'evidence [of] material

Thus, the results of QIS4 in the United States placed a question mark on the reliability of the IRB approaches. The study provided quantitative evidence that some of the claims arguing that the IRB approaches were not technically sound could be true.⁶⁹⁵ In a hearing before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, John Duggan – who was the Comptroller of the Currency – stated that QIS4 results in the US ‘were based on crude approximations of Basel II requirements, nevertheless raised real concerns among the agencies because they forecast substantial reductions in capital for Basel II banks and substantial differences in capital requirements for very similar credits.’⁶⁹⁶

Donald E. Powell, the chairman of the Federal Deposit Insurance Corporation was very clear about the disappointing QIS4 results in the U.S.:

Putting aside these international comparisons, let me be clear that the FDIC views the extremely low capital numbers coming out of Basel II formulas as evidence that changes must be necessary going forward. We view the QIS-4 results as examples of why, under Basel II, the leverage ratio will play a more important role than ever in ensuring the soundness of our banking system.’

‘I believe my colleagues at the table share our discomfort with the low levels of capital indicated by QIS-4 results. They have noted that the leverage ratio would rightly prevent banks from lowering their capital that much. They also share our hope that experience in the Basel II transition years would help us pinpoint and correct the aspects of the framework that give rise to troubling QIS-4 results.’⁶⁹⁷

reductions in the aggregate minimum required capital for the QIS4 participant population and significant dispersion of results across institutions and portfolio types.’ The full statement is at: <www.federalreserve.gov/boarddocs/press/bcreg/2005/20050429/default.htm> Accessed 10 February 2016.

⁶⁹⁵ ‘In addition to lowered capital reserve levels, QIS4 found a much greater-than-expected dispersion of risk across banks with similar portfolios. This counterintuitive result called into question the efficacy of Basel II for calculating and weighting risk, particularly vis-à-vis concentrated versus diversified portfolios.’ This was written by the Executive Managing Director of Risk Solutions At Standard and Poors, Sharma, J. (2006) *Basel II: Responding to A Whole New World of Risk*, in *USBanker*, 1 September 2006.

⁶⁹⁶ ‘The Development of New Basel Capital Accords’ *Hearing before the Committee on Banking, Housing, and Urban Affairs, United States Senate: Statement of John C. Duggan, Comptroller of the Currency* 10 November 2005, 3.

⁶⁹⁷ *ibid*, 6.

The QIS4's results in the US triggered a justification by the Committee. As one editorial in *The Banker* put it, the doubts that the interpretation of the QIS4 data had 'led – rather embarrassingly, *experts say* – to the call for yet another series of tests'⁶⁹⁸.

As a response of the QIS4, The Committee's justification took the form of yet another set of tests: the fifth quantitative impact study (QIS5) that the BCBS directly carried out. The study was part of a series of efforts to forecast some of the new accord's possible outcomes and effects on the banking industry. The study consisted of a questionnaire that 35 five domestic regulators distributed among their banks. The QIS5 found that banks migrating to the IRB approach would reduce their regulatory capital as a result, but not as much as to jeopardize the financial system⁶⁹⁹.

After the QIS5, the Committee confirmed its decision over the methods of IRB and advance IRB approaches⁷⁰⁰. The Committee also decided to uphold the calibration of 1.06 to measure the risk linked to the IRB approach so that the regulatory capital

⁶⁹⁸ *The Banker*, 1 April 2005 'Call for Further Impact Study For Basel II' I have added the emphasis.

⁶⁹⁹ BCBS, *Press Release*, 24 May 2006.

⁷⁰⁰ 'The QIS results for the G10 countries show that minimum required capital under Basel II (including the 1.06 scaling factor to credit risk-weighted assets) would decrease relative to the current Accord. For Group 1 banks, minimum required capital under the most likely approaches to credit and operational risk would on average decrease by 6.8%. Among the two IRB approaches, the advanced approach shows more reduction in minimum required capital (-7.1%) than the foundation approach (-1.3%). Minimum required capital under the standardised approach would increase by 1.7% for Group 1 banks. However, only very few G10 Group 1 banks are expected to adopt this approach. Group 2 banks show a larger reduction in minimum required capital under the internal ratings-based approaches, and minimum required capital would decrease by 1.3% under the standardised approach, in particular due to the higher proportion of retail exposures for those banks... In general, results for the CEBS2 countries are broadly in line with the figures which were obtained on the G10 level. Results for banks in the rather small sample of other non-G10 countries show substantial dispersion both within and between countries, mostly due to the specialised business profile of certain banks and particularities of national implementation. The wide range of bank- and country-specific circumstances suggests that supervisory discretion is particularly important in these countries, and the results might therefore not be representative for all non-G10 countries. Although data quality is an issue for some banks in other non-G10 countries, the results appear to be broadly in line with results for G10 banks to the extent that the risk profiles are similar. ' BCBS (2006) *Results of the fifth quantitative impact study*, BIS: Basle, 1-2.

would stay at acceptable levels⁷⁰¹. Mr. Nout Wellink, then Chairman of the BCBS, justified the decision in a speech in 2006:

In addition, because the quantitative and qualitative parameters for using the advanced approaches are intended as a baseline of sound practices, they can accommodate continued innovation by firms. And since the advanced approaches *are driven by rigorous internal processes for risk measurement and management*, they are clearly well suited for today's sophisticated global banks. Indeed, the results of our fifth Quantitative Impact Study reveal that virtually every global bank intends to implement one of the advanced approaches⁷⁰².

Mr. Wellink remarks were part of the BCBS' justification of the IRB approaches that in his opinion, stressed the rigorous work that the BCBS has done regarding the measurement of default risk. The Committee's justification also used the evidence from the QIS5 to argue its decision to uphold both IRB approaches.

The justification from the BCBS was, in turn, assessed by different parties who provided evaluations of the BCBS' QIS5. Responding to the QIS5 results' publication, Standard & Poors endorsed the study stating that it confirmed that 'the quest by bank regulators for stable capital levels and improved risk-management practices is achievable.'⁷⁰³ Others took the QIS5 findings at their face value too, thus endorsing the BCBS' justification⁷⁰⁴.

⁷⁰¹ The meaning of acceptable levels has changed by the time. Basel I established that all banks must hold at least 8% of all their assets. With the invention of IRB and A-IRB that level went down to 5-6%

⁷⁰² *Formal opening address by Dr Nout Wellink, President of the Netherlands Bank and Chairman of the Basel Committee on Banking Supervision, at the 14th International Conference of Banking Supervisors, Mérida, México, 4 October 2006.*, 2; See: <www.bis.org/review/r061006.pdf?frames=0> Accessed 11 February 2013.

⁷⁰³ The report continued: 'The overall decline in minimum capital requirements recorded in a very benign environment appears moderate indeed in Standard & Poor's Ratings Services view. We expect that banks will manage their internal capital targets with a wider buffer above regulatory minima than under Basel I to cope in particular with volatility issues.' Standard & Poors (2006) *Basel II Dress Rehearsal Signals Global Quest For Stable Capital Levels Achievable*, S&P: New York.

⁷⁰⁴ 'Peter Konesny of the German Savings Banks Association (DSGV), a member of the ESBG, said: "The last quantitative impact study [QIS 5] conducted by the Basel Committee showed a slight capital reduction in the requirements for retail banks in general. We expect this even for the standardised approaches.'" Imeson, M. 'The majority of Europe's Savings Banks are viewing the Capital Requirements Directive, which transposes Basel II into European Law, as a good thing', *The Banker*, 1-VII-2006.

Finally, the Centre for European Policy Studies (CESP) saw the QIS5 as an interesting exercise, with better and more reliable results than its predecessors, but voiced their concerns over some methodological issues:

In light of the significant limitations of the fifth quantitative impact study (QIS5) in general and the unreliability of its results in adverse market conditions in particular, international regulators are strongly encouraged to conduct a new impact study followed by a deeper macroeconomic analysis to gauge the effects of the 2007 market turmoil⁷⁰⁵.

The CESP is an important think-tank in European policy that often takes part in the governance process within the European Union (EU). Its publications and analyses are influential in the decision making of the EU.

In summary, the discussion about the viability of the IRB approaches followed the pattern of an accountability process. It had a series of accountability claims from which the American QIS4 stood out. The BCBS answered those claims with a new study (the QIS5) and an explanation from its chairman about the benefits of the IRB approaches to measure credit risk. Finally, four different communicative events reacted at to the Committee's justification. In the next subsection I explain the second example which shows another chain of communication that has the elements of an accountability process too.

⁷⁰⁵ Musch, F. (2008) *Basel II Implementation in the midst of Turbulence*, CEPS: Brussels, 3; Kupiek makes a similar assessment, see Kupiek, P. (2006) *Financial Stability and Basel II*, Bank of New Zealand: Wellington.

b) The second example: the disagreement over the rules to measure banks' risk of default from loans to small and medium-sized enterprises

Around 2001 there was a controversy over the methods proposed by Basel II to measure the risk of banks credit default regarding the loans to small and medium sized enterprises (SMEs) – also called bank exposures to SMEs. One early draft of Basel II proposed that banks would have to keep more capital for loans to SMEs than for other type of exposures. The German government was especially against this measure because it considered the rule detrimental for SMEs, the ‘back-bone’ of the German economy⁷⁰⁶. The rule, as it was originally drafted in Basel II, meant that the banks would need to keep more capital if they granted credits to SMEs; which would in turn increase the cost for banks to lend money to SMEs and would make more difficult for SMEs to access the financial services. The rationale of this rule made sense for financial stability, though. According to statistics, SMEs tend to fail more often than other types of business⁷⁰⁷.

William McDonough, then chairman of the BCBS, acknowledged the need for SMEs to ‘retain access to credit at reasonable and fair prices’⁷⁰⁸ and assured that Basel II would not be damaging for SMEs or for Germany’s economy, which is based largely

⁷⁰⁶ In the words of the German chancellor, Gerhard Schroeder: ‘Germany’s (...) [disagreement with the draft of Basel II] has to do with the Mittelstand, the 3m small and medium-sized companies that are the economy’s backbone. The Basel 2 formulae for credit risk are based on credit ratings applied to company debt, either by rating agencies or internally by banks themselves. But few smaller companies are rated in this way. Moreover, German companies are more than usually dependent on medium-term bank loans, and the longer the loan the more it is penalised under the proposals.’ *The Economist*, 8 November 2001, ‘The Basle Perplex’ at: www.economist.com/node/852945; ‘The new rules may also prove too expensive to justify for smaller firms, who may seek comfort from larger colleagues.’ Hart, Joanne, *Evening Standard* 11 January 2002 ‘Basel 2 set to change bank shares and deals scene’; *German bank lobby welcomes Basel 2 rules delay*, 25 June 2001, *Reuters News*.

⁷⁰⁷ Edward I. Altman and Gabriele Sabato ‘Effects of the New Basel Capital Accord on Bank Capital Requirements for SMEs’, (28 *Journal of Financial Services Research* 1 2005).

⁷⁰⁸ *Market News*, 25 April, 2002 ‘McDonough – Basel Accord To Cut Capital Requirements On Biz Loans.’; Dow Jones Newswires, 10 July, 2002 ‘Basel Committee Sets Timetable On Bank Risk Cover Overhaul.’

on SMEs – the German *Mittelstand*. On July 2002, the BCBS announced that it would change its standards for bank exposures to SMEs⁷⁰⁹. The new Basel II draft had a new formula, lowering the risk by 10% on average to those exposures⁷¹⁰. The risk could be lower in case SMEs' exposures qualified as 'credit for retail'⁷¹¹.

The change was received positively by German public opinion and by the German officials, who had pressed for the change in the first place⁷¹². A week before the official announcement by the Committee, Schroeder, the German chancellor, had already announced that his government had negotiated a positive change in Basel II for SMEs⁷¹³. The German press emphasized, however, that the agreement was a 'political compromise' and not a technical discussion⁷¹⁴.

Outside Germany and particularly in Europe, some criticised the change in Basel's II new rules regarding SMEs exposures. This group, however, tended to think that the changes were not enough. The European Parliament, for instance, adopted a report made by member of the European Parliament (MEP) Alexander Radwan. The report assessed Basel II –even with the recent changes– as damaging for SMEs in their

⁷⁰⁹ BCBS, *Basel Committee reaches agreement on New Capital Accord issues*, Press Release, 10 July 2002: 'The Committee approved new elements of the corporate and retail IRB frameworks and the standardised approach designed to ensure a more appropriate treatment of small- and medium-sized enterprises (SMEs) under the new Accord', see: <www.bis.org/press/p020710.htm> Accessed 25 March 2014.

⁷¹⁰ The press release explained that: 'In recognition of the different risks associated with SME borrowers, under the IRB approach for corporate credits, banks will be permitted to separately distinguish loans to SME borrowers (defined as those with less than Euro 50 mn in annual sales) from those to larger firms. Under the proposed treatment, exposures to SMEs will be able to receive a lower capital requirement than exposures to larger firms. The reduction in the required amount of capital will be as high as twenty percent, depending on the size of the borrower, and should result in an average reduction of approximately ten percent across the entire set of SME borrowers in the IRB framework for corporate loans' *ibid*

⁷¹¹ The retail section of the market was considered to be less exposed to systemic risk.

⁷¹² *Financial Times Deutschland*, 4 July 2002, 'Deutschland drückt Mittelstands-Interessen bei Basel II durch.'

⁷¹³ *Reuters-Nachrichten auf Deutsch*, 3 July 2002, 'Fokus1-Schröder-Basel II wird Mittelstands-Forderungen gerecht'

⁷¹⁴ Szent-Ivanyi, Timot, 'Kreditvergabe an Mittelstand gesichert – Kompromiss bei "Basel II" – Verhandlungen', *Berliner Zeitung*, 4 July 2002; RTR, 'Basel II wird Forderungen des Mittelstands gerecht', *General Anzeiger*, 4 July 2002; Wanner, Claudia, 'Baseler Ausschuss formuliert Kompromiss', *Financial Times Deutschland*, 11 July 2002; see also 'Western Europe – SMEs – SMEs Mind the Financing Gap', *The Banker*, 1 October 2002.

quest for credit. The report argued for ‘greater flexibility’ and that ‘excessive risk weights’ could make ‘investment in private equity and venture capital uneconomic.’⁷¹⁵

On the contrary, other parties judged that the Committee should not have modified the rules towards SMEs exposures and saw the change as a political bargain to assure Germany’s permanence in Basel II negotiations⁷¹⁶. While it was necessary to compromise with the rules regarding SMEs, a political bargain –so the argument went– undermined the technical authority of Basel II. The European country had indeed threatened to veto the accord if it kept the rules to SMEs exposures as in the original draft. There was, besides, a strong link between the context of electoral competition in Germany by that time and the strength of the claims against the rules regarding SMEs. If the motivation for the more lenient regime to SMEs was not backed up by a thorough research into financial stability, who could guarantee that Basel II was an evidence-based product that could strengthen financial health. In the US, only a handful of complex and big banks would be complying with the accord⁷¹⁷.

The European Shadow Financial Regulatory Committee (ESFRC) was one of the parties considering the move as a political measure and evaluating it negatively. The ESFRC is a group of professors and other experts in banking, finance and regulation of

⁷¹⁵ *European Report*, ‘Financial services – MEPs lead Criticism of Basel II Accord over SME capital adequacy’, 6 September 2003.

⁷¹⁶ ‘On Wednesday, the Basel Committee settled key issues still open including ensuring Basel II will not hurt lending to small and mid-sized companies. ‘The government changed its mind and agreed to Basel II after McDonough paid a call to German Chancellor Gerhard Schroeder earlier this year. Schroeder, up for election in September, threw public support behind the plan last week (...) McDonough said the aim was to ensure lending to small companies in all countries is maintained (...) That was a major sticking point for German banks, given much of their lending is to such firms. The German government, mindful of such fears, at first had opposed Basel II.’ Radcliffe, Alice, Reuters, 10 July 2002 ‘Uptade 2-New Global Bank Rules Expected by Late 2003.’ The same story was covered by other media like *Lloyds List*, see Tony Gray, 11 July, 2002 ‘Basle II Bank Capital Rules in Place by end of 2006 which underlies ‘German opposition’ as a ‘stumbling block’ for the accord’.

⁷¹⁷ *Institutional Investor*, 1 July 2003, ‘Basel under threat’.

financial institutions⁷¹⁸. In a comment to the 3rd Consultation Paper (3CP) organized by the BCBS, the ESFRC criticised that ‘[d]uring the consultative processes, concessions have been made to political pressures, such as for example in lending to SMEs...’⁷¹⁹ They did not oppose in principle a change to favour SMEs but they argued that market distortions, in case they were present, should be addressed by general rules with strong financial evidence rather than creating exceptions for certain types of borrowers – as the SMEs:

‘If there are distortions in the credit markets for SMEs, they should be remedied through fundamental reform accompanied by transitional measures and not by ad-hoc approaches favouring SMEs, such as differentiated capital requirements based on the size of the borrower or reclassification of smaller loans as retail.’⁷²⁰

A few days later, on 10 July 2003, Jaime Caruana, the new chairman of the BCBS, gave a speech in a European Parliament’s workshop addressing the impact of Basel II to SMEs. In his address he said:

We have investigated *thoroughly* the *economics* of SME lending. Even though probabilities of default may be higher for individual SMEs, our research identified *persuasive empirical evidence* that most banks’ holdings of loans to SMEs benefit from a greater degree of diversification than their holdings of loans to larger corporations do. Diversification helps to reduce both a bank’s exposure to the credit risk posed by SME lending and the commensurate need for capital. Moreover, we’ve taken a closer look at the precautions banks take when lending to smaller businesses, such as asking for guarantees or collateral. These measures help to lower further the potential losses a bank might incur in

⁷¹⁸ See: <www.ceps.eu/content/european-shadow-financial-regulatory-committee-esfrc> Accessed 4 May 2014.

⁷¹⁹ ESFR Statement No. 16 *Bank Supervisors’ Business: Risk Management or Systemic Stability?*, 4, the document was also presented as a comment in the 3rd consultation process of the BCBS. See: <www.bis.org/bcbs/cp3/eushfireco.pdf> Accessed 4 May 2014.

⁷²⁰ *ibid*; *The Banker* also picked up on the ESFRC critique to the way the changes to SMEs exposures had been done: ‘In addition [said the ESFRC], we strongly object to the treatment of operational risk, the politically influenced issues around lending to the small and medium sized enterprises (SMEs)’ *The Banker*, ‘Basel II – Complex Catalyst for Change – Stephen Timewell Looks At The Basel Committee On Banking...’, 1 June 2003.

lending to a small business and can similarly reduce the need for capital. (Emphasis added)⁷²¹

Later that year, in a piece published by the *Financial Times*, Mr. Caruana omitted the political explanation for the changes in treatment to SMEs exposures. Instead he argued that the changes were due to the higher level of diversification that those exposures have:

After nearly five years of work on an updated and improved standard, our proposals have evolved considerably. One example is the improved treatment of small and medium-sized enterprises, which recognises the benefits of a greater degree of diversification and ensures continued favourable access to credit under the new Basel accord.⁷²²

Although Mr. Caruana's responses did not mention the claim that criticised the political motivation of the changes to Basel II's treatment of exposures to SMEs, they stressed that the decision was *firmly* grounded on financial reasons, and not political pressures. With his statements, the chairman of the BCBS was at the same time justifying two claims. First, he was defending the position that the application of Basel II to banks would not be detrimental for SMEs access to financial services. And second, he was supporting the position that the concessions made to SMEs' exposures were not politically motivated but, on the contrary, that lowering the risk of SMEs exposures in an average of 10% made good financial sense. Lending to the sector – SMEs – was good for banks because it diversified the risk among many lenders.

The discussion around the consequences of Basel II for SMEs continued. As a reaction of Mr. Caruana's statement in the European Parliament's workshop, which discussed the same issue, the Centre for European Policy Studies (CESP) highlighted

⁷²¹ Address by Mr. Jaime Caruana in the workshop organized by the European Parliament on the Consequences of Basel II for SMEs, 10 July, 2003, at <www.bis.org/review/r030714d.pdf?frames=0> Accessed 16 September 2013.

⁷²² Caruana, Jaime, 'A vision of stability within the Basel accord' *Financial Times*, 30 October 2003.

the negative effects that the accord would have on SMEs⁷²³. They stressed the importance of the SMEs sector and the economic relevance of the distinctions that the accord provided when measuring capital ratios regarding SMEs⁷²⁴. They also questioned that the rationale for changing the percentage for calculating regulatory capital in the case of SMEs' exposure was political⁷²⁵.

From the opposite camp and as a result of the same workshop at the European Parliament where Caruana justified the decision of changing the Basel II rule for SMEs exposures, the European SMEs employers' association considered that 'a preferential treatment for loans to SMEs was totally justified, since portfolio and diversification effects in a bank's loan portfolio reduce the bank's risk'⁷²⁶.

The discussion went on. I will analyse some of its repercussions at the end of this chapter. Most of the communicative events regarding Basel II rules for exposures to SMEs, however, did not touch on the political motivation of the changes in 2002. On the contrary, they explored in depth the implications of the accord for SMEs and the measures that still needed to be in place for helping that sector. In the next subsection I explain another example of a chain of communication from the data set that looks like an accountability process.

⁷²³ R Ayadi *The New Basel Capital Accord and SME Financing: SMEs and the New Rating Culture* (CESP 2005).

⁷²⁴ 'SMEs play a key role in the European economy: they are an essential source of jobs and they foster innovation and growth. Therefore, it is crucial to ensure that they have access to credit. Several financing sources are available to them, but banking credit has traditionally been and will continue to be the chief source of their funding.' Ayadi, R. (2005) *The New Basel Capital Accord and SME Financing: SMEs and the New Rating Culture* n 719, 2.

⁷²⁵ *ibid.*

⁷²⁶ UEAPME *Basel II: SMEs welcomes progress made in 3rd Consultation but says improvement still needed*, Press Release, 10 July 2003.

c) The third example: the discussion about the over-complexity of Basel III

Basel II, as I explained in chapter 4 of the thesis, was never implemented in full. While the European Union passed a Directive that enforced the accord from January 2007 onwards⁷²⁷, the United States delayed the implementation of Basel II because of, among other things, the controversial IRB and advanced IRB approaches⁷²⁸. Other countries had earlier implemented Basel II, but because of the delay in the US and the EU, the accord was never a global workable standard. The Committee began to speak about changes to Basel II in 2007⁷²⁹, and announced a series of changes to tackle the financial crisis in 2008⁷³⁰. Those changes finally turned into a new accord called Basel III that the Committee published on 16 December 2010⁷³¹. Basel III had two parts, one that focused on liquidity of financial institutions⁷³² and a second one that centred its attention on capital regulation for banks⁷³³. Basel III complemented previous accords (i.e. Basel I and Basel II) and added some standards designed to overcome the pitfalls that caused the 2007-2008 financial crisis, like a liquidity cover ratio (LCR) and a couple of *buffers* to increase the capital held by banks.

The BCBS published in 16 December 2010 its Basel III accord. From different quarters came the critique that Basel III was too complex⁷³⁴. For example, in a session of the UK's parliament, Lord McFall of Alcluith summarized them saying that:

⁷²⁷ Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006.

⁷²⁸ Michael Barr, Geoffrey P Miller 'Global Administrative Law: The View from Basel' (n 67).

⁷²⁹ Atkins, T. 'Interview: Basel bank watchdog eyes new risk charges', *Reuters News*, 10-IX-2007.

⁷³⁰ BCBS Press Release, *Basel Committee on Banking Supervision announces steps to strengthen the resilience of the banking system*, 16 April 2008, at: <www.bis.org/press/p080416.htm> Accessed 17 August 2012.

⁷³¹ BCBS Press Release, *Basel III rules text and results of the quantitative impact study issued by the Basel Committee*, 16 December 2010, at: www.bis.org/press/p101216.htm; Basel III suffered a minor modification that was published on 1 June 2011.

⁷³² BCBS *Basel III: International framework for liquidity risk measurement, standards and monitoring* n 250.

⁷³³ *ibid.*

⁷³⁴ 'The Bank [of England], too, has criticised Basel III and argued that it is too complex' King, I., 'Business Big decisions this quarter on UK and eurozone interest rates', *The Times*, 4 April 2011.

Glass-Steagall, which governed the global prudential system, was more than 30 pages, Basel II increased that tenfold to 350 pages and Basel III is now 600 pages. Does this not tell us that the system is governed by complexity and opacity and that the desire to game it increases the need for structural change, irrespective of what is happening elsewhere in the world, is urgent in the UK and we should get on with it.⁷³⁵

Andrew Haldane, an official of the Bank of England, said in 2011 that Basel III was in his opinion ‘too complex to verify, too error-prone to be reliably robust, and too leaden-footed [backward-looking] to enable prompt corrective action.’⁷³⁶ Haldane even suggested that the ‘tower of Basel’ was favouring financial crises with its regulations and standards. To stop financial disasters one should ‘tear down’ that tower⁷³⁷. Haldane’s argument consisted in the idea that simple measures are better for regulating the financial system’s complexity. For him it was more effective to keep the fixed percentages of minimum capital requirements that Basel I had, rather than enforcing the very complex mechanism of measuring ‘risk weigh assets’ and ascribing different percentages to different exposures. The latter approach meant in Haldane’s words fighting complexity with more complexity and was similar to fighting fire with fire⁷³⁸. Haldane’s remarks were shared by Charles Calomiris⁷³⁹, a professor from Columbia, and Karel Lannoo, the Chief Executive Officer of the CEPS⁷⁴⁰. The general sense in these claims was that Basel III complex mechanisms for measuring regulatory capital

⁷³⁵ Questions to HM Government, 10 December 2012, Column 860.

⁷³⁶ ‘Bank regulation: should we trust market?’, *Financial Times*, 24 March 2011. Later Mr. Haldane also said that ‘Modern finance is complex, perhaps too complex . . . As you do not fight fire with fire, you do not fight complexity with complexity. Because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity. Less may be more.’ Masters B. ‘Call for simpler bank oversight’, *Financial Times*, 1-IX-2012.

⁷³⁷ Douglas, Jason, ‘BOE’s Haldane: Tear Down This “Tower of Basel “ to Stop Crises’, *Dow Jones Global News Select*, 31 August 2012.

⁷³⁸ Brooke Masters ‘Call for simpler bank oversight’ *Financial Times* (London, 4 September 2012).

⁷³⁹ ‘To summarize our view, we think that both of the standards that are being suggested, as they’re currently conceived, are too complex. They’re likely to get more complex, and that alongside that complexity, and partly as a result of it, the complexity will result also in opacity of the application of the standard, very high cost of compliance with it, and potential ineffectiveness.’ ‘The American Enterprise Institute for Public Policy research holds a briefing of the Shadow Financial Regulatory Committee – News briefing’, *Financial Market Regulatory Wire*, 12 September 2011.

⁷⁴⁰ Lannoo, K. (2011) *The Forest of Basel III has too many trees*, CEPS: Brussels.

would be detrimental for the efficiency of the global financial regulatory process: a simpler view would bring better results.

Haldane's remarks had a big reception in financial sectors, perhaps because he was a senior official of the Bank of England. In October 2012, Stefan Ingves, the successor of Nout Wellink as the BCBS' chairman⁷⁴¹, recognized the claim that Basel III was too complex⁷⁴². He answered by justifying the accord, however, explaining that it enhanced global financial stability by raising the capital level for banks and by simplifying the regulatory framework – at least as much as it was possible. He emphasized that Basel II was a minimum standard and countries could 'impose more stringent rules if they wish'⁷⁴³. Mr. Ingves continued: Basel III had raised by five points (from 2% to 7 %) the percentage of common-equity capital that banks should hold. Common-equity capital (or Tier 1) is the basic percentage of capital that banks must hold at all times. Depending on the type and riskiness of assets that they have, regulatory capital can increase. Common-equity capital can increase up to 9.5% in the event of a credit boom, and for the most important banks of the financial system, that percentage would be 12%. Mr. Ingves emphasized that Basel III was 'both prudent and

⁷⁴¹ 'Stefan Ingves: Basel III is simpler and stronger' *The Wall Street Journal*, 15 October 2012, see: <www.bis.org/review/r121017b.pdf?frames=0> Accessed 12 October 2013.

⁷⁴² The Committee had already argued that Basel III was not overly complex. Nout Wellink remarked that 'In my view, Basel III is not overly complex nor (...) does Basel III complement the Basel II and Basel I frameworks. It simplifies and strengthens the numerator of the capital ratio – an area left largely unchanged by Basel II – and introduces some macro prudential components to the regulatory framework.' Wellink, N. *Remarks of Nout Wellink, Chairman, Basel Committee on Banking Supervision: FSI high level Meeting on "The Emerging Framework to Strengthen Banking Regulation and Financial Stability for Africa"*, Cape Town, South Africa, 27 January 2011, 2; 'Introducing a new set of standards is a complex process. Unlike the capital framework, for which there is extensive experience and data that help inform calibration, there is no similar track record for liquidity standards. The Committee is therefore taking a carefully considered approach to refine the design and calibration and we will review the impact of these changes to ensure that they deliver a rigorous overall liquidity standard. But let me be clear on this point: the Committee is committed to adopting both the LCR and the NSFR as the international standards for liquidity.' *Remarks of Nout Wellink, Chairman, Basel Committee on Banking Supervision President, De Nederlandsche Bank* "Fundamentally strengthening the regulatory framework for banks" 3 September 2010, 3.

⁷⁴³ 'Stefan Ingves: Basel III is simpler and stronger' *The Wall Street Journal*, 15 October 2012.

as simple as possible'⁷⁴⁴. He stressed that simplicity is not a synonym of efficacy, and that some simple measures had been in place and had not prevented banking failures anyway⁷⁴⁵.

Another justification of Basel III complexity came from Wayne Byres, at the time Secretary General of the Basel Committee. He framed it as an analogy: 'Pilots do not focus on a single dial in the cockpit when they fly. Instead, a range of instruments, designed to give them a broader context and perspective, provide much greater information content'⁷⁴⁶. This meant that the 'simpler method' to measure regulatory capital was short-sighted. Banking regulators needed to base their work on various methods to assess a complex financial system. To rely on only one of them would be useless.

As a response to the answers of the BCBS' officials, Justin O'Brien from the Centre for Law, Markets and Regulation at the University of New South Wales in Australia picked up Haldane's claim (i.e., Basel III is too complex) and the BCBS' justification. He stated the need 'to change the culture of regulations, not rewrite the rule book'⁷⁴⁷. In Prof. O'Brien's opinion, Basel III was too complex and the BCBS' justifications were not enough⁷⁴⁸. He stressed that the problem might be in the culture

⁷⁴⁴ *idem*.

⁷⁴⁵ Mr. Invges went on: 'For instance, the definition of capital now focuses on tangible common equity, the truest form of loss-absorbing capital. Moreover, all components of the capital base and associated deductions such as goodwill or deferred tax assets must be disclosed in a fully comparable manner. By standardising and simplifying the measure of capital, Basel III makes the regulatory framework easier to understand, and will enable market discipline to work better (...) Another important step has been the introduction of a non-risk based leverage ratio as a supplement to the risk-based requirement. This is a "belt and suspenders" approach to capital regulation. The leverage ratio will help contain the buildup of excessive leverage in the system, serving as a backstop to the risk-based regime and safeguarding against banks' attempts to "game" the risk-based requirements. Equally critically, the risk-based framework helps ensure that banks do not game the leverage ratio. Let's not forget that simple measures like a leverage ratio have been in place in the past and did not alone prevent banking failures.' *ibid*

⁷⁴⁶ Jones, H. 'Basel official defends new global bank capital rules', *Reuters News*, 24 October 2012

⁷⁴⁷ 'Risk Modeling: A simplistic response to new complexity?', *Leading Company*, 19 October 2012.

⁷⁴⁸ '[Haldane's speech] has come at a very interesting time. If you look at the recent Treasury select committee report into LIBOR, it points to a fundamental problem, not just with the culture within Barclays but banking as a whole and with oversight. A complicated system of regulation creates

and practices of the financial professionals and less in the technical tools that regulators create.

Another opinion provided by Barney Reynolds, a lawyer, judged that, although Basel III was indeed complex, the alternative proposed by Haldane – fixed leverage ratios – was not cost-free⁷⁴⁹. An editorial from the *Financial Times* picked up Mr. Byres justification of Basel III complexity and judged that regulation should have both ‘belts and braces’, i.e., leverage and risk-weight capital ratios. This meant that both approaches were necessary. On the one hand, regulators needed sophisticated tools to keep the financial system running; on the other, they needed simple ‘braces’ that acted as a ‘safety net’. The editorial conceded that it is true that risk-weight capital ratios are prone to manipulation by financial institutions – an argument underlying Haldane’s criticism. But so are leverage ratios.⁷⁵⁰ The FT proposed a system with both fixed leverage ratios and weighted capital.

Similarly to what happened in all the examples I have put forward so far, the discussion went on. I will further analyse this example in the second part of this chapter. For now, in the next section I discuss another example of a discussion that also centred on Basel III.

circumstances whereby those rules can be transacted around. And, the more complicated the structure, the more invasive the oversight has to be.’ *ibid.*

⁷⁴⁹ ‘Barney Reynolds, a partner at Shearman & Sterling, a law firm, said the critics were right that current reforms “involve applying more and more safety belts but leave the vehicle able to crash. But there’s a cost to [their] solutions also”. Masters, B. P. Jenkins, ‘Watchdogs warn on bank reform’, *Financial Times*, 27 October 2012.

⁷⁵⁰ ‘Leverage ratios may be simple. They are, however, as prone to manipulation as risk-weighted capital ratios. Whereas risk weight models can be tweaked to produce thinner cushions of capital to hold against assets, a leverage ratio encourages loading up on the riskiest assets available, which offer higher returns for the same capital (...) An equally correct reaction is to say that neither is sufficient. The ratios must not just capture the right risk, but be high enough to bite. For leverage, even the 4-7 per cent suggested by Mr Haldane may not be enough. This implies that the ratios introduced in Basel III on both risk-weighted assets and plain leverage are too lenient.’ ‘A belt-and-braces approach to banks’, *Financial Times*, 28 October 2012.

d) The fourth example: Losing the rules in relation to liquidity in 2013

As I explained in chapter 2, Basel III, released on October 2010, had two main parts. First, the *International framework for liquidity risk measurement, standards and monitoring*; and second, *A global regulatory framework for more resilient banks and banking systems*.⁷⁵¹ The first part set the standards for measuring the type and amount of liquid assets that the banks must hold. The second, complemented some measures already in place, like increasing the minimum capital requirement of Tier 1 from 2% to 6% and introducing a couple of buffers; first a ‘mandatory capital conservation buffer’ of 2.5% that the bank should hold at all times and second, a ‘discretionary counter-cyclical buffer’ that regulators could enforce on banks in times of economic expansion.

In this subsection, however, I will focus my attention on the first part of Basel III, which introduced the concept of Liquidity Coverage Ratio (LCR). From chapter 2 the reader will recall that LCR originally meant that a bank must hold liquid assets (mostly cash and government bonds⁷⁵²) to face the 100% of its obligations for a stress period of 30 days⁷⁵³. The rationale for LCR was to avoid a situation such as the credit crunch of 2008 where banks in particular and the economy in general had a shortage of liquidity for weeks. The schedule for implementing Basel III foresaw that the LCR would be enforced by January 2015 in all the countries part of the BCBS. In January 2013, however, the BCBS’ Governing Body decided that it would delay its implementation until January 2019⁷⁵⁴. Besides, the Committee made some concessions

⁷⁵¹ BCBS *Basel III: International framework for liquidity risk measurement, standards and monitoring* n 250; BCBS (2010, 2011) *Basel III: A global regulatory framework for more resilient banks and banking systems*, BIS: Basle.

⁷⁵² ‘the liquidity of an asset is judged by the speed with which it can be exchanged for goods without financial loss’ Paul Coggan, *How the City Works* (n 36), xiii.

⁷⁵³ Unstressed scenarios would include unexpected significant withdrawals of deposits, lines of credit, or other wholesale funding vehicles; Rodriguez Vayadares, Mayra, ‘You Call That Liquid? New Basel III Liquidity Rules Ineffectual’, *American Banker*, 7 January 2013.

⁷⁵⁴ BCBS, Press Release, *Basel Committee releases revised version of Basel III’s Liquidity Coverage Ratio*, 7 January 2013; at: <www.bis.org/press/p130107.htm> Accessed 1 November 2014.

to the type of assets that qualified as liquid (e.g., the new rule allowed banks to consider corporate loans and even some kind of securities as part of the LCR).

Days before the change in the LCR rule was officially announced, a report from the Dow Jones Market Intelligence Unit criticized the delay in the implementation of Basel III. The source considered that the delay had been a blow to the accord and had left ‘one to wonder if Basel III is ever going to be fully implemented in the designed manner.’⁷⁵⁵ Another article from the Canadian *Financial Post* supported the measure. Although the change had come ‘after heavy pressure from banks and some regulators,’ the modification was justified because to comply with LCRs would mean to ‘suck up’ too much liquid assets from the economy⁷⁵⁶. Finally, a news source from the industry of securitization quoted three bankers from the City in London who saw the change as very positive⁷⁵⁷.

The BCBS announced in 7 January 2013 its decision to delay the schedule for implementing Basel III and the change of the LCR. The Committee might have seen the criticism coming. Sir Mervyn King, acting as a Chairman of the Group of Governors and Heads of Supervision (GHOS), the BCBS’ highest authority, justified the same day of the announcement that the BCBS’ decision ‘was more realistic’ and that it did not ‘make sense to impose a requirement on banks that might damage the recovery’. Mr. King’s defended the change against the accusation that it amounted to ‘watering down’ the rules: ‘It’s in the eye of the beholder as to whether these [changes] are material or not, (...) Clearly one of the aims of this was to listen to the comments that people had made [and] nobody set out to make it stronger or weaker, but to make it more

⁷⁵⁵ White, M. ‘Dow Jones Top News and Commentary’, *Dow Jones Banking Intelligence*, 3 January 2013

⁷⁵⁶ Jones, H., ‘Regulators to ease up on banks’ liquidity; Basel rules’, *Financial Post*, 4 January 2013; See also, with the same argument, ‘Basel Committee to discuss liquidity on Sunday’, *Reuters News*, 4 January 2013.

⁷⁵⁷ Leask, H., ‘Securitization professionals are welcoming the BCBS’ tweaks to the LCR’ *Total Securitization and Credit Investment*, 4 January 2013.

realistic.’⁷⁵⁸ The change was based on the assumption that loosening the rules on liquidity would give banks the incentive to lend more money.

Bank shares rallied in Europe the day after the announcement⁷⁵⁹. With previous rules, large banks needed to raise 1.8 trillion Euros to comply with the LCR. The big banks’ annual average pre-tax return would also fall by 10 points according to an IMF analysis of 2012⁷⁶⁰. Notwithstanding the explanations that Melvin King gave, criticism came the Committee’s way. Three types of claims were issued: the first emphasized that the lobbying effort by the banks had paid off. Ross-Sorkin, author of the best-selling book ‘Too-Big-To-Fail’⁷⁶¹ considered the decision a result of the banks’ lobbying efforts’⁷⁶². A couple of articles in the *Financial Times*⁷⁶³ and the *Guardian*⁷⁶⁴ went a bit further and considered that the banks had gotten a ‘gift for New Year’ and yet another win. Another article in the *Financial Times* explained that the reasons for the delay were ‘capitulation to good sense as much as one to sectoral interests’⁷⁶⁵. The second type of criticism argued that the Committee’s decision implied ‘watering down’ the rules on the financial industry, as a cable from the *Deutsche Welle* worded it⁷⁶⁶; or a ‘partial retreat from hard-line reforms of the financial system,’ in the words of K. Hopkins in *The*

⁷⁵⁸ Enrich, D., G.T. Smith, and A. Morse, ‘UPDATE: Basel Regulators Give Ground to Banks’, *Dow Jones News Service*, 6 January 2013.

⁷⁵⁹ This highlights the fact that what the Committee decides, often has consequences for the regulated, no matter that the BCBS has no ‘formal’ authority.

⁷⁶⁰ *The Economist Intelligence Unit*, ‘World Finance: Going With The Flow’, 8 January 2013.

⁷⁶¹ Andrew Ross-Sorkin, *Too Big to Fail: Inside the Battle to Save Wall Street* (n 10).

⁷⁶² ‘Over the last weekend, Dimon got what he had wanted: a form of deregulation of sorts. The new international capital requirements for banks, known as Basel III – apologies if your eyes are glazing over – were significantly relaxed by regulators.’ Ross-Sorkin, A. ‘Basel III retreat the realistic option’, *The Australian Financial Review*, 9 January 2013.

⁷⁶³ ‘International banks got a gift for the New Year when regulators announced that they would be given more time to comply with the first-ever liquidity standards and be allowed to count a wider range of assets toward the requirements including some equities and mortgage-backed securities’ Masters, B., ‘Banks win more flexible Basel rules’, *Financial Times*, 6 January 2013.

⁷⁶⁴ Treanor, J. ‘Analysis: Banks win again as regulators delay new liquidity rule: Financial Watchdog falls under pressure from sector’, *The Guardian*, 8 January 2013.

⁷⁶⁵ ‘Basel Bends on Liquidity Rules’, *Financial Times*, 7 January 2013.

⁷⁶⁶ ‘Basel Body waters down bank liquidity rules’, *Deutsche Welle*, 6 January 2013.

*Times*⁷⁶⁷. The third type of criticism came from some parties who declared that the easing of the rules took the financial system a step backwards⁷⁶⁸, and was ‘business as usual’⁷⁶⁹. Bob Penn, a lawyer, criticised that the new rules could create loopholes that banks might use to ‘play the system’⁷⁷⁰. A fourth type of criticism argued that the new measures would not be useful to boost liquidity in the market anyway⁷⁷¹. Mayra Rodriguez Valladares wrote a piece in *American Banker* criticizing the new rules because they included some assets that were not liquid and that were partially responsible for the 2007 credit crunch (i.e., some types of residential securities)⁷⁷². She argued that the new LCR rules were indeed a way of watering down the regulation for big banks: ‘in today’s financial world, regulators pretend to supervise while banks pretend to be liquid’⁷⁷³. Pat McConnell, an honorary fellow in Macquarie University Applied Finance Centre in Australia, also criticised the change on LCR that was for him a way of surrendering to the global big banks. In his opinion the communiqué by which the BCBS announced the change of the LCR ‘could just as easily been labelled “After talking about this for two years, we have given into the banks, yet again”’⁷⁷⁴.

⁷⁶⁷ Hopkins, K. ‘Twelfth night gift for Banks as Basel rules are relaxed’, *The Times*, 7 January 2013

⁷⁶⁸ ‘This will fuel demand for riskier debt, such as mortgage-backed securities and corporate bonds, and takes the financial world a substantial step backwards towards its pre-crisis set of incentives.’ Saft, J. ‘Column: Basel’s golden ticket for bankers’, *Reuters News*, 8 January 2013.

⁷⁶⁹ The BCBS’ decision: ‘has broadened the definition of liquid assets to include some shares, a much wider range of corporate bonds and even some mortgage-backed securities — albeit severely haircut (they being what got the banks into the mess in the first place). But worry not, these mortgage backed securities will be rated by those credit-rating agencies who got the subprime market so wrong back in 2007. Number two, the method of calculating the liquidity coverage ratio has been altered in a way which significantly reduces the size of the buffers most banks will have to hold against potential runs on deposits. And, finally, the new rules will come in gently over four years from 2015 to 2019 rather than all at once in two years’ time.’ Goodway, N. ‘No wonder the Banks cheer: Basel III is business as usual’, *London Evening Standard*, 8 January 2013.

⁷⁷⁰ Masters, B. ‘The Basel Committee’s decision to loosen the new bank liquidity rules...’, *Financial Times*, 7 January 2013.

⁷⁷¹ *Wall Street Journal on-line Blog*, ‘Corporate Bond Yields May Fall Further Amid Relaxed Basel Rules’, 7 January 2013.

⁷⁷² Rodriguez Valladares, M. ‘You Call That Liquid? New Basel III Liquidity Rules Ineffectual.

⁷⁷³ *ibid.*

⁷⁷⁴ McConnell, P. ‘Is the Basel process broken? You can bank on it’, *the Conversation*, 8 January 2013.

The change in the LCR provoked also positive comments. Michael Barnier, the EU commissioner of Financial Markets welcomed the easing of the LCR rule⁷⁷⁵. Simon Nixon, from *Dow Jones* judged that the announcement was a ‘sensible u-turn’⁷⁷⁶ and commended that the BCBS had acknowledged that it had made a mistake⁷⁷⁷. *The Times* judged that the new LCR rules were a good thing because one could not enforce regulation when the economic environment was in a stressful situation⁷⁷⁸. Karen Shaw, a financial analyst, argued that the change was good for the industry because the old rules were impossible to enforce. The rules were designed without realizing that different banks need different liquidity ratios; and the ‘one-size-fits-all’ approach was never going to work in her opinion. The new rules, on the contrary, acknowledged diversity in the financial industry⁷⁷⁹.

An article in the comment section of the *Financial Times* argued that there were sensible changes in the LCR rules like recognizing that government bonds were not as safe as they seemed two years before. The crises of some governments like Spain, Portugal, and Greece had shown that those instruments were not as safe as originally thought. But the article argued that the delay in Basel III implementation was not justified⁷⁸⁰.

The shares of European Banks went up because they did not expect the rules to be that flexible. This suggested that those banks were the main beneficiaries of the new LCR rules⁷⁸¹.

⁷⁷⁵ *Agence France Presse*, ‘EU welcomes relaxation of bank capital buffer terms’, 7 January 2013.

⁷⁷⁶ Nixon, S., ‘Heard on the Street: Basel’s Sensible Liquidity U-turn’, *Dow Jones Global Equities News*, 7 January 2013.

⁷⁷⁷ *ibid.*

⁷⁷⁸ *The Times*, ‘Regulatory Repair’, January 8 2013.

⁷⁷⁹ Borak, D., ‘Basel Liquidity Plan Praised For tempered Approach’, *American Banker*, 8 January 2013.

⁷⁸⁰ *Financial Times*, ‘Basel bends on liquidity rules’, 7 January 2013.

⁷⁸¹ Masters, B. And A Stevenson, ‘Looser Base Rules Boost European Banks’, *Financial Times*, 7 January 2013.

A few months later, Mr. Stefan Ingves defended the Committee's decision during a speech in Cape Town⁷⁸². Mr. Ingves acknowledged the claims that criticized the easing of the liquidity ratios⁷⁸³, but stated that they were simplistic. According to him, the reason for the delay was to make sure the settings were right and thus, this reason was a legitimate one. He mentioned that adjustments had been done to tighten the measurement of some assets (e.g., derivative-related risks) and to loosen some others' (e.g., traditional retail)⁷⁸⁴. The starting belief that the BCBS 'had granted *carte blanche* to the securitisation sector' was, according to the Committee's Chairman 'well wide of the mark'⁷⁸⁵. Mr. Ingves emphasized that the consequences of the new measures would 'improve the reported LCR of the banking system'⁷⁸⁶. Addressing the changes in implementation deadlines, Mr. Ingves said that the delay guaranteed by the new liquidity standard would not 'hinder the ability of the global banking system to finance a recovery.'⁷⁸⁷

Mr. Ingves' words were mentioned by Chng Sok Hui, the Chief Financial Officer of Singapore's DBS – a private bank – who mentioned Mr. Ingves' answer in an interview and judged that the BCBS' decision to loosen the LCR made sense⁷⁸⁸. But this assessment is logical because DBS is a bank, and as such, it was a beneficiary of the move. From the regulatory point of view, however, the Australian Prudential Regulation Authority (APRA) also judged the delay authorized by the BCBS. The APRA decided not to ease the LCR rule in some cases, as the Committee did in January 2013, and

⁷⁸² 'Remarks by Mr Stefan Ingves, Governor of the Sveriges Riksbank and Chairman of the Basel Committee on Banking Supervision, at the 8th High Level Meeting organised by the Basel Committee on Banking Supervision and the Financial Stability Institute' Cape Town, 24 January 2013, at: <www.bis.org/review/r130124a.pdf?frames=0> Accessed 10 February 2015.

⁷⁸³ '...many headline writers categorised it as some kind of win for the banking industry over the regulators' *idem*.

⁷⁸⁴ *idem*.

⁷⁸⁵ *idem*.

⁷⁸⁶ *idem*, the measure was based on the 200 biggest global banks.

⁷⁸⁷ *idem*.

⁷⁸⁸ 'Basel III framework may not always accurately represent capital strength', *The Asian Banker*, 21 February 2013.

instead kept the old 2010 version of the rule⁷⁸⁹. The reason to do that was that the APRA considered that Australian banks were able to comply with the rule according to the original timetable. In their opinion a change was not justified.

From the academic perspective, the assessments of the BCBS' justification were mixed. On the one hand, there were those like Frederick Malherbe of the London Business School that argued that liquidity ratios may backfire in the future, creating a shortage of lending money in the market⁷⁹⁰. The measures to ease the LCR by the Committee would be, thus, justified. On the other, Professor Anat Adamati, from Yale Business School, judged that the LCR was crucial for financial stability because it would provide liquidity in times of economic hardship⁷⁹¹.

These reactions to Stefan Ingves' remarks had more repercussions in the financial and banking regulatory community and the discussion was far from over. I will explain them in the second part of the chapter, as I do with the other examples. For now I explain in the next subsection the last example.

e) The fifth example: the discussion of Basel III as detrimental for US banking

As I advanced in this chapter's introduction, this example is at the same time highly topical for the research and difficult to frame as an accountability process. Its status as an accountability-type process is difficult to defend because most of the criticism I narrate happened before the final decision from the Committee had been made. The final decision consisted of a new set of rules that complemented Basel III

⁷⁸⁹ Kehoe, J. 'APRA cool on widening liquidity assets' *Financial Review*, 16 February 2013.

⁷⁹⁰ Malherbe, F. (2013), 'Self-Fulfilling Liquidity Dry-Ups', *The Journal of Finance* (forthcoming).

⁷⁹¹ Anat Adamati and Martin Hellwig, *The Bankers New Clothes: What's Wrong with Banking and What to Do about It* (n 12), 93-94.

and that obliged the biggest and more complex banks (i.e. those labelled ‘too-big-to-fail’) to set aside an extra percentage of their capital as a buffer for eventual economic downturn. The discussion started well before the Committee took finally the decision in October 2012.

The discussion was about the BCBS’ project to increase the regulatory capital for bigger and more complex banks. The BCBS announced that it was thinking about taking the measure as a *fait accompli* because there was consensus among financial and banking regulators about the convenience of the measure⁷⁹². The final decision, however, took some time and the heads of state of the G-20 endorsed the new rule in November 2011.

Those bigger and more complex banks, however, were naturally not happy with the proposed change. To name those banks that were ‘too-big-to-fail’ the BCBS and the FSB coined the term ‘systemically important financial institutions’ (SIFIs). Following the example of Switzerland, the BCBS proposed to set the capital of SIFIs around 19%.

The claim was pressed by some bankers in the United States and was voiced by Jamie Dimon, the CEO of JP Morgan Chase⁷⁹³. Mr. Dimon said in an interview with the *Financial Times*, that ‘I’m very close to thinking the United States shouldn’t be in Basel [the BCBS] any more. I would not have agreed to rules that are blatantly anti-American.’⁷⁹⁴ The reason, however, was not opposition to the whole Basel III accord.

⁷⁹² ‘Barry Zubrow, chief risk officer [of JP Morgan Chase], tells lawmakers in prepared testimony to the House financial services committee that banks and Congress have a right to weigh in on a new capital standard "before it is adopted, not after international negotiations have made its adoption a *fait accompli*’; Braithwaite, T. ‘JP Morgan Chase will call on Congress...’ *Financial Times*, 16 June 2011.

⁷⁹³ Braithwaite, T., Masters, B., and Thomas H., ‘Bankers push on ‘anti-American’ parts of Basel III’, *Financial Times*, 16 September 2011.

⁷⁹⁴ Braithwaite, T., P. Jenkins, ‘JPMorgan chief says bank rules ‘anti-US’’, *Financial Times*, September 12 2011.

Dimon argued that imposing greater capital requirements on banks would impact negatively on the American economy.

Stefan Walter, just about leaving his post as the BCBS' general secretary, justified the Committee's stand. The rules were designed in a way that 'shares the pain fairly among different national banking industries.'⁷⁹⁵ The official said that he expected that the US would implement Basel III, including the new rule about SIFIs.

Mark Carney, then governor of the Bank of Canada and Chairman of the Financial Stability Board⁷⁹⁶ had an encounter with Mr. Dimon in Washington, D.C., in the context of a conference for bankers. There, the governor 'stood his ground' arguing that the mechanisms designed by the BCBS and the regulatory effort of the G-20 were solid.⁷⁹⁷ Mr. Carney famously said that '[i]f some institutions feel pressure today, it is because they have done too little for too long, rather than because they are being asked to do too much, too soon.'⁷⁹⁸ In the same speech, Mr. Carney emphasized the importance of 'consistency in implementation across jurisdictions'⁷⁹⁹.

Carney's and Walter's justifications were seen as appropriate and Dimon's criticism was judged as self-interested and a strategy to avoid strong regulation⁸⁰⁰. A group called *Basel III Compliance Professionals Association*, based in Washington,

⁷⁹⁵ Wood, D. 'Q&A: Stefan Walter on Basel III, RWAs, 'anti-American' rules and CVA', *Risk.net*, November 2011.

⁷⁹⁶ Chapter 4 explains that the FSB is a forum of which the BCBS is part of. With the new structure approved in 2009, the FSB is hierarchically superior to the Committee.

⁷⁹⁷ 'countering Mr. Dimon's critique that the planned measures are "anti-American" and risk hurting economic growth with a similarly passionate defence of the G20's efforts to construct a regulatory regime that will significantly reduce the risk of another global financial crisis, according to a person familiar with what transpired at the gathering' Carmichael, K., T. Perkins, and G. Robertson, 'Bankers, regulators square off amid turmoil; CEO Jamie Dimon unleashes tirade at Bank of Canada Governor Mark Carney over proposals for global banks to build bigger financial cushions', *The Globe and Mail*, 26 September 2011.

⁷⁹⁸ 'Remarks by Mark Carney, Governor of the Bank of Canada, Institute of International Finance, Washington, D.C.' 25 September 2011, 3, at

<www.bankofcanada.ca/wp-content/uploads/2011/09/sp250911.pdf> Accessed 15 May 2013-

⁷⁹⁹ *ibid*, 1

⁸⁰⁰ Stout, Lynn, 'Pro-American, but Anti-Banker', *The New York Times*, 28 September 2011

D.C. criticized the way Mr. Dimon worded his claim: ‘he should say that European banks can use different accounting and modelling principles, and they may have a competitive advantage, so the American regulators must ensure that the standards in the States are similar to the European ones.’⁸⁰¹ It is true that organizations such as this one would naturally defend the work of the BCBS because it is in its self-interest to justify the regulations on which their jobs are based. But the *Basel III Compliance Group* was not alone in its negative assessment of Jamie Dimon. Paul Krugman, and two articles in *The Atlantic* and *The Wall Street Journal* also criticised the way Dimon worded his complaint⁸⁰².

In summary, this example shows how important language is for accountability-like processes in the case of the BCBS. By the time the Committee responded to the criticism from Jamie Dimon, the accountability claims had been judged and dismissed by the financial professional community. The idea that the language to present an accountability claim is very important will be discussed further in the next section.

3. Communicative accountability in the work of the BCBS

Chapter 6 explained that the concept of communicative accountability is the process by which a sequence of connected communicative events takes the form of the working definition of accountability. I said there that a communicative event can be an article in the comment section of a newspaper, a television interview, a comment in a social network (*facebook, twitter, etc.*), a justification in a press release, or a journalistic article

⁸⁰¹ Basel iii Compliance Professionals Association (BiiiCPA), Newsletter, October 2011, at: <www.basel-iii-association.com/Basel_3_News_October_2011.pdf> Accessed 15 May 2015

⁸⁰² Weinreich, G. ‘As U.S. banks heave under mortgage lawsuits’ *Advone*, 12 September 2011

in the media. For Luhmann a communicative event is any point in the communication process⁸⁰³.

In chapter 6 I have also explained the Luhmannian understanding of communication. As I said there, following Luhmann, the interconnection of different communicative events that resemble an accountability processes happens at three different levels: First, the accountability claims, the justifications, and the judgments of those justifications mention the same theme (e.g., they all speak about the over complexity of Basel III, the ease on the capital liquidity ratios, the implications of Basel II for SMEs). Second, these events make reference to each other by using the first level of analysis (i.e., Luhmann's *information*). In this guise, a communicative event that has the form of a judgment explicitly or implicitly refers to another communicative event in the form of a justification from the BCBS, which in turn refers to another communicative event that takes the form of an accountability claim. Third, all communicative events that form part of the same communication have a common perspective which corresponds to the *meaning* or *appeal* – Luhmann's third selection in communication. I stressed in chapter 6 that only if the sequence shares the same language and resonates with the same perspective there is coherence in the chain of communication.

All the five examples I mapped in the first part of this chapter follow this pattern. In the case of the discussion of IRB and Advance IRB approaches, for example, the Chairman of the BCBS chose in his justification only one accountability claim – The QIS4. The four communicative events that followed referred to and judged the QIS5 which was the Committee's justification. In all of these examples of this chapter one can find the basic connections between the events that call for accountability and

⁸⁰³ Niklas Luhmann, *Social Systems* (n 100), 81.

those which justify the BCBS. Likewise, there is a connection between the events by which the Committee justifies and those which judge that justification.

A chain of communication may have three or more events shaped in the form of an accountability process that refer to the same theme (e.g., that Basel III is overly complex and ill designed, as Mr. Haldane and others argued). Only if the sequence shares the same language and resonates with the same perspective there is coherence in the chain of communication. Most significantly, Luhmann's third selection (i.e., *meaning*) gives a common perspective to the various communicative events.

In summary, the concept of communicative accountability enriches and develops the understanding of accountability. Accountability processes of financial TRNs like the BCBS are complex interactions between, on the one hand, many parties that ask the account and judge it and, on the other, the BCBS or other TRNs that answer with one or more justifications. The process' cohesion, however, relies on two characteristics: firstly, on the references that communicative events make to each other (i.e., in the case of accountability, those that judge the justification of the accountee, and the justification that mentions the accountability claim or claims); and secondly, the language and concepts that each communicative event uses are of great importance. The language and the concepts that communicative processes allude to draw on the shared perspective of an epistemic and professional community.

As I explained in chapter 6, when the BCBS refers to themes over which the banking regulatory community claims expertise accountability-like discussions might follow those decisions. At the same time the standards, expectations, and language of the banking regulatory community stand as a backdrop to the accountability process. Thus, accountability-shaped processes in the financial governance and regulation that the BCBS carries out are not only interactions between the account or and the

accountee. Additionally, the third selection (i.e., *meaning*) resonates with the particular language of an epistemic and professional community. Accordingly, I argue that communicative accountability can explain the role of the BCBS' expectations in the professional community. I also argue that this role creates in the accountee a *soft* obligation to justify his or her decision. This can be shown by explaining the consequences that the judgments of the professional community (i.e. the banking regulatory profession) created in the five examples that I put forward in this chapter.

In this vein, here I will explain the reaction of the banking regulatory community to the 5 communication chains described in the first part of the chapter. The objective is to find out what happened as a result of those consequences chains against the backdrop of the wider conversation in the relevant professional community (i.e., that of banking regulators and supervisors). In the next sections I explain the events that referred to the accountability like process of the five examples I explained in the first part of the chapter this, in turn, shows the wider judgment of the professional community as part of these accountability-like processes.

To map the wider judgment of the professional community I use the same methodology I utilised for the five examples discussed in the first part of the chapter. In this guise, I identified communicative events that refer to the accountability shaped communication chain that forms the five examples. In each one of them there the reader can identify the three Luhmannian selections: theme (*information*, i.e., that they speak about the accountability's process topic), language (*code*, i.e., that they use phrasing that chimes with the relevant professional community) and meaning (*appeal*, i.e., that they either uphold or undermine the status of the BCBS). The process is schematically explained in figure 7.1 below, which is in turn a version of last chapter's figure 6.4. In

the figure Event 2 has not ‘satellite’ events because these ones would typically be Judgment of the accountee’s justification (i.e. events type 3).

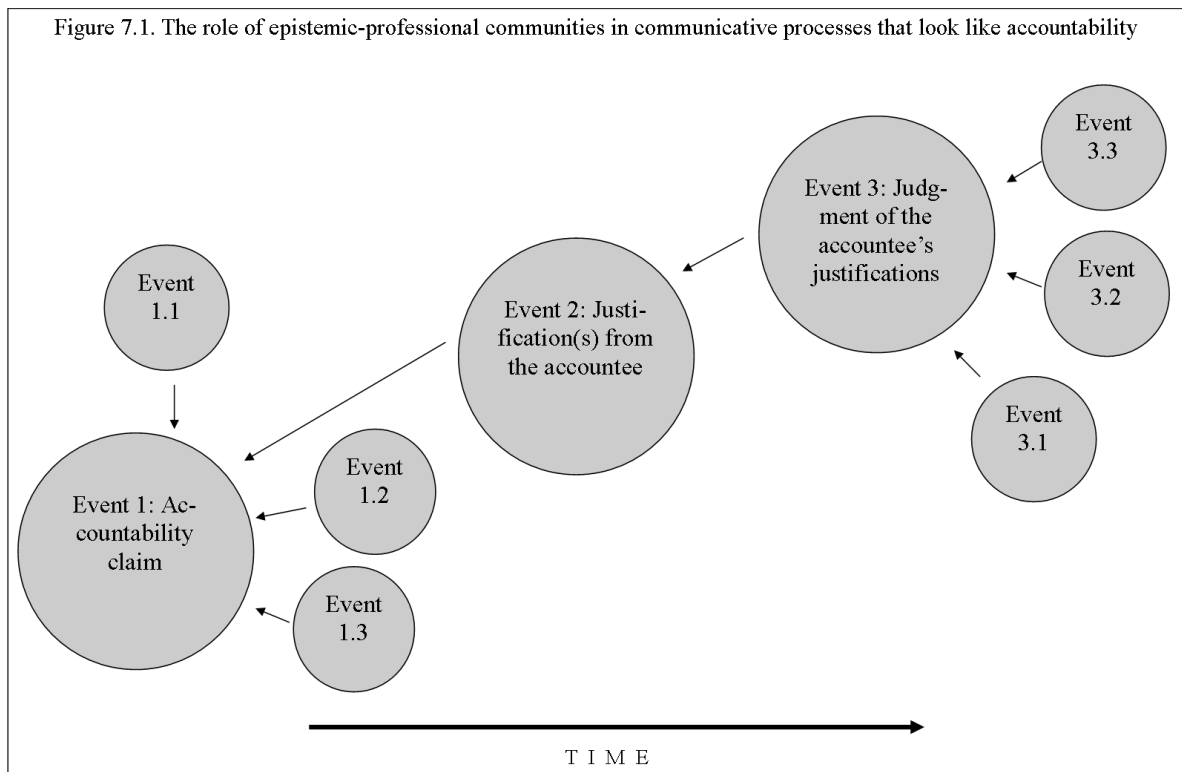


Figure 7.1 shows the elements (i.e., communicative events) of communicative accountability. The figure depicts on the one hand the communication chain in the form of an accountability process (i.e., events 1, 2, and 3) and, on the other, the following repercussions in the professional community (i.e., events 1.1, 1.2, 1.3, 3.1, 3.2, and 3.3). In the next paragraphs I show those events that reflect the wider opinion of the professional community in each one of the 5 examples I have put forward. .

a) The consequences of the discussion about the IRB standards

In the first part of the chapter I explained how IRB and A-IRB approaches were tools set forth by the BCBS so that the banks could measure their default risk using their own models. The QIS5 exercise was commended by some and criticised by others. A critical note came from Goodhart and Persaud a couple of years later, once the 2007-2008 ‘credit crunch’s’ effects were fully present⁸⁰⁴. The authors criticized that the measurement of risk default of IRB and advance-IRB approaches used market values. They argued that the regulatory model proposed by the accord provoked pro-cycality, i.e. that financial institutions lend more and save less capital when prices of lending were up. Goodhart and Persaud stated that financial institutions should instead save capital in good times:

At the heart of the present approach are estimates of risk and value that use current and past market prices. This convergence of market measures of risk and regulatory capital looks sophisticated and makes life easier for banks. But it is puzzling why market measures of a bank's risk should be at the centre of financial regulation.

The reason why we have bank regulation is that every now and then markets fail and the resulting crashes have widespread and devastating effect. Yet regulators have used market prices to build their defences against market failure. Unsurprisingly, this has proved as much help as the *Maginot* line. If market prices were good at predicting crashes, they would not happen.

The risk sensitivity approach is upside down. Statisticians need to stand back a little and look at the broad sweep of financial history. Financial market crashes do not emerge randomly, but follow booms. What fuels the boom are market

⁸⁰⁴ Charles A E Goodhart, Avinash D Persaud, ‘How to avoid the next crash’ (n 236); The arguments of Goodhart are also in Charles A E Goodhart, Miguel Angel Segoviano ‘Banking Stability Measures’ (n 236).

estimates that risks are low. This optimism encourages imprudent lending, which eventually leads to the next crash⁸⁰⁵.

Daniel Tarullo was also of the opinion that the IRB and A-IRB approaches were unfit and too complex for measuring default risk in banks:

Two core aims of Basel II are unqualifiedly desirable: to align capital requirements more closely with the risks actually assumed by banks, and to continuously prompt banks to adopt the best available risk management practices. However, the potential of the Basel II A-IRB proposal to achieve those aims is questionable. This approach entails a major change in the method for calculating capital requirements for the most systemically important banks. Yet the impact of this change on actual capital levels is not understood. Moreover, while most supervisors seem accepting of at least moderate declines in A-IRB bank capital levels, they have provided no analysis of why they believe current bank capital levels to be unnecessarily high.

Of equal concern, the A-IRB model is at the same time enormously complex, full of opportunities for bank and national supervisory discretion and only indirectly related to the state-of-the-art risk evaluation and management systems actually used by banks for business purposes⁸⁰⁶.

Consensus after the financial crisis, finally, revolved around the cyclicity of the IRB and A-IRB approaches⁸⁰⁷. Nevertheless, the IRB approaches remained as part of the proposed methodology of Basel III to measure market risk. In a 2015 document the European Banking Authority (EBA) acknowledged that:

⁸⁰⁵ Charles A E Goodhart, Avinash D Persaud, 'How to avoid the next crash' (n 236).

⁸⁰⁶ Tarullo, Daniel K. *Banking on Basel: The Future of International Financial Regulation* (n 177).

⁸⁰⁷ Lord Turner, then chairman of the former FSA expressed a balanced opinion about the IRB approaches: 'So, if you do it on individual, **internal risk-based approach** it does heavily depend on how you utilise that; badly used it can be strongly pro-cyclical, correctly used, with models that actually ask what happened in the last downturn, it needn't be. So, I'm sure there will be a school of thought that says, no, through-the-cycle models if get them right, and even value at risk, that as long as we add stress test to value at risk, or as long as we get people when they work out value at risk, to run figures as to how variable we value at risk, over ten year cycles, we can still use that. (...) At the other end, I think there's going to be a school of thought that says, this is all just too complicated, some banks will always just be too optimistic, therefore it's sort of, forward to the past, we need gross leverage ratios, at least as an underpin to what was there. Or we need more formulaically counter-cyclical things such as the Spanish, or such as Charles Goodhart, and I think all of that is now up for debate.' *Financial Times* (17 October 2008) 'FT Interview: Lord Turner, chairman of the FSA'.

‘from an overall perspective the IRB framework has proven its validity as the risk sensitive way of measuring capital requirements that encourages the institutions to implement more sound and sophisticated internal risk management practices (...) The EBA consequently recognises the value of internal models, although substantial weaknesses in the application of the IRB Approach and inconsistencies in the outcomes of internal models have also been acknowledged.’⁸⁰⁸

At the same time, Basel III proposed deep changes for both approaches so that qualified banks may employ more robust and accurate internal models for risk quantification⁸⁰⁹.

The main analysis that I present here in relation to this example is that these communicative events have the same theme as the communication chain in the form of accountability that discussed the adequacy of IRB and A-IRB approaches of the BCBS more general. For that reason this criticism was ‘heard’ by the BCBS. The financial and banking regulatory community reached a consensus about the usefulness of the IRB framework but, at the same time, it acknowledged that the Committee needed to strengthen the models so that the procycality of those approaches was avoided.

In this case study, communicative accountability consisted on a series of events that shared a common theme and were formulated with a common meaning: the usefulness or uselessness of IRB and A-IRB for global banking regulation and the appropriateness of the BCBS’ standards in this matter. It is also relevant that the events share a technical language that allows experts to chime in and deters laymen from the conversation. In the next subsection I explain the repercussions of the discussion about Basel II mandated SMEs’ exposures within the banking regulatory community.

⁸⁰⁸ EBA *Discussion Paper: Future of the IRB Approach*, (EBA/DP/2015/01 2005), 11.

⁸⁰⁹ Capgemini (2013) *Basel III: Comparison of Standardized and Advanced Approaches*, see: <https://www.capgemini.com/resource-file-access/resource/pdf/basel_iii_comparison_of_standardized_and_advanced_approaches.pdf> Accessed 10 February 2016.

b) The expectations in the banking regulatory community about the Basel II rules on SMEs exposures

In the case of Basel II's impact on lending to SMEs, there was a controversy between those members of the community of bankers and bank regulators who thought that the relaxation of the rules for exposures to SMEs was politically motivated and those who thought that it was justified by a financial point of view.

In 2006, the Centre for European Policy Studies (CEPS) carried out a survey of a number of experts of the finance and banking industries in Europe⁸¹⁰. 88% of the participants answered that the shift in the BCBS' standards regarding SMEs was a political compromise. At the same time, however, they agreed that the measure was necessary. The survey conducted by the CESP showed that the banking sector thought that sometimes political concessions had to be done even when those decisions were not strictly justified by financial expertise. In this case the final expectation among the surveyed sample of financial professionals was that it was legitimate to make political concessions.

A clarification is in order here. According to Luhmannian ideas – the theoretical framework that this thesis uses – it is possible that other subsystems (e.g., politics, law, economics) might as well influence the BCBS' decision-making because, due to structural coupling, the Basel Committee and its main accountability forum suffer

⁸¹⁰ The CESP's survey was '...on the practical implications of the new Basel II Accord for the European financial system. A questionnaire was distributed to 250 participants at a conference jointly organised by CEPS with FESE (Federation of European Securities Exchanges) and PwC (PricewaterhouseCoopers) on "The Changing Regulatory Regime in Europe: A Challenging New Business Concept" in November 2003 in Brussels. This conference brought together market participants, regulators and academics to discuss the issues raised by the Basel II consultation process in order to obtain a direct assessment of how deeply the current proposal has been understood and accepted or even rejected throughout the European financial industry, CEPS undertook a statistical analysis of the 54 relevant responses collected. When asked about the extent to which SME financing had become a political issue, 88% of respondents confirmed the political nature of the SME financing debate and 70% indicated that the agreement on special treatment reached in July 2002 appears rather beneficial' R Ayadi *The New Basel Capital Accord and SME Financing: SMEs and the New Rating Culture* n 719, 45.

restrictions – in the form of noise – by other subsystems that act as their environment. Germany's opposition to the original rule about SMEs' exposures constituted a restriction of this sort. Additionally, it is also possible that one system delegates certain understandings to other systems. For Luhmann this happens in relation to the legal and the political system. The legitimacy of statutes and other laws upon which the legal system relies is delegated to the political system (i.e., the Parliaments or Congresses pass legislation)⁸¹¹.

As I explained in the first part of this chapter, in this case the Committee justified its position saying that the change to ease the rules on banking lending to SMEs was based on financial reasons and not on political ones. However, a sector of the European banking community believed that the real reason for the change was the threat to veto Basel II made by Germany. Nevertheless, they also thought that this change was justified. From Luhmann's perspective, this apparent contradiction is possible because the social system to which the professional community of banking regulators belongs to, delegates some definitions to the political system. Additionally, it seems that the final expectation was that the BCBS might be pragmatic when recognizing some restrictions (political in this case study) for the implementing of its standards. Thus, in this example we can see that a different perspective from finance and banking regulation might be valid for the relevant professional community, even if it departs from the technical language of finance and banking. The next section takes a deeper look on the reactions from the banking regulatory community to the discussion around the over-complexity of Basel III.

⁸¹¹ Niklas Luhmann *Ecological Communication* (n. 580).

c) Assessments of the BCBS's work by the banking regulatory community: The consequences of the accountability-like process in relation to Basel III's over-complexity

The discussion about the over-complexity of Basel III also was assessed by the financial, banking, and banking regulatory community. The judgments of the BCBS' justifications were divided. On the one hand, Mr. Mark Carney, former governor of the Bank of Canada and since 2012 governor of the Bank of England thought that complexity had a role in banking regulation and was indeed a needed feature of the system. On the other, Andrew Haldane – who would be from 2012 Mr. Carney's subordinate – kept saying that Basel III was too complex⁸¹². This example shows that there is an ongoing discussion within the relevant professional community about what type of standards should apply to a TRN's decision making.

However, BCBS' justifications were not widely accepted. In the U.S. the financial relevant community feared that implementing Basel III 'could stall the wheels of finance and set our capital, contract and currency markets on a hopeless path toward cliff hanging if not cliff suicide.'⁸¹³ As a result, a conviction grew to 'slow it [Basel III] down and do it right'⁸¹⁴. Even when some governments stated their intention to implement Basel III from January 2013⁸¹⁵, concerns remained about its complexity⁸¹⁶.

⁸¹² 'Infighting among agencies runs deep - including skirmishes that Mr. Carney has already engaged in. Earlier this year, he delivered putdowns of Andy Haldane, executive director of financial stability at the Bank of England. Mr. Haldane, among other things, argued that regulatory efforts such as Basel III bank capital rules were too complex. "Less may be more," said Mr. Haldane.- Mr. Carney obviously thinks more is more, and called Mr. Haldane's remarks "uneven." It is hard to see how the two men will get along at the bank. The mood in London appears to run in favour of more, not less, government control of British financial markets 'Carney leaves full punch bowl but no party', *National Post*, 27 November 2012.

⁸¹³ 'Grody: the first steps towards risk adjusting the financial system', *Futures and Options World*, 1 December 2012.

⁸¹⁴ *ibid.*

⁸¹⁵ Mexico started implementation of Basel III on January 2013. Most of the accord's features were already set in place, Interview with a member of the BCBS (Mexico City, 5 January 2012).

An IMF's endorsement in 2013 did not help to ease the accord's implementation⁸¹⁷. The U.S. unwillingness to implement Basel III, the fact that European countries were formulating their own version of the accord, and the Bank of England's criticism of Basel III as 'too complex' deterred other countries from enforcing the accord in time.⁸¹⁸

Finally, Daniel Tarullo, a member of the United States Federal Reserve's board, said that 'there is a widespread view that the proposed rule [Basel III] erred on the side of too much complexity.'⁸¹⁹ The view was confirmed by Mr. Stefan Ingves, who acknowledged that Basel III might have been too convoluted and that the BCBS would make a review of the risk-weighted methods in the following months.⁸²⁰ In this example, the wider community of bankers, financial professionals, and financial regulators thought that Basel III was overly complex. The fact was even recognized by the Chairman of the BCBS⁸²¹. As a result of the communicative accountability process

⁸¹⁶ Neil Grummitt, Australian Prudential Regulation Authority's general manager, acknowledged 'the regulations were too complex and (...) Australia's banking sector did not have the problems of international counterparts, but said tougher rules were needed as the global financial sector remained on edge.' Liondis, G., 'Bank rules may stifle investment' *The Australian Financial Review*, 13 December 2012.

⁸¹⁷ 'We need to move beyond the system that gave us the crisis, a financial sector in which some, as the ancient Greeks might say, toyed with hubris and unleashed nemesis. Of course, there has been important progress, especially on the Basel III agenda to create more resilient capital and liquidity buffers. But momentum is flagging, both on implementing the agreed reforms and on progress in areas like derivatives and shadow banking.' Lagarde, Christine, 'The Future of global economy', *China Daily*, 28 December 2012, also from interview with an official from the IMF, 10-January-2013.

⁸¹⁸ 'The fact that the US is delaying the implementation of Basel III capital rules and European countries are formulating their own versions means that Asian economies are at the forefront of implementing Basel III capital requirements. The complex liquidity requirements were still being finalised as 2012 came to a close. The Bank of England has openly questioned whether the Basel III rules are too complex. It is therefore not surprising that Asian bankers are questioning why they should be taking a complex medicine for an illness they do not yet have, prescribed in haste for someone who may be thinking twice about taking it, the side-effects of which are not fully understood.' Andrew Sheng president of Fung Global Institute', *The Banker*, 1 January 2013.

⁸¹⁹ 'Fed's Tarullo: Hope Final Basel Capital Rulemaking to Be Complete This Spring', *Dow Jones Global FX & Fixed Income News*, 13 February 2013.

⁸²⁰ 'Keynote address by Mr Stefan Ingves, Governor of the Sveriges Riksbank and Chairman of the Basel Committee on Banking Supervision to the Third BCBS-FSI High-Level Meeting for Central and Eastern Europe on "Strengthening Financial Sector Supervision and Current Regulatory Priorities"', 12 March 2013. At: <www.bis.org/review/r130312a.pdf?frames=0> Accessed 10 February 2016; 'Banking supervisors may seek to simplify capital rules', *Reuters News*, 12 March 2013.

⁸²¹ Keynote address by Mr Stefan Ingves, Governor of the Sveriges Riksbank and Chairman of the Basel Committee on Banking Supervision to the Third BCBS-FSI High-Level Meeting for Central and Eastern Europe on "Strengthening Financial Sector Supervision and Current Regulatory Priorities"', 12 March

in this case, the expectation within the relevant system was at the end that Basel III was too complex and that this might slow down its implementation. This discussion is very interesting for the concept of communicative accountability that this thesis puts forward. While the main criticism of Basel III was that it may be too complex, the meaning departed from what a layman understands as ‘complexity’ (i.e., difficulty to understand). Instead, the meaning of complexity was more specific and resonated with the banking regulatory community. It meant that the over-complexity of Basel III constituted an obstacle for supervising banks. Furthermore, two regulatory philosophies were implied. On the one hand, a view that relied on the quality of regulatory design and, on the other hand, an understanding that ‘less is more’. Hence, it is clear that the discussion of complexity resonated with a specific professional community. In Luhmannian terms, this means that the common understanding of the term ‘complexity’ belonged to the social system of banking regulation.

In the next subsection I delve into the discussion about the ease of Basel III liquidity rules.

d) The result of the discussion about the ease of Basel III liquidity rules in the banking regulatory community

The community outside bankers, banking experts and banking regulators tended to see the ease of the rules as a win for the banks that lobbied their way to ‘water down’ Basel III regulations⁸²². Nevertheless, members of the relevant professional community for the BCBS (i.e., banks’ regulators and banking experts) tended to justify the ease of the

2013. See: <www.bis.org/review/r130312a.pdf?frames=0> Accessed 10 February 2016; ‘Banking supervisors may seek to simplify capital rules’, *Reuters News*, 12 March 2013.

⁸²² *The Wall Street Journal* 30 May 2013 ‘How Mervyn King lost the war of Capital’.

implementation schedule of the LCR (liquidity coverage ratio) because it proved to be ‘too stringent’ and particularly ill-designed for times of economic stress in Europe and elsewhere⁸²³. Daniel Tarullo, by then the chairman of the New York Fed shared his opinion at the Peterson Institute for International Economics that ‘creating liquidity levels substantially higher than those contemplated in the LCR and eventual NSFR may not be the most efficient way for some firms to become better insulated from the run risk that can lead to adverse feedback loop and contagion possibilities.’⁸²⁴

Additionally, David Wilson, from Capgemini Financial Services argued that new regulations on liquidity were affecting ‘the top and bottom line of the firms’ at very complicated times for an industry that had not had fully recovered from the financial crisis⁸²⁵. So, in this case, the members of the relevant professional community of the BCBS thought that easing the schedule for adoption of the LCR might not had been a bad idea, considering the economic downturn that followed the 2008 financial crisis and the high compliance cost that banks were facing.

The implication of this case study for the idea of communicative accountability is that even when the wider public opinion criticized the delay and even portrayed it as a regulatory capture, the epistemic community of banking regulators justified the change in the implementation times as a necessity given the ominous economic context. This case study also shows the relevance of the banking regulatory community for the BCBS. In the next section I explain the last example which follows the repercussions of the discussion about Basel III being ‘anti-American.’

⁸²³ Borak, Dona, *The American Banker*, ‘Big Banks Push for Fixes on Liquidity Rules’, 3 September 2013.

⁸²⁴ *ibid.*

⁸²⁵ Goff, Sharlene, *Financial Times*, ‘Tighter rules bear down on wealth managers’, 27 November 2013.

e) The assessment of the banking regulatory community of Jamie Dimon's remarks about Basel III being detrimental for the US

The conversation around Jamie Dimon's remarks arguing that Basel III was 'anti-American' is a good example of how this epistemic community talks about the communicative events that are part of the accountability process. Paul Krugman, for example, thought that Mr. Jamie Dimon's claim was not sound: 'If he [Mr. Dimon] says Basel III is bad for America, you can bet that he means 'bad for JPMorgan Chase.'⁸²⁶ Others praised the Basel III accord as a result of 'extensive negotiations in which the U.S. played a leading role and in which we gained a number of important concessions from Europe, probably more that they gained from us.'⁸²⁷ For these latter people, Basel III was the opposite of 'anti-American.'

Members of the financial profession thought that Mr. Jamie Dimon's wording was unfortunate.⁸²⁸ The Institute of International Finance (IIF) published a document in which it argued that Mr. Dimon's claims had a point⁸²⁹. Nevertheless, an article in the *New York Times* said that '[i]t's almost beside the point whether Mr. Dimon's arguments hold up (though there is evidence that some key ones do not). He is grandstanding for a different audience.'⁸³⁰ Some of Dimon's colleagues thought that his discourse was not advancing the bankers' interest.⁸³¹ There was a consensus that bankers should use the

⁸²⁶ Krugman, P. 'Satire is Dead', *The New York Times*, 11 September 2011; many of the authors' opinions about Jaimie Dimmon's remarks are at: <www.nytimes.com/roomfordebate/2011/09/28/are-global-banking-rules-anti-american> Accessed 10 February 2016.

⁸²⁷ Elliott, D. J., 'Looking for Devils in the Details', *The New York Times*, September 28 2011.

⁸²⁸ Johnson, S. 'In the Interest of Americans', *The New York Times*, September 28 2011.

⁸²⁹ IIF (2011) *The cumulative impact on the global economy of changes in the financial regulatory framework*, IIF, Washington, D.C. The report used the financial/economic language and was addressed by some officials like Mr. Carney.

⁸³⁰ Erman, B. 'Dimon's rhetoric a killer of reasonable bank reform', *The Globe and Mail*, 27 September 2011.

⁸³¹ 'One of their own had just trash-talked a central banker rumoured to be in line to head the Financial Stability Board. That's the regulatory body that will recommend the finalized Basel III reforms to the Group of 20 economies. Ackerman and Blankfein quickly proffered written apologies to Carney. And Dimon himself - realizing he'd become a liability to his peers - got off a message to Carney' Olive, D., 'Banker's outburst shows he's his own worst enemy', *Toronto Star*, 5 October 2011.

language and arguments of economics and finance and thus, address their claims to the financial community. Otherwise their claims, as happened with Mr. Dimon, would backfire. This case study shows that language matters because of two reasons. First, because the BCBS seems to hear the claims that are formulated in a given language and dismiss other criticism that does not resonates with it (like patriotism in this case). And second, because Mr. Dimon's argument had a point and could have been issued differently. The final expectation among the social system of banking regulation, however, was that the *appeal* of Mr. Dimon's claim was not relevant for the BCBS' work.

In conclusion, I argue that the wider conversation among the community of bankers, financial professionals and banking regulators is in the background to those discussions that I described in this chapter and that resemble accountability processes. I also argue that these discussions may have consequences for the BCBS and, thus, provoke in the Committee the obligation to respond and justify its decisions. The three levels of analysis that I put forward, following the Luhmannian understanding of communication are useful to construct the concept of communicative accountability. Most significantly, the third level of analysis (i.e., the meaning) highlights the significance of the language and relevant topics of the financial community for the processes of accountability.

By contrast, the lack of use of the relevant language and relevant topics when criticizing the BCBS might be the reason why those criticisms are never answered by the Committee. I show this with a couple of examples.

3.1. The impact of alternative languages and concepts: the ‘no-communicative accountability’ of the BCBS

One banking executive said that ‘[w]hen you do mention Basel, your average member of Congress thinks “that pairs well with tomato and mozzarella”’⁸³². This is also true of many ordinary members of society. The issues that the BCBS deals with are very technical and therefore, stand far and away from the ordinary language of most people. It is thus difficult to keep track of the discussion around the BCBS’ work. It is understandable that the professional community of bankers and banking regulators is the relevant one regarding the BCBS’ communicative accountability.

Notwithstanding the relevance of the technical language in the work and accountability of the BCBS, it is true that the visibility of the Committee has increased with time. As I mentioned in chapter 3, the BCBS is more recognizable since the financial crisis of 2007-2008 and its aftermath⁸³³.

I have encountered, however, two relevant accountability claims that do not use the language and concepts of the financial professional epistemic community. The first claim came as a result of the Basel II third consultation paper. An organization called ‘Community on the Move’ submitted a comment focusing on the lack of regulation for sub-prime operations. Most significantly, they point at the ‘reputation risk’ that banks have when they make business with authoritarian governments that violate human rights⁸³⁴:

‘More recently, legal and financial claims concerning activities in South Africa are pending against a number of the banks that would be affected by Basel II; we also note, for example, the United Nations 2001 report naming Citigroup, *inter alia*, as being an enabler in the trade of conflict diamonds from the Democratic

⁸³² *Reuters News*, ‘Rankled Banks to launch campaign against US reforms’, 9 June 2011.

⁸³³ The table is the result of searching for ‘Basel Committee’ or ‘BCBS’ in the *Factiva* database.

⁸³⁴ Comment submitted by *Community on the Move*.

Republic of Congo, and earlier reports that Citibank (as well as Dresdner Bank and Banque Nationale de Paris) continued banking business with the deposed and discredited Interahamwe-tied government of Rwanda in 1994 (*see, e.g., Le Soir*, January 27, 1997; the Human Rights Enforcement Project, *humanrightsenforcement.org* is working on this and related issues). These examples of types of operations/reputational risk, even beyond the subprime lending issues on which this comment has focused, of which Basel II must take account. It is imperative that the (...) BCBS and Basel II conduct further outreach (including beyond bank and their regulators), that harm to consumers (which can and does reverberate in harm to banks' reputations and capital) be taken account of in Basel II.'

Although the BCBS acknowledged this claim and published the comment in its website, there was not an explicit or implicit answer from the Committee.

The second example is about transparency and publicity of the BCBS and other TRNs closely related to it: the FSB and the IOSCO. The non-governmental organization (NGO) 'Transparency International' demanded in 2010 that 'the exact responsibilities of groups such as the Financial Stability Board, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions need to be spelled out to ensure good governance and public confidence'⁸³⁵. In another article, Hugette Labelle, the chair of Transparency international argued that institutions like the BCBS 'are very important. Their work has to be transparent so they don't become centers for secret decision-making in a way that's not always publicly accountable.'⁸³⁶ Neither the BCBS nor the FSB responded to this claim.

These two claims did not have repercussions in the relevant financial and banking regulatory community. The reason why there were no responses to these claims might be linked to their lack of usage of the language or the themes of the banking regulatory community. Therefore, as these claims did not resonate with the relevant community, they did not create an incentive for the BCBS to respond and justify.

⁸³⁵ Tara Perkins 'Harper's G20 urged to tackle secrecy' *The Globe and Mail* 9 March 2010.

⁸³⁶ *Wall Street Journal*, 'Davos: FSB urged to look at own Transparency', 28 January 2010.

4. Conclusion: communicative accountability in the BCBS

The accountability gap that TRNs such as the BCBS possess led me to investigate the existence of processes of accountability ‘in the margins of the state’⁸³⁷. As I argued in chapter 5, these processes are not typically the product of those mechanisms, such as statutes, courts, or parliaments traditionally linked to the state. Neither are they based on principal-agent relationships (i.e., a legitimate delegation from the state). On the contrary, the lack of ‘formal’, ‘hard law’ or ‘legalized’ processes of accountability in transnational financial regulation creates the necessity to find alternative, informal ways for holding the powerful to account. Similarly, the lack of formal mechanisms of accountability should not be taken as an absolute absence of accountability.

The goal of this chapter has been to analyse chains of communication that revolve around a justification given by the BCBS. My findings show that it is possible to identify sequences of critiques, justifications, and judgments that resemble accountability processes. I use the working concept of accountability for this purpose. The chapter has identified five examples that discuss the central role of the BCBS to level the playing field in transnational financial regulation. To achieve this over the years the Committee has created homogeneous standards to enforce minimum capital requirements, principles of good financial regulation, and minimum liquidity standards. Many of the BCBS’ decisions stand at the centre of a wider conversation that includes bankers, financial professionals (e.g., brokers, dealers, financial analysts, financial accountants, economists, financial lawyers, etc.), and financial regulators.

⁸³⁷ Calliess, Galf-Peter, Peer Zumbansen, *Rough consensus and Running Code: A theory of Transnational Private Law* (n 1); Kenneth W. Abbott and Duncan Snidal ‘The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State’ (n 358).

While analysing the qualitative data set I identified a community that criticises, commends, and comments on the regulatory outcomes of the BCBS. This community has shared understandings. For example, their members know the meaning of concepts such as ‘liquidity coverage ratio’, ‘minimum capital requirements’, ‘ring-fencing’, ‘derivatives’, ‘A-IRB’, ‘off-balance sheet obligations’, ‘shadow banking’, ‘SIFIs’, ‘SWAPS’, ‘over-the-counter derivatives’, ‘CDRs’, ‘Tier-1 assets’, ‘loss given default’, etc. Moreover, besides their mutual understanding of this very technical language, their members also have a shared and very high interest in these themes. On the contrary, the relevance the professional community gives to these topics trumps other concepts like ‘transparency’, ‘legitimacy’, ‘participation’, ‘due process’, and ‘representation’; which are nowhere to be seen in the conversation at the centre of which the BCBS stands. It is clear that some themes raise the attention of the financial community more than others.

Consequently, it should be noted that when the thesis refers to the community of bankers, banking regulators, financial experts and journalists, it refers to the common language and understanding that they share. For Luhmmanian theory, the identity of the person that partakes in a communication process (e.g. her or his job) is irrelevant as long as the communicative event resonates with that process.

The five examples of this chapter show that both the relevance of the person or organization that criticised or judged the BCBS’ work and the media outlet that published the comment do matter. As I explained in chapter 3, there is a hierarchy among experts. In terms of system theory⁸³⁸, such a community is ‘differentiated’ geographically (i.e., according to centres and peripheries) and hierarchically (i.e., according to senior and junior professionals). Similarly, the BCBS tends to only answer

⁸³⁸ Luhmann 1995, Poul F Kjaer, Gunter Teubner, Alberto Febbrajo, *The Financial Crisis in Constitutional Perspective: the Dark Side of Functional Differentiation* (n 383).

those claims that use the language of the financial, banking, and banking regulatory community.

The five examples that I put forward can be analysed as a sequence of communicative events. Some of them – mainly the first ones in time – are accountability claims; then, some others are justifications of the BCBS and, finally, others are judgments of those justifications. I have also found a third dimension that connects every event with every other one in a chain of communication. This third dimension consists of the following elements. Firstly, each event refers to one theme (the consequences of Basel II for SMEs, the over-complexity of Basel III, the LCR, etc.); secondly, they use a ‘channel’ like an article in a newspaper or an interview; and thirdly, they have a common meaning that connects them with the shared understanding of a professional community.

In conclusion, the first part of the chapter has used the working definition of accountability set out in chapter 5 to map five chains of communication that resemble accountability. The analysis of these five examples shows that there is a community of bankers, financial professionals and financial regulators whose language is key for discussing the work of the BCBS.

If the BCBS possesses ‘enormous moral authority’⁸³⁹ it is because the relevant professional community that participates and oversees the Committee’s work has a good opinion about it. This explains why some accountability claims are answered by the Committee in the form of a justification and others are not. From the Luhmannian perspective the reason that explains this phenomenon is that the claims phrased in the language of the banking regulatory community can be understood by it. Thus, the

⁸³⁹ LeBor, Adam (2013) *The Tower of Basel: The Shadowy History of the Secret Bank that Runs the World*, Public Affairs, New York, Loc. 303.

Committee answers them because the opinion of this community affects its organisation and the validity of its regulatory products (i.e., it does have consequences in the form of the higher or lower standing before the professional community). If, on the contrary, claims are not phrased in the language of the banking regulatory community and do not chime with the expectations of that community the BCBS perceives those claims as noise or *irritations*.

This chapter has mapped accountability processes that take the form of communication and that the triple selection that I borrowed from the Luhmannian theoretical toolbox helps to identify and unify. In the five examples of this chapter I have identified that the theme, the language, and the appeal are key not only to unify and make sense of those accountability processes, but also lead to a situation where the initial accountability claim was answered by the BCBS with a justification, because the accountability claim resonated with the professional community of banks' supervisors and regulators.

I have also shown that there are other claims that have chimed with other audiences (e.g., human rights, transparency, governance, representation or with issues that resonate with the wider public: fairness, anti-corruption, and equality). The movement *Occupy* in its various incarnations (London, New York, Madrid, and Basle) had a very wide agenda that unified its voices around a sentiment of anger directed towards the financial industry⁸⁴⁰.

For a technical body that deals with highly complex issues like the BCBS, however, those claims and criticisms are likely taken as 'noise'. 'We do not understand them' were the words a high-ranking former officer from a banking regulatory agency told me in one interview⁸⁴¹. He was referring to the *occupy* movement. I venture the

⁸⁴⁰ N+1, *The Problem are The Banks: Letters to Wallstreet* (n 6).

⁸⁴¹ Former member of the BCBS, interview with the author (Basle, Switzerland November 2011).

idea that people at the BCBS claim that they do not understand those claims not because they do not hear them, but because they do not chime neither with the technical language of the Committee, nor with the relevant professional community that the BCBS forms part.

Communicative accountability in the work of the BCBS means that the Committee is also subject to accountability processes, even in the uncertain and informal environment of transnational financial regulation. Those processes are *mediated* by a professional community and therefore they can be even more effective than traditional accountability mechanisms in the context of the state. The standing of one BCBS' official or the Committee as a whole before the professional community of banking regulators is a powerful incentive to engage in the accountability shaped chains of communication that I have put forward in this chapter.

Chapter 8. Conclusion: BCBS' communicative accountability and the challenges it poses for legitimacy

In this thesis I sought to explore and map possible accountability mechanisms to hold the BCBS accountable in the absence of formal accountability mechanisms. I have argued that Luhmannian concepts can be useful for identifying, conceptualizing and making sense of communicative processes that hold the BCBS accountable. These processes can be mapped by identifying communicative events that are linked with each other because they share the same theme, they use the same language, and they resonate in the same professional community. These events form a chain of communication that resembles an accountability process because they ask for the account, get it, judge it and as a result of the process, expectations are managed, and sometimes sanctions, (in the form of reputational sanctions) follow. I use the passive voice in all the steps intentionally because for Luhmann and, as a consequence, for the empirical analysis put forward in chapter 7, there is not a central actor that manages the process. On the contrary each stage is decentred and unplanned. The accountability process is nevertheless coherent, because all the communicative events it comprises share the same theme and, by the use of a particular language, resonate with a relevant professional community.

This chapter is divided into three sections. The first one synthesises the argument of the thesis in light of its main conclusion: that a concept of communicative accountability which derives from Luhmann's ideas can make sense of communicative processes in relation to the work of the BCBS. These processes really hold the TRN accountable. In this vein, in the second section I argue that communicative accountability is a step forward for enhancing the transparency and good governance of the BCBS, but it lacks in legitimacy. The problem is that the context of TRNs makes it

very difficult – if not impossible – to draw on the traditional domestic legitimating mechanisms that are pervasive in most countries, in order to both legitimise these TRNs’ work and their accountability. The tools of public international law also fall short to hold TRNs accountable. Consequently, this section advances a definition of legitimacy as ‘the right to rule’⁸⁴² and argues that novel categories are needed to enhance the legitimacy of financial TRNs such as the BCBS.

The challenge consists of enhancing the legitimacy of financial TRNs like the BCBS with reference to the principles of inclusion, non-domination, and democratic rule. Finally, section three of this chapter lies down possible avenues for further research in relation to communicative accountability of financial TRNs like the Committee.

1. The argument of the thesis

I started this thesis by describing the limitations of traditional domestic mechanisms for rendering TRNs accountable. At the same time I underlined the necessity of transnational regulation, given the level of complexity and internationalisation that some regulatory problems have. In the case of financial regulation, the volume of international flows and the interconnectedness of many ‘systemically important financial institutions’ (SIFIs, as the BCBS has called them) justify the increasingly important role that some TRNs have. I defined a TRN as an ‘informal multilateral forum that brings together representatives from national regulatory agencies or

⁸⁴² JG Merquior, *Rousseau and Weber, Two studies in the theory of legitimacy* (n 496).

departments to facilitate multilateral co-operation on issues of mutual interest within the authority of their participants.’⁸⁴³

With other financial TRNs such as the IOSCO and the IAIS, the BCBS stands at the centre of the transnational scene and it is, as many view it, a necessary tool for tackling the urgent problems that the global financial industry faces. At the same time, TRNs like the Committee have accountability gaps because they lack a public mandate, their transparency is sub-optimal (e.g., although the BCBS has made public more information about itself and its standards over the years, the minutes from its meetings are not available to third parties on a regular basis⁸⁴⁴), and most of the countries of the world are excluded from its decision making. At the same time, these countries must accept and enforce the standards so that they are not left outside of the financial system.

The thesis has argued that the literature specialized in international administrative law and international relations has put forward various proposals to overcome such an accountability deficit⁸⁴⁵. These proposals and analyses propose mechanisms to rein in global governance processes, so that they become more legitimate and democratic, with higher levels of representation, participation, and accountability. I explained that the challenge these proposals face, however, is that they still project into transnational regulation the traditional categories of domestic governance (e.g., electoral representation, principal-agent relationships, parliamentary

⁸⁴³ Pierre Hugues Verdier, ‘Transnational Regulatory Networks and Their Limits’ (n 2) 118.

⁸⁴⁴ Even the very old ones. Goodhart explains that he was granted access only to the synthesis of the minutes, but not the minutes themselves. See Charles A E Goodhart, *The Basel Committee on Banking Supervision: a History of the Early Years, 1974-1997* (n 65), 14.

⁸⁴⁵ Michael Barr, Geoffrey P Miller ‘Global Administrative Law: The View from Basel’ (n 67); James Bohman ‘From Demos to Demoi: Democracy Across Borders’ (n 94); Jurgen Habermas, *The Postnational Constellation* (n 86); Adrienne Heritier, Dirk Lehmkuhl ‘The Shadow of Hierarchy and New Modes of Governance’ (n 374); Rainer Hülse, ‘Even Clubs can’t do without Legitimacy: Why the Anti-Money Laundering Blacklist was suspended’ (n 46); Keohane, R. (2003) ‘Global Governance and Democratic Accountability’ (n 53); Kingsbury, B., N. Krisch & R. B. Stewart, (2005) ‘The Emergence of Global Administrative Law’ (n 87); Charles F Sabel, Jonathan Zeitlin ‘Learning from Difference: The New Architecture of Experimentalist Governance in the EU’ (n 465); Anne-Marie Slaughter, ‘The Accountability of Government Networks’ (2001) *Indiana Journal of Global Legal Studies* 8.

and congressional oversight, etc.). Additionally, little empirical research has been carried out about the way justifications – a major element of accountability processes, as I have explained in chapter 5 – are actually provided in and by TRNs⁸⁴⁶. I therefore hope that the idea of communicative accountability that this thesis puts forward might contribute to both filling the TRNs' accountability gap and to an innovative socio-legal research.

Chapters 2 and 3 have explained the history of the exercise of regulatory powers by the BCBS with reference to its most important standards: the Concordat of 1975, and the three Basel accords (Basel I, Basel II, and Basel III). Both chapters set out the necessary background because the accountability mechanisms put forward in chapter 7 revolved around these very regulatory outcomes of the BCBS. Chapter 3 also explained the particular governance of the Committee. In this vein, I highlighted the professional dimension of such governance and how there is therefore a deep connection between the discussion about the BCBS' work and the professional conversation revolving around the main challenges of cross-border banking regulation and the best way to tackle them.

I highlighted that the Committee is not a simple and informal network of cooperation between central banks and financial supervisors. Moreover its standards (e.g. the accords, the Concordat, and other best practices) have been enforced both by the BCBS' members and by other non member countries outside the G-10 or G-20. Using a series of soft law tools the BCBS is capable of designing the entry requirements for the global financial system. This does not mean that the Committee's standards are unreasonable or arbitrary. On the contrary, they are aimed to mirror the best practices of the professional community of banking regulators. But, as argued in chapter 3, the

⁸⁴⁶ One exception to this lack of empirical research on TRNs accountability is Gijs Jan Bransma, Thomas Schillemans, 'The Accountability Cube: Measuring Accountability' (2012) 23 *Journal of Public Administration and Research and Theory* 4.

wider acceptance of Basel I might have been caused by a stronger consensus among the relevant professional community in comparison to more limited consensus in relation to other accords. Conversely, even with the enhanced transparency and participation of the Basel II negotiating process, that accord was more difficult to implement because it was the result of conflicted views among the community of banking regulators (e.g., on the appropriateness of advanced internal risk based approaches to measure default risk in banks).

The governance structures that I explain in chapter 3 suggest robust processes for analysing cross-border banking's challenges and coming up with solutions. I also stressed that these structures (e.g. the group of heads of supervision or GHOS) resemble the ones regulatory agencies have. Although the governance of the BCBS is not exactly the same as the domestic regulatory agencies, the Committee is far from being a simple mechanism for coordination. Chapter 3, however, also explains that countries play an important role in enforcing the BCBS standards. Without them the Committee's work would not be possible and would be ineffective. This feature might suggest that the BCBS is nothing but a simple coordination mechanism – granted, a very sophisticated one – for member countries. Were this argument true, the Committee would lack power, and the quest for its accountability would be inconsequential.

Therefore, in chapter 4 I explore whether the BCBS and other financial TRNs exercise regulatory power. *Prima facie* it would seem that they do not. I first argued that financial TRNs such as the BCBS lack a clear status in public international law. The BCBS, on the one hand, is not a fully-fledged international organization, having been conceived of as an informal setting for transnational coordination. On the other hand, however, it is more than a mere mechanism for coordination between public officials from different states. I argued that the BCBS exercises regulatory power even when

using the tools of soft law. In this guise, the role that the relevant professional community plays in the Committee's work additionally reinforces the regulatory power of the BCBS by, for example, many countries signalling their credible commitment towards transnational banking stability by enforcing the Committee's standards.

Because the BCBS exercises regulatory power, the quest for its accountability becomes a relevant enquiry. A challenge, however, remains. Most of the discussion about accountability has been embedded in the political categories of the state. It is common to link accountability with representation, electoral mandates, democracy, and so forth. With these limitations in mind, chapter 5 reviewed the literature about accountability to find a concept of accountability that was able to make sense in the context of both domestic and transnational accountability mechanisms. I argue that the working concept of accountability set forth in that chapter can apply to transnational networks like the BCBS. Additionally the working concept could make sense of softer versions of accountability, in which reputation and informal authority are the main incentives for getting a justification from an accountee, as opposed to legal authority and punishment.

According to the working concept, accountability is the process, by which one or more external claims are issued requesting and obtaining a justification or explanation from a person or organization that exercises regulatory power; a judgment is made according to a set of standards; and a decision is finally taken about what consequences should follow. In chapter 5 I also clarified that accountability mechanisms must have consequences for the accountee, either beneficial or detrimental. These consequences, however, might not always have the form of sanctions under hard law. Softer consequences, based on reputation, authority or prestige, are also possible. Finally, chapter 5 argues that processes of accountability presuppose a necessity to issue a

justification to the accountor. In the literature about accountability these needs to justify might be moral or based on social norms. In the communicative theory set out by Luhmann, the need to justify is built upon the integrity of the system.

With these ideas in mind, chapter 6 used Luhmann's concept of communication to flesh out accountability in transnational regulation. It argues that a Luhmannian theoretical framework is valid for transnational regulation because it understands communication as an anarchic, decentralized process. And the transnational sphere lacks 'a centre' such as the state in the context of national jurisdictions. First, it emphasizes the common understanding of past and present communication. And second, Luhmann's model of communication adapts better to the environment of anarchy and uncertainty in global governance processes than other communication theories such as the ones put forward by Habermas and Castells⁸⁴⁷. As I explained in chapter 6, Luhmann argues that communication organizes itself by a series of unplanned selections. He calls this way of organization *autopoiesis* (i.e., self-reference). Luhmann's concept of communication, however, departs from the metaphor of transmission. The idea of transmission also assumes that there is a two way process between transmitting and receiving information. On the contrary, chapter 6 explains that for Luhmann communication is not a 'thing' but a connection⁸⁴⁸ and meaning is essential to the process of communication⁸⁴⁹.

Selection stands at the core of Luhmann's idea of communication. This means that communication is a chain of communicative events because each event connects with another event by communicative events selecting each other. Therefore,

⁸⁴⁷ Manuel Castells, *Communication Power* (n 81).

⁸⁴⁸ 'The metaphor of transmission locates what is essential about communication in the act of transmission, in the utterance. It directs attention and demands for skillfulness onto the one who makes the utterance. But the utterance is nothing more than a selection proposal, a suggestion. Communication emerges only to the extent that this suggestion is picked up, that its stimulation is processed.' Niklas Luhmann, *Social Systems* (n 100), 139.

⁸⁴⁹ *ibid*, 140.

communication is the sequential selection of events that forms meaning⁸⁵⁰. Chapter 6 explained that behind a given opinion in a social group there is a sequence of events that were selected through a process of trial and error by a community that shares understandings. Communication, therefore, is a chain of sequential communicative events. Each communicative event is a unity, but can be analyzed as the product of three selections: presentation, expression, and appeal⁸⁵¹ or *information, utterance, and understanding*, in Luhmannian terms.

Chapter 6 develops a concept of communicative accountability using Luhmann's insights. According to the working concept of accountability there are three stages in any accountability process: there is an accountability claim at the beginning of the process, followed by a response from the accountee in the form of a justification; and finally, the justification is judged according to a set of standards and it is decided the relevant consequences for the accountee. The concept of communicative accountability is the result of applying the Luhmannian understanding of communication to the stages of the working concept of accountability.

In this vein, coherence results from otherwise unconnected points in a conversation. Firstly, the events that form the three-stage process that looks like accountability (i.e., the accountability claims, the justifications, and the judgments of those justifications) mention the same theme or *information*. Secondly, these events refer to each other because they mention each other. A communicative event that has the form of a judgment might explicitly or implicitly refer to another communicative event that takes the form of a justification from the accountee. Thirdly, this communicative event refers in turn to another one that takes the form of an accountability claim.

⁸⁵⁰ David Seidl *Luhmann's theory of autopoietic social systems* (n 102), 7.

⁸⁵¹ *ibid*, 142.

Therefore, the sequence of communication gets its coherence by sharing the same language (i.e., *utterance*) and resonates with the same common perspective of a wider group (i.e., *meaning*). Depending on the *utterance* and *meaning*, the sequence of communicative events can potentially chime with various epistemic and professional communities. If the discussion is about the law, it chimes with the legal community. If it is about the technical merits of certain public policy, they resonate in a scientific or technical community (e.g., if the discussion is about the best way to build an underground transportation system, it chimes with engineers and builders). I argued that this conceptual framework could also be applied for exploring the possible communicative accountability processes to which the BCBS is subject to.

Therefore, chapter 7 analysed the qualitative data set of my research and examined in detail five examples where the BCBS issued a justification in response to a claim – or set of claims – that was later judged by several actors. Chapter 7 case studies revolved around the impact assessments of the implementation of Basel II, the effects of Basel II implementation on small and medium enterprises (SMEs), the discussion about the over-complexity of Basel III, the BCBS' proposal for losing the rules on liquidity, and the claims that Basel III was detrimental for the US' economy.

The elements of the working concept of accountability can be identified in each one of the five examples put forward in chapter 7: there is an accountability claim, a justification from the BCBS, and a judgment of that justification. Hence, it is argued that the five examples look like accountability processes because they all contain the elements of the working concept of accountability. The five examples start with an accountability claim that sets the theme and the tone for the following steps (e.g. the justification and the judgment). More importantly each example is an accountability process because it resonates with the financial community for three key reasons first, the

claims, justification, and judgments used the language of the financial community; second, the claims, justification, and judgments chimed with the expectations and standards of this community; and third, because the claim, justification, and judgment come from a group or an individual that has high standing in the financial community.

The second part of chapter 7 addressed the question of whether the five case studies put forward should be considered as accountability processes. I argued that they should and with reference to the qualitative data set of the BCBS I fleshed out the concept of communicative accountability. Hence, the communicative chains that chapter 7 puts forward are forms of accountability for the BCBS because they have consequences. This feature is closely linked to the ‘inner conversation’ of the relevant professional community, which consists of banking regulators and supervisors. This community sets expectations for the BCBS and its members which, when met, have beneficial consequences in the form of acceptance, authority and prestige; however, when unmet, they can provoke a damage to the reputation of the BCBS and its members. A failure to manage expectations can mean that the Committee is no longer seen as an effective instrument for financial regulation, undermining its work and authority.

I argue that the idea of communicative accountability is a useful application of Luhmannian thought in order to make sense of accountability processes in unplanned, anarchical contexts that are common in transnational regulation. The lack of clear accountability mechanisms and expectations is detrimental for governance networks like the BCBS. Contrary to what could be thought, this absence of certainty increases the risk of being held accountable by conflicting and excluding competing standards (e.g., legal, political, and professional perspectives). As I explained in chapter 4, however, both the complexity of the subject with which the BCBS deals (i.e.,

transnational banking) and the very high costs attached to the delegation of powers to an hypothetical IO through a treaty, make it very difficult to increase certainty about the accountability regime for the BCBS.

It is therefore natural that, as I have explained in chapter 7, the BCBS decides to respond and justify to claims that are phrased in the language of the banking regulatory community and that chime with that same community. Otherwise the risk of being held accountable by other communities, (e.g. lawyers, activists, or politicians) would make the work of the BCBS harder.

A deeper look into the question of the BCBS' accountability and its relationship with the professional community of banking regulators might lead us to a wider realisation. Just as the BCBS is subject to accountability claims coming from different quarters of society, the wider community of banking regulators is also subject to accountability claims. Following a Luhmannian analysis, the banking regulatory community might understand some of those claims (i.e., those phrased in their language), but other claims phrased in other languages (e.g., human rights, fairness, equality, representation, etc.) might be heard as simple noise – or in Luhmann's terms *irritations*. A translation might be needed so that the system – i.e., the professional community – is capable to understand those claims. In the final section of this chapter I advance some ideas that the notion of communicative accountability opens up for further research.

In this thesis I have argued that the particular concept of communicative accountability put forward is a form for rendering the BCBS accountable. Nevertheless, it may lack in legitimacy. Chapter 5 explained that not all forms of accountability are equally right. In the case of the BCBS, the legitimacy of communicative accountability

derives from that of the banking regulatory community. In turn, the wider professional legitimacy of this group is linked to the reputation and prestige bankers have in society, which is not very positive as we speak. Although this thesis was focused on accountability and accountability only, the next section delves into the BCBS' legitimacy and its relation to communicative accountability of financial TRNs.

2. The legitimacy of communicative accountability

Accountability, as I have explained in this thesis, is a relationship between an accountant, an accountee, and a forum. According to the communicative framework I provided in chapter 6, that relationship might take the form of a chain of events that link to each other because they share a theme, a language, and resonate with a particular social group. In the case of the BCBS, that social group is the community of banking regulators. The aim of the Committee is a goal that seeks – at least in principle – a good society⁸⁵². But it might be possible that some powerful organisations are accountable to – let me put it this way – the wrong kind of interests seeking the wrong kind of goals⁸⁵³.

An accountability relationship either exists or it does not. Using Luhmannian ideas, this thesis argued that there is an accountability relationship between the BCBS and the relevant professional community of banking regulators. Whether that relationship is legitimate however, is a different question that needs a normative assessment. Intentionally I have left that assessment aside in the thesis. In this section, however, I explore the legitimacy of the BCBS' communicative accountability. In other

⁸⁵² Robert Schiller, *Finance and the Good Society* (n 263).

⁸⁵³ A sordid case consists when authorities with public power are accountable to criminal organisations. See: Donatella Della Porta, 'A judges' revolution? Political corruption and the judiciary in Italy' (2001) 29 *European Journal of Political Research* 1, 1-21; Roberto Saviano, *Gomorra*, (Mondadori 2006)

words I seek to find out whether the communicative accountability of the BCBS is enough to legitimise its work.

In the following paragraphs I first explore the meaning of the BCBS' legitimacy. Secondly, I argue that, while the communicative dimension of the Committee's accountability is very powerful and could constitute the foundation of a stronger regime, it is not enough and needs administrative-like processes to strengthen its legitimacy, a problem that, as addressed in the introduction of this thesis, the BCBS shares with other domestic and transnational decentred regimes. Finally I put forward three principles that might legitimise the necessary work of financial TRNs such as the BCBS.

For Max Weber legitimacy rests on the people's *belief*⁸⁵⁴. Weber's purpose was not to define legitimacy but rather to use the concept as a sociological typology⁸⁵⁵. In this vein, he linked 'legitimacy' with 'legality,' which means that a norm (or regime) is legitimate if a society accepts it and complies with it for whatever reason. Therefore Weber does not discuss whether a particular order *should* or *should not* be legitimate. Rather, for the author legitimacy exists because a society complies with a norm or accepts a political regime. Consequently, Stillman argues that the question of legitimacy is the 'question of fact whether a given rulership is believed to be based on good title by most men subject to it.'⁸⁵⁶

In this guise, the legitimacy of the BCBS would depend on countries enforcing its standards and banks complying with them. If they do, the BCBS work is legitimate. This is one way of explaining legitimacy: the acceptance of a particular rulership (the BCBS' in our case). Another way to assess the legitimacy of a powerful organisation,

⁸⁵⁴ JG Merquior, *Rousseau and Weber, Two studies in the theory of legitimacy* (n 496).

⁸⁵⁵ Max Weber, *Economy and Society: An Outline of Interpretative Sociology* (n 632).

⁸⁵⁶ Peter G Stillman, 'The Concept of Legitimacy' (1974) 7 *Polity* 1, 34.

however, is by finding an objective point of reference (e.g. values or principles in a particular society) that justifies its rule. Because both approaches are incomplete, Melquior⁸⁵⁷ suggests to link ‘legitimacy’ to ‘credibility’: ‘[A] power is reckoned legitimate whenever its holder can effectively call on other centres of power for support.’⁸⁵⁸

The view of legitimacy as credibility in the use of power, however, has problems too. One of them is how to distinguish rulership from raw domination. Violence – or the threat of it – can provoke the acquiescence of subjects to a particular regime, but that does not mean that that regime is legitimate. In the history of political ideas this problem has been avoided when the political regime is one in which its subjects decide freely to obey and accept a *social contract* and rulers must exercise power with the conditions agreed by subjects⁸⁵⁹. In other words, legitimacy is the acceptance of an ‘authority based on free consent’⁸⁶⁰.

It comes as no surprise that legitimacy’s beginnings as a social issue can be traced back to the European Enlightenment of the XVIII century⁸⁶¹. Interestingly, however, the political context in which the discussion about legitimacy takes place is dominated by the modern state and therefore by concepts like sovereignty and representation. In the legal context the battle for codification is happening during those years in continental Europe. In this vein, it was equally important that the contents of

⁸⁵⁷ JG Merquior, *Rousseau and Weber, Two studies in the theory of legitimacy* (n 496).

⁸⁵⁸ *ibid.*

⁸⁵⁹ Rousseau Jean Jacques, *The Social Contract* (first published 1762, Penguin 2006).

⁸⁶⁰ JG Merquior, *Rousseau and Weber, Two studies in the theory of legitimacy* (n 496), 9.

⁸⁶¹ *ibid.*, 10.

legal codes were coherent and rational, as well as that the source from which they derive their authority was a *legitimate* assembly with the power to enact laws⁸⁶².

Put it this way, the theoretical preoccupations of legitimacy strongly refer to the context of the modern state⁸⁶³. Therefore, the modern state – or liberal democracies as I have argued in the introduction – deal with the problem of legitimacy using mechanisms as the division of power, political representation by parliaments and legislatures, democratic elections, and judicial review. As I pointed out in the introduction, however, all these mechanisms are nowhere to be found in transnational governance and regulation, hence the motivation for this thesis. The objective source of legitimacy seems to be historically linked to a form of constitutionalism. And we know that constitutionalism belongs to the modern state and liberal democracies, which seldom hold accountable transnational networks like the BCBS.

If that is the case, we desperately need alternative ways to portray legitimacy that allow us to discuss it but – much to what happens with accountability – without referring to the particular political architecture of the state. Authors like Rossenau⁸⁶⁴ and Keohane⁸⁶⁵ refer to democratic ‘legitimacy’ as a way to enhance transnational governance structures or as a quality that is absent from them. The challenge is however, to find or build democratic legitimacy (or accountability) in a context that is foreign to the foundational discussions about modern democracy and legitimacy (i.e., the context of modern states). The challenge is how to find legitimacy, democracy, and accountability away from a model of government à-la Rousseau, precisely the context in which financial TRNs like the BCBS work.

⁸⁶² Randall Lesaffer, *European Legal History* (n 401).

⁸⁶³ Paul Kahn, *Legitimacy and History*, (Yale University Press 1992).

⁸⁶⁴ James Rosenau ‘Governance in the Twenty-First Century’ (n 76),

⁸⁶⁵ Robert Keohane, ‘Global Governance and Democratic Accountability’ (n 53).

Clark addresses this problem⁸⁶⁶. The author puts legitimacy between the struggles for power in international relations, the norms that dynamically change from time to time, and the consensus among all the interested and affected parties:

However, the precise conceptualization of this relationship is extremely difficult, and the spectrum of opinion ranges from some absolute opposition between power and legitimacy at the one end (whereby the generation of legitimacy is autonomous from the power relations that it 'legitimizes'), to the opposite end where legitimacy is reduced to the preferences of those hegemonic forces that are thought to manufacture it in the first place. As stated, this study is located in the middle, assuming a degree of autonomy for both material power and norms. These interact in the practice of legitimacy.⁸⁶⁷

Additionally, Coicaud suggests an approach to legitimacy in the context of transnational governance and regulation⁸⁶⁸. For the author legitimacy is 'the right to rule.'⁸⁶⁹ The author emphasizes the discussion around who can govern, with which means, and how the government should be. By defining legitimacy as a right, it immediately delegates its discussion to the legal community; at the same time it puts the discussion away from that about power. Legitimacy therefore is more than a ruler acceptance by a community and becomes a quality that can be discussed according to certain principles.

Clark's phrase 'practice of legitimacy'⁸⁷⁰ chimes with Black's idea of multiple legitimacy claims in transnational governance⁸⁷¹, and Hood and Scott⁸⁷² portrayal of different ways of regulation moving away from the traditional ones that are embedded in the structures of the states (e.g. parliament, elections, courts, etc.).

⁸⁶⁶ Ian Clark, *Legitimacy in International Society*, (Oxford University Press 2007).

⁸⁶⁷ *ibid*, 20.

⁸⁶⁸ Niko Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68).

⁸⁶⁹ Jean-Marc Coicaud, *Legitimacy and Politics* (Cambridge University Press 2002), 25.

⁸⁷⁰ Ian Clark, *Legitimacy in International Society* n 865, 45

⁸⁷¹ Julia Black, 'Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes' (n 48).

⁸⁷² Christopher Hood, Colin Scott, *Regulating Government in a 'Managerial' Age: Towards a Cross-National Perspective*, (LSE-CARR 2000).

TRNs like the BCBS face a legitimacy challenge that cannot be completely overcome by professional legitimacy alone. In other words, the communicative accountability of the BCBS is not enough to legitimise the rule of the Committee. It helps and is a step forward. Additionally, it is a valid foundation for building enhancing the BCBS legitimacy, but it cannot stand on its own. It needs additional mechanisms for legitimising its work not only among the professional community of banking regulators but also among the wider political community.

I have explained how Fisher and Shapiro put forward a two-tier rationale for bureaucracies' legitimacy. From another perspective and due to the so-called 'Chevron doctrine' regulatory agencies are independent bodies with a high level of expertise. On the other hand they are also part of a polity and, as such, are subject to administrative procedure⁸⁷³. In the BCBS' case communicative accountability provides legitimacy to a professional community that mirrors the technical deference that central bankers and prudential supervisors have in each country. Nevertheless, these regulators must comply with administrative rules at the domestic levels, which are absent at the transnational one. The problem is that it is not feasible to project to the transnational level the political framework of the state. As chapter 4 explained, the complexity is very high (hence the need for a technical expert community) and the sovereignty costs of delegating authority to a IO would be extraordinary.

Additionally, creating an institution similar to other IOs under international law (e.g., such as the IMF or the World Bank) is not an absolute solution for the lack of legitimacy because they have their own share of concerns in the same matter⁸⁷⁴. The problem is thus twofold. First, the discussion about legitimacy was at its inception

⁸⁷³ Sidney Shapiro, Elizabeth Fisher, 'Chevron and the Legitimacy of "Expert" Public Administration' (n 437).

⁸⁷⁴ Robert Keohane, 'Global Governance and Democratic Accountability' (n 53).

embedded in the then nascent modern state. As a consequence of this, most of the mechanisms that we know of for legitimising power are closely linked to the structures of the state and liberal democracies. Second, TRNs cannot properly perform their work if they are subject to the same constitutional and administrative constraints as regulatory agencies at the domestic level. We face the challenge of finding novel mechanisms for legitimising the work of TRNs but that are adequate for the way transnational regulation works.

Although there is not a definitive answer to this problem yet, there are some very interesting proposals that might lead the discussion for the quest of a more legitimised accountability in transnational regulation. Krisch proposes pluralism as a way of legitimising the use of power in globalisation. In this vein, he advances the idea that there are some powerful organisations that deserve obedience and others that do not. The difference between the two consists on the way they exercise that power, i.e., whether they have mechanisms for enhancing its transparency and all interested and affected parties are included in the decision making process⁸⁷⁵. For Krisch, as I have mentioned before, the BCBS should not deserve our obedience⁸⁷⁶. Not at least until it becomes more inclusive and transparent.

Based on Philip Pettit, transnational governance should possess a principle of non-domination⁸⁷⁷, which is different from the negative meaning of freedom as non-interference and the positive view of freedom as self-mastery. Non-domination means a freedom that has a real sense of agency and that is capable to discuss constructively with others in a given society⁸⁷⁸. As Pettit puts it:

⁸⁷⁵ Niko Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68).

⁸⁷⁶ *ibid.*

⁸⁷⁷ Philip Pettit *Republicanism: a theory of freedom and government* (Oxford University Press 2003).

⁸⁷⁸ Llano, Alejandro, *Humanismo Cívico*, (Taurus 2000).

The grievance I have in mind is that of having to live at the mercy of another, having to live in a manner that leaves you vulnerable to some ill that the other is in a position arbitrarily to impose; and this, in particular, when each of you is in a position to see that you are dominated by the other, in a position to see that you each see this, and so on. It is the grievance expressed by the wife who finds herself in a position where her husband can beat her at will, and without any possibility of redress; by the employee who dare not raise a complaint against an employer, and who is vulnerable to any of a range of abuses, some petty, some serious, that the employer may choose to perpetrate; by the debtor who has to depend on the grace of the moneylender, or the bank official, for avoiding utter destitution and ruin; and by the welfare dependant who finds that they are vulnerable to the caprice of a counter clerk for whether or not their children will receive meal vouchers.

Contemporary thought suggests that individuals in these positions retain their freedom to the extent that they are not actively coerced or obstructed. But whether or not they avoid interference, they certainly have a grievance. They live in the shadow of the other's presence, even if no arm is raised against them. They live in uncertainty about the other's reactions and in need of keeping a weather eye open for the other's moods. They find themselves in a position where they are demeaned by their vulnerability, being unable to look the other in the eye, and where they may even be forced to fawn or toady or flatter in the attempt to ingratiate themselves.⁸⁷⁹

Communicative accountability in reference to the work of the Basel Committee on Banking Supervision is a good way of tackling the risk of being held accountable by many, contradictory accountability claims. It is reasonable that the BCBS clings to the language and expectations of the professional community of banking regulators as their main forum for accountability. Nevertheless, communicative accountability needs to enhance its legitimacy by enforcing principles like non-domination, inclusiveness, and real transparency in its work.

It might be the case, however, that the only way to instil these principles into the professional community of banking regulators is by using a communicative way. According to Luhmann, as I explained in chapter 6, organisations (and networks in the case of the BCBS) have a code, i.e., a perspective to understand the world that listens to

⁸⁷⁹ Philip Pettit, *Republicanism: a theory of freedom and government* n 876, 4-5.

those communicative events that resonate with that perspective and acknowledges those others that do not, but in this case it acknowledges as noise or irritations⁸⁸⁰. In turn, these organisations use a code that they share with a wider professional community. Because professional communities are a consequence of functional specialisation⁸⁸¹ Luhmann's system theory conceptualises them as systems in its own right. The professional community (i.e. a system) must be convinced that it has to enhance its legitimacy, for that purpose it must translate the noise and irritation it feels into coherent communication that it can understand.

In this vein, Kjaer, Teubner and Febrajo use a systems theoretical perspective to put forward the idea of 'constitutional moments' which are moments in time in which the risk of a system collapsing is similar to the opportunity for change⁸⁸². To enhance its legitimacy, the professional banking regulatory community should try to hear the accountability claims that are directed to it, perhaps using other languages (e.g., human rights, fairness, equality, transparency, participation, representation, etc.). The following section suggests some further possibilities to continue the research on communicative accountability in financial TRNs like the BCBS.

3. The limits of the thesis and the possibilities for further research

The thesis' objective has been to explore alternative and softer mechanisms for holding financial TRNs like the BCBS accountable. It finds that there are chains of communication united by a Luhmannian triple selection that take the form of

⁸⁸⁰ Niklas Luhmann, *Social Systems* (n 100).

⁸⁸¹ Paul F Kjaer, Gunter Teubner, Alberto Febbrajo, *The Financial Crisis in Constitutional Perspective: the Dark Side of Functional Differentiation* (n 383).

⁸⁸² *ibid.*

accountability processes. I have only identified those mechanisms and highlighted the importance of the relevant professional community for the BCBS. But I did not assess whether these mechanisms are the most effective or convenient ones for transnational governance. A pragmatic view, however, might suggest that policy makers should acknowledge these communicative mechanisms and build upon them.

Another objective of this thesis was to explore a communicative dimension of accountability in relation to the work of the BCBS. Chapter 7 thus explains five examples in which I could find coherent accountability processes with consequences for the Committee. To pursue further research, however, a comparative study could be made about other financial TRNs (like the IOSCO or the IAIS) applying the concept of communicative accountability that I set out in this thesis. Moreover, an exploration of other transnational networks in different contexts (e.g., environmental protection, food safety, water regulation, etc.) might provide a deeper insight into the role of the relevant epistemic community.

The concept of communicative accountability that I put forward suggests that to advance certain values and standards in TRNs like the BCBS one first needs to convince the wider professional banking regulatory community about the pertinence of those values and standards. A good example is transparency, which is not a core value of the banking and financial community. The theme, however, has appeared in discussions in the summit of Davos, Switzerland⁸⁸³, and could be part of the financial conversation in the near future. If this happens, claims criticizing the Committee for its lack of transparency will possibly be successful and have consequences for the BCBS.

⁸⁸³ See: <https://www.transparency.org/news/feature/our_message_for_the_world_economic_forum>, Accessed on 15 April 2015.

In the case of the BCBS, an additional follow up might be to investigate whether the professional community of banking regulators is also subject to accountability claims in the same fashion as I have explained the BCBS is. If that is the case it would be very interesting to find out to whom the community responds to and why. As I clarified in chapter 6, for Luhmann all systems are functionally closed but cognitively open⁸⁸⁴. This means that all systems acknowledge all communication, but they only understand communicative events that chime with its code or perspective. At the same time, systems delegate to each other diverse tasks. Luhmann argues that the legal system – at least at the domestic level – delegates its legitimacy to the political system. This happens for example, when statutes are enacted by parliaments or legislatures following a political rationale (i.e., involving lobbying groups and political negotiations). Another example happens between the economic system and the legal system. The former speaks about property rights while it delegates in the latter the mechanisms for deciding who the owner of those property rights is. In the BCBS' case it might be the case that, due to the external pressure that the wider public exercises, the banking regulatory community decides to delegate to the legal transnational system the mechanisms to enhance its legitimacy and accountability.

A final possibility for further research might be to apply the idea of communicative accountability that I put forth drawing on Luhmann's concepts to accountability processes that may take place in social networks. *Twitter*, for instance, has tools to make the three Luhmannian selections and therefore gives anyone the ability to identify sequences of communicative events. While the *hashtag* ('#') allows the viewer to follow the plethora of communicative events that share a common theme, the 'at' ('@') refers to different users and to call others into the conversation.

⁸⁸⁴ Niklas Luhmann, *Social Systems* (n 100).

As a conclusion, the thesis contributes to the socio-legal literature about regulation in the transnational sphere by proposing a way to identify accountability processes in complex and decentralized global regulatory environments. Its contribution in particular is a concept of communicative accountability that, based on Luhmann's idea of communication, further develops an account of the role of professional and epistemic communities when holding TRNs accountable. The thesis maps accountability processes in relation to the work of the BCBS. By doing so, it provides empirical qualitative evidence about how transnational regulation might be working and how Luhmannian concepts might be subject to empirical analysis.

Nevertheless, as Krisch argues, the panorama of transnational governance and regulation is much more complex and uncertain. It is full with proposals that struggle to convince us about their own and unique validity. Some project the traditional categories from the past into the future, while others try to innovate. Yet, as any time of uncertainty, 'transformation comes with freedom, opportunities, and anxiety.'⁸⁸⁵

⁸⁸⁵ Niko Krisch, *Beyond Constitutionalism: The Pluralist Structure of Postnational Law* (n 68), loc. 589.

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