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Financial Market Regulation in the Shadow of the Sovereign Debt Crisis

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Abstract

The financial market crisis of 2008/2009 triggered efforts at re-regulation at all political levels, national, European, and international. Reform demands had been radical and comprehensive but effective regulatory change was halting, and then in summer 2011 the related connected sovereign debt and euro crises came to preoccupy political attention. Regulatory financial market reform nevertheless continued. This paper traces both the shift in political attention and the continuing regulatory activities of different bodies between the summer of 2011 and the summer of 2013. The analysis highlights the time profile, the specific selectivity, the recursive nature, and the stepwise concretization of reforms. Finally, the issue is raised whether the reform process will eventually lead to increasing regulatory harmonization, or increasing international diversity of financial market regulation.

Zusammenfassung

Die Finanzmarktkrise von 2008/2009 hat auf allen politischen Ebenen – der nationalen, europäischen und internationalen – Versuche einer Regulierungsreform ausgelöst. Die anfänglichen Reformziele waren radikal und umfassend, aber der tatsächliche Reformprozess kam bis zum Sommer 2011 nur zögernd voran. Zu diesem Zeitpunkt drängte die Staatsschuldenkrise und die mit ihr verbundene Euro-Krise das Thema Finanzmarktregulierung in den Hintergrund. Das Discussion Paper verfolgt sowohl den Wandel politischer Aufmerksamkeit wie die dennoch weiter laufenden Aktivitäten wichtiger, speziell internationaler Institutionen in Sachen Regulierungsreform in der Zeit zwischen Mitte 2011 und Mitte 2013. Es wird gezeigt, dass der Reformprozess eine charakteristische Zeitstruktur, eine spezifische Selektivität und Rekursivität besitzt und durch eine schrittweise Konkretisierung gekennzeichnet ist. Am Ende stellt sich die Frage, ob der Reformprozess zu wachsender internationaler Harmonisierung oder umgekehrt zu wachsender Diversität von Finanzmarktregulierung führen wird.

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Financial Market Regulation in the Shadow of the Sovereign Debt Crisis

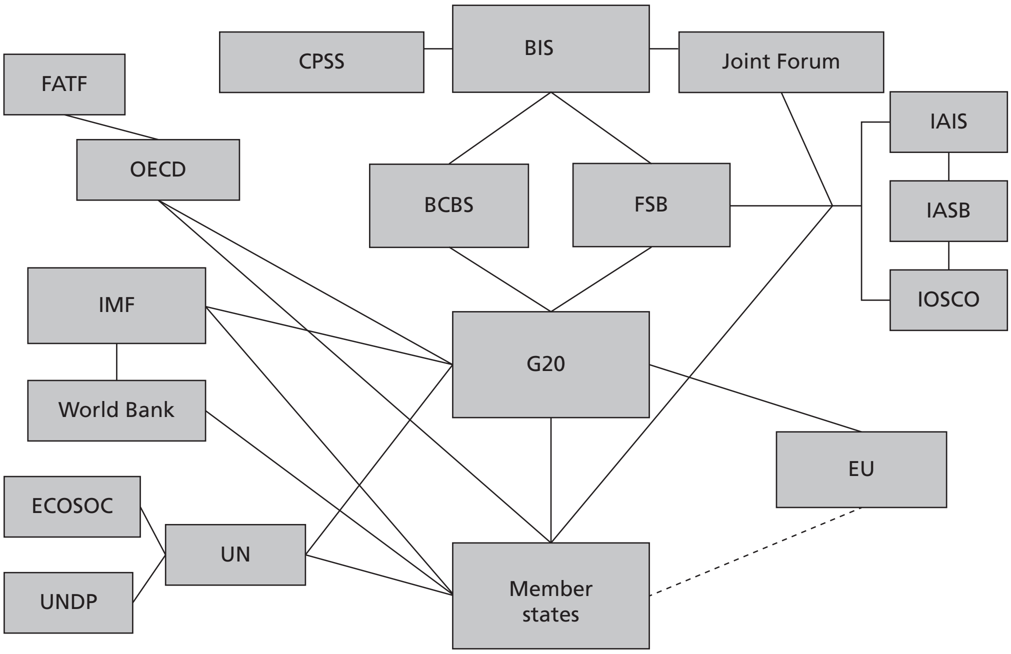
1 Financial crisis and the beginning of regulatory reform

The near collapse of financial markets in 2008, generally perceived as a global crisis, has been widely attributed to the failure to regulate properly a financial system that had expanded internationally and become increasingly autonomous. Surprised and shocked by the crisis and its threatening economic impact, politicians first focused on crisis management, but soon there was agreement that a comprehensive regulatory reform was needed. Reform initiatives started at all political levels – the national, the European, and the international. At the time of the crisis, there existed no coherent governance structure that would have made possible a coordinated, international response to the regulatory challenge. Regulatory competences were concentrated at the national level. The EU had largely refrained from using its legislative powers for the purpose of market shaping, continuing to use them instead for its dominant goal of market making. The international standardization bodies – the Basel Committee of Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), and the International Accounting Standards Board (IASB) – depend on voluntary compliance with the rules they develop. Given the extreme time pressure, a general overhaul of the regulatory structure prior to starting regulatory reforms was out of the question, so the task was shouldered by already existing regulatory authorities and standard-setting institutions.

In response to the crisis, there were some changes in financial market governance at the national level, though the changes were uneven.[1] At the international level there were changes in the mandate, the composition, and the weight of some agencies in the overall process of regulation. The G20, established in 1999 as a low-key body of central bank governors and finance ministers who rarely attended in person to discuss financial matters, was transformed into the "premier forum of our international economic cooperation" (G20 2009b), where heads of government now meet for highly publicized summits. The former Financial Stability Forum, supposed to coordinate the work of international standard setters but largely played the role of information broker, was transformed into the Financial Stability Board that worked closely with the G20. The International Monetary Fund IMF was given additional resources, and since stricter capital requirements had quickly become a central reform demand, the BCBS assumed a focal role in the reform process. However, no new agencies were established at the international level, nor were existing bodies given the competence to make binding decisions for lower level jurisdictions and market actors. Figure 1 shows the interna-

1 The following summary of reforms that took place at the international and European levels, as well as the level of five Western states until the late summer of 2011 is based on the material in Mayntz (2012a).

Figure 1 International governance of financial markets

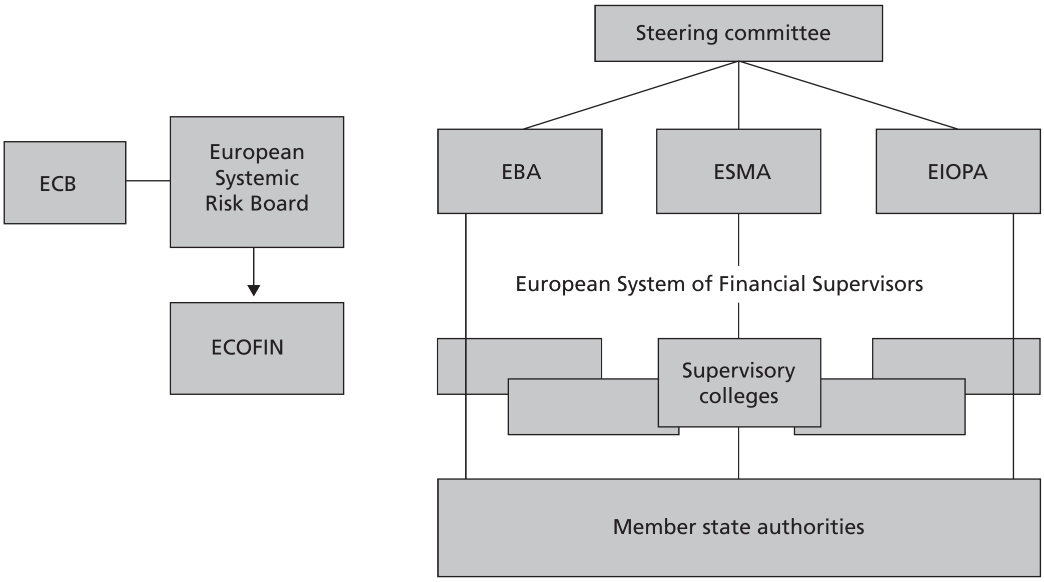


tional governance architecture as it had developed by 2010, and as it still looks today.[2] More substantial change took place, at least formally, at the level of the EU, where a new agency, the European Systemic Risk Board, was created and where the three previously existing committees that were supposed to coordinate national supervisors were transformed into European supervisory agencies. These agencies have some decision-making power and the competence to intervene, under certain conditions, in areas that so far have been under exclusive national jurisdiction (Figure 2).

By the middle of 2011 there had been a – limited – upward shift of de facto regulatory power, and an – even more limited – upward shift of formal competences in the multi-level governance of financial markets. Since legislative competence is still concentrated at the national level, this upward shift has meant that the downward connection between levels has become more important. The G20 has strongly voiced the need for specific reforms and have "tasked" international organizations as well as national and regional jurisdictions to become active. The standards formulated by international bodies, notably the BCBS, served as a template for EU decisions and have also shaped regulatory decisions taken by non-member states of the EU. EU member countries, expecting a new or amended EU directive, often put off introducing new rules by themselves. National decisions were affected by higher level demands and rulings, but national actors have been active in formulating these very demands and rulings. By virtue of these upward and downward connections, the policy-making process had become, if not more centralized, more international.

2 All figures in this text have been prepared by Natalie Mohr.

Figure 2 European governance of financial markets



Reform demands voiced after the outbreak of the crisis were radical and comprehensive. At the second G20 summit meeting in London in 2009, the assembled heads of government proclaimed, “We have agreed that all systemically important institutions, markets, and instruments should be subject to an appropriate degree of regulation and oversight” (G20 2009a). Similarly comprehensive reform demands were voiced by the Stiglitz commission of the UN (United Nations 2009) and the OECD (OECD 2009). Banking regulation was to become stricter, rules were to be extended to cover previously unregulated components of the financial system, and regulatory standards were to be harmonized or at least coordinated at the international level in order to make regulatory arbitrage unattractive. In immediate response to the crisis, there was a flurry of disparate regulatory interventions by individual governments. At the same time, delegates of national authorities meeting in higher level bodies tried to negotiate internationally agreed reforms. Already in the course of 2010, however, critical observers feared that, contrary to early demands for radical reform, regulatory change would be neither comprehensive nor internationally coordinated. As had to be expected, reform plans met with the resistance of the powerful financial industry, but politicians themselves were careful not to strangle a financial system whose functioning was considered essential for the economy. Nevertheless, there had been some reforms by the summer of 2011. At all political levels, action had been taken to change the incentive of existing banker compensation schemes for risky behavior. The capital requirements for banks set down in the rules of Basel II, the internationally agreed regulatory framework formulated by the BCBS, had first been amended, but by December 2010, a new and more demanding set of rules, called Basel III, had been agreed on and was endorsed by the G20. Basel III rules had been extended to cover not only capital requirements but also liquidity and leverage ratios. Regulation had also been extended to hedge funds and rating agencies, and deposit guarantees and consumer information had been improved. But many of the regulatory changes that had been initiated were still "work in progress"; legislative decisions were still pending, and it was not certain what would happen in the translation of a new law or framework directive into concrete rules. The reforms concluded by the summer of 2011 were admittedly insufficient to discipline risk taking by financial institutions, to deal with the problem of moral hazard presented by banks too big to fail, and to counter the threat of domino effects resulting from the high degree of interconnectedness among market actors, but these were issues still to be attended to. It was at this stage in the reform process that the financial market crisis, which was largely a banking crisis, was superseded by the sovereign debt and related euro crises.

When the attention of political leaders and international organizations turned towards the new issues of sovereign debt, to currency issues and economic recession, this had to affect financial reform and in particular banking reform efforts in one way or another. The financial crisis had been a banking crisis; the sovereign debt crisis again involved banks, banks that had bought government bonds, but now the banks were not the culprits. Banks had been chided for granting high-risk "subprime" mortgages on a large scale and for investing heavily in risky securitized mortgages; now it was hoped they would buy government bonds of highly indebted states without asking for a correspondingly high-risk premium. The relation between politics and the finance industry was thus reversed: political authorities bent on disciplining financial institutions suddenly found themselves in the position of petitioner. On the one hand, this shift in the balance of power between prospective regulators and the objects of regulation could conceivably have brought the regulatory reform process to a standstill in the fall of 2011. On the other, the new crisis, throwing into relief the problematic relationship between the political and the financial system, might have given a new push to regulatory reform.

In fact, however, regulatory reform neither ground to a standstill, nor did the new crisis give it additional momentum. What initially may have appeared to impede a concerted regulatory response, namely the fact that the reform task devolved upon the incoherent set of already existing institutions formally responsible for financial market regulation, now worked against both stopping and stepping up reforms. Once activated by the financial crisis, these institutions simply continued their job. The commitments and tasks formulated by the G20 heads of government both legitimated and circumscribed their continuing activity. Out of the limelight of public attention and within the framework of the already felt restrictions, regulatory reform thus continued. This will be shown in the next section of this paper, using documentary material to trace the ongoing activities of regulatory institutions up to the spring of 2013.

2 Regulatory reforms under the shadow of the sovereign debt crisis

The sovereign debt and related euro crises that became manifest in the summer of 2011 led to a shift in public attention, but the stream of activities dealing with financial market regulation has continued uninterruptedly to this day. This is clearly evidenced by counting the activities of national, European, and international institutions relating to financial market regulation that were registered by the Global Financial Market Association (GFMA) between October 2011 and the end of April 2013.[3] While there has been no overall decrease in registered activities during this period, their frequency distribution has changed (see Table 1). The percentage of registered activities of international institutions, still at the top of the list, has declined in favor of activities of "other countries." In this category, especially institutions from Singapore, Hong Kong, and Australia have figured with increasing frequency, indicating the growing importance of financial centers beyond Europe and the United States.

Table 1 Activities relating to financial market regulation, in percent

Institutions	10/2011–05/2012	05/2012–04/2013
International	32.5	27.9
European	26.7	26.8
USA	13.8	10.9
Great Britain	12.2	14.7
Other	14.8	19.5
N	311	457

Source: Own Analysis of weekly GFMA Reviews.

The generally observed shift of attention to new issues has been most noticeable in institutions with a mandate extending beyond financial market regulation. At the international level, the G20 has continued to play its role as an "apex policy forum" (Baker 2011), but financial market regulation is no longer the paramount concern at G20 summits (see Figure 3). While the reform of the financial sector and of international financial institutions dominated the first two summit declarations (Washington 2008 and London 2009), the Pittsburgh summit declaration in the fall of 2009 devoted only four of nine sections to these topics. Already at the press conference inaugurating the French G20 presidency on 4 January 2011, the reform of the international monetary system was first among the priorities mentioned. At Cannes in 2011, the stability and resilience of the international monetary system became a new focus, while the Leaders Declaration of Los Cabos in 2012 opened with the statement that "[we] are united in our resolve to

3 The GFMA is a peak organization of international financial industry associations, including among others the Securities and Financial Markets Association (SIFMA, a private association of about 600 financial institutions), and the Association for Financial Markets in Europe (AFME). The weekly GFMA overviews cover jurisdictions worldwide and report activities dealing with questions of financial market regulation, such as measures taken or debated, monitoring reviews, proposals published for consultation, G20 and other top level meetings, and public pronouncements by heads of international institutions.

Figure 3 G-20 Financial sector reform concerns per summit

Word count of statements on "Financial Sector Reforms" and "International Financial Institutions Reform" (IFI Reform) in percent of total words per Declaration.
Source: Quantitative Analysis of G-20 Final Summit Declaration Documents (G20 2008, 2009a, G20 2009b, G20 2010a, G20 2010b, G20 2011, G20 2012).

promote growth and jobs," with financial reform moving farther down on the agenda. The shifting focus of the G20 reflects its claim to be the "premier forum of our international economic (sic!) cooperation" (G20 2009b), a self-defined mandate wider than that of the former, pre-summit G20 that had been specifically concerned with financial stability.

Summit declarations are generally normative, formulating reform needs and goals. Many statements in G20 summit declarations are simply expressive, affirming shared convictions and beliefs. But there are also statements indicating the commitment of G20 leaders to do something specific and statements calling on or tasking a specific body or class of authorities to do something specific. In all summit declarations so far, statements indicating the commitment of G20 heads of government to do something specific outweigh the delegation of tasks to other institutions (184 : 134),[4] with no substantive change in the relative weights over time; nevertheless, the frequency of explicit delegations is striking, indicating the role of the G20 as promoter and coordinator of the reform process.

As for the topics referring to financial market reform dealt with by the G20, Figure 4 indicates that while the reform of the banking sector has been a dominant concern, reform of international financial institutions is a close second. As for other regulatory concerns, attention has been more or less evenly distributed among financial instruments, tax havens, and rating agencies. The relatively frequent concern of the G20 with

4 Quantitative analysis by Natalie Mohr.

Figure 4 G20 Financial market reform topics

		N Total	In percent
Reform of international financial institutions	Increase in resources generally	6	1.85
	IMF	36	11.11
	World Bank and MDBs	16	4.94
	FSF/FSB	12	3.70
	Cooperation between IFIs	6	1.85
	Sub-total	76	23.45
Banking sector	Capital and liquidity	24	7.40
	Supervision	12	3.70
	G-/SIFIs	19	5.86
	Bank resolution	8	2.47
	Cross-border banking	14	4.32
	Accounting standards	15	4.63
	Sub-total	92	28.40
Other regulatory concerns	Non-bank financial institutions	7	2.16
	Financial instruments	20	6.17
	Tax-havens/tax-information exchange	17	5.25
	Credit rating agencies	17	5.25
	Sub-total	61	18.83
Convergence of regulations and standards	Convergence of regulations	19	5.86
	Cooperation and information sharing	7	2.16
	Peer reviews. progress reports	18	5.56
	Stress testing	2	0.60
	Non-cooperative jurisdictions	14	4.32
	Sub-total	60	18.52
Financial market integrity	Risk management and compensation schemes	17	5,25
	Consumer protection	4	1,23
	Market transparency	6	1,85
	Money laundering and shadow banking	8	2,47
	Sub-total	35	10,80
Total		324	100 %

All statements on financial regulation, expressing a commitment to a regulation or a delegation of regulatory tasks to other bodies, were codified. Codification depended on the addressed area of regulation. The table represents the sum of all G20 commitments and delegations per area of regulation and for all summit declarations between 2008 and 2012.
Source: Qualitative Text Analysis of G20 Final Summit Declaration Documents (see footnote 4).

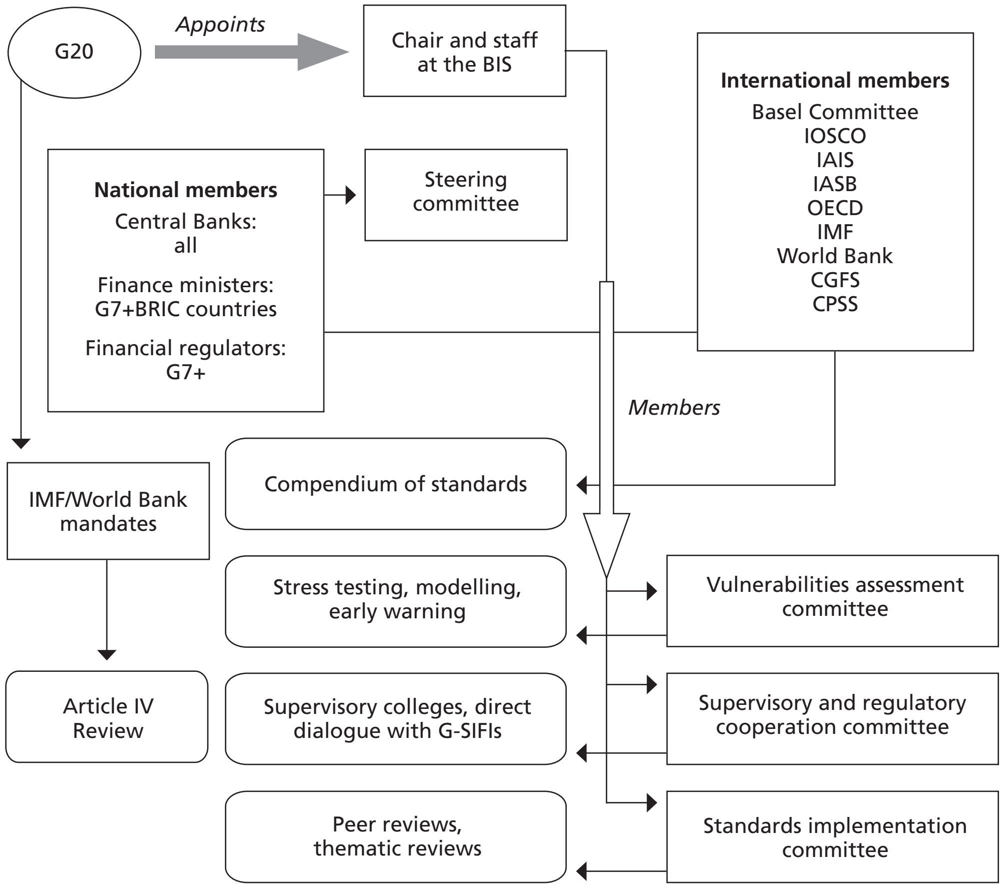
non-cooperative jurisdictions points to the major weakness of this body, its lack of decision-making powers. True, it is heads of government who meet at G20 summits, but even where they do agree on the desirability of a given measure, their ability to commit their countries is strictly limited. The G20 was strong in formulating goals but has been criticized for failing to deliver on its promises and to see its policy choices implemented (e.g., Alexandroff/ Kriton 2010). After the Cannes meeting in 2011, the Financial Times featured articles entitled "Forum's high ambitions deliver meagre results" and "Summitry once again proves its own irrelevance" (Financial Times, 7 November 2011). Vestergaard (2011) criticizes the G20 both on account of its limited representational legitimacy and for lacking effectiveness, notably with respect to IMF reform and the reform of banking standards. But the G20 has never been meant to produce binding decisions or binding international contracts. When the financial crisis erupted, the formation of a new global regulator with a wide representational basis and the power to make binding decisions, as demanded among others by Vestergaard (2011), was obviously politically impossible.

The mandate of the IMF has covered much more than financial markets from the very beginning. In the early phase of financial crisis management, IMF resources were increased, and the IMF was drawn into the reform network coordinated by the FSB and given specific tasks by the G20, but it did not become a major actor in regulatory reform. With the sovereign debt crisis, the IMF recovered some of its previously lost importance as a lender, becoming involved in saving especially some European states from bankruptcy. The financial stability reports regularly published by the IMF reflect the corresponding shift of attention: while issues of financial stability and specific aspects of regulatory reform dominate until April 2011, the April 2012 report deals extensively with the sovereign debt crisis (IMF 2012). The shift of attention has, of course, been particularly pronounced at the level of the EU, the place where sovereign debt, linked to the institution of a common currency, first became a manifest crisis.

In contrast to the G20 and the IMF, the attention of the FSB has not shifted to topics other than financial market regulation. Since the summer of 2011, the FSB has consolidated its role as the operative arm of the G20, calling itself "a central locus of coordination" and describing itself as being "responsible for coordinating and promoting the monitoring of the implementation of agreed G20 and FSB financial reforms" (FSB 2011d: 1). The FSB has, in fact, become the most important international actor in matters of financial market regulatory reform. Figure 5 illustrates the focal position of the FSB and the network character that financial market governance has developed at the international level. An impressive example of the FSB's role as network coordinator is provided by the FSB summary and timelines for dealing with the moral hazard problem posed by systemically important financial institutions (SIFIs). This paper (FSB 2010) details 22 tasks to be fulfilled, with completion envisaged mainly for 2011, but also extending to the end of 2012; eight of these tasks are to be fulfilled by various international bodies (most often the BCBS), while the FSB itself or together with some other entity is responsible for 11 tasks.

By now, the emphasis of the FSB is on the implementation of agreed regulatory reforms (FSB 2011d). Already in 2011, a framework for monitoring the implementation of agreed G20/ FSB reforms was formalized (FSB 2011b). The main monitoring mechanisms used by the FSB are progress reports from the Standard Setting Bodies (SSBs), and thematic and country peer reviews; Figure 6 shows the structure of information flows. The Standing Committee on Standards Implementation (SCSI), a special unit within the FSB, has been created expressly for the peer review program; it collects information from national authorities within the framework of the FSB Implementation Monitoring Network (IMN). Another important information source is the reports produced by the Financial Sector Assessment Programme (FSAP), run by the IMF and the World Bank. The FSB has no sanctioning powers of its own to encourage implementa-

Figure 5 International governance structure of financial markets

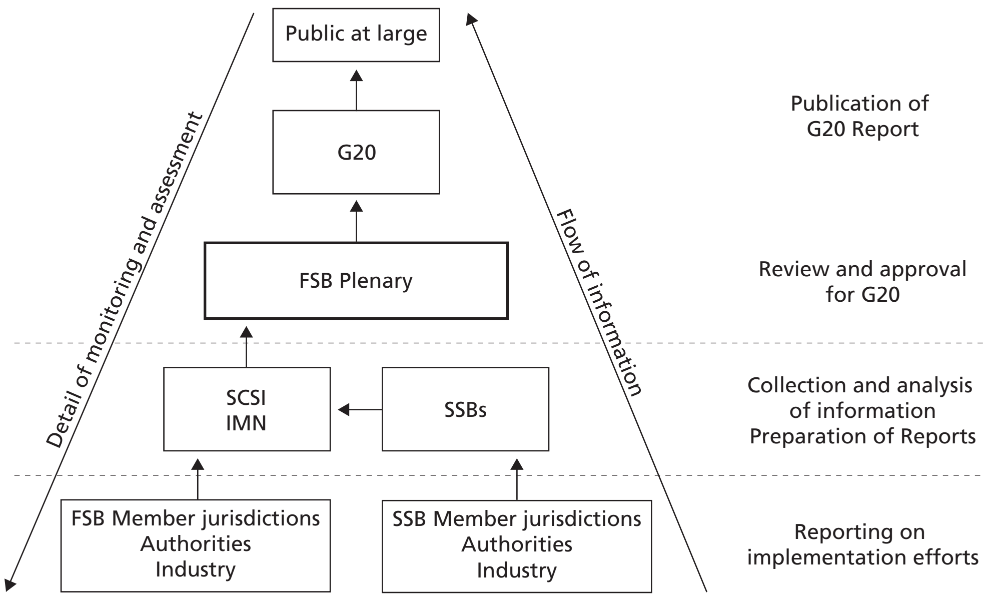


Source: Donelly (2012: 269).

tion (Helleiner 2010); the measures it can take largely boil down to naming and shaming, and reminding G20 leaders of their commitments. Membership in the FSB does imply the obligation to conform to the core international standards that were operative already before 2007, plus any new standard issued by the FSB itself, but this is a rare case. Most FSB reform proposals have the character of recommendations, one notable exception being the Principles on Compensation (FSB 2009).

As time went on, the FSB also took up issues not yet addressed before the sovereign debt crisis became acute. From the very beginning of the financial crisis, experts and potential regulators have been aware that large, systemically important financial institutions (SIFIs), the OTC (over the counter) derivatives trade, and the shadow banking system have played an important role in its occurrence. But exact knowledge of their role in producing the crisis was lacking. This is one reason why it took a longer time to start dealing with these aspects of the financial system than it took to define new capital requirements for banks, compensation rules for bankers, and conflict-of-interest avoidance rules for rating agencies. By the end of 2011, finally, the "priority areas" singled out for monitoring by the FSB extended beyond the implementation of banker compensa-

Figure 6 Coordination framework for the monitoring of regulatory implementation



Source: FSB (2011a: 5).

tion and the new Basel capital standards to include the market for OTC derivatives, global systemically important banks (G-SIBs), the resolution of failing banks, and the shadow banking system (FSB 2011a).

Before SIFIs can be regulated, the regulatory target must be defined more clearly, something that posed a problem in view of the large variety of and lacking data about existing financial institutions. Already in October 2009, the FSB, together with IMF and BIS, presented "Initial Considerations" on how to assess the systemic importance of financial institutions and instruments (BIS, FSB and IMF 2009). A year later, the FSB presented recommendations on how to reduce the moral hazard posed by SIFIs generally and by SIBs (systemically important banks) in particular (FSB 2010). In 2011, the regulation of SIFIs became a focal concern both for the FSB and for IOSCO. At its meeting on 3 October 2011, the FSB mentioned "addressing systemically important financial institutions (SIFIs)" first on its list of key financial regulatory reforms, followed by shadow banking oversight and OTC derivatives (FSB 2011g). By late 2011, the FSB had considered the criteria for defining G-SIBs, published a list of SIFIs, dealt with SIFI supervision, and presented a collection of policy measures to address the problems posed by SIFIs (FSB 2011c).

The main measures discussed in order to curb the risk SIFIs pose to the stability of the financial system are a cap on their size, higher capital requirements, and the introduction of a resolution procedure in case of failure. The easiest measure is clearly the definition of additional loss absorbency requirements for financial institutions categorized as "systemically important"; in the framework of Basel III this has in fact already been done (BCBS 2011d). A cap on the size of big banks is a particularly contested measure, both on theoretical grounds and because of fierce opposition from the banks that would be affected. Leaving aside the problem of a meaningful measure of size, systemic importance cannot simply be reduced to size. Regulatory efforts have therefore focused instead on the creation of resolution regimes. In October 2011, the FSB issued a framework to guide the regulatory initiatives of its members (FSB 2011f). In July 2012, the European Systemic Risk Board followed suit by publishing a paper on resolution (ESRB 2012). By now, a number of countries have started to develop or amend existing rules for the identification and, if necessary, the restructuring or resolution of banks threatening to fail. In Germany, for instance, a law to that purpose was passed in 2010 (FMStG), amended in 2012, yet still considered to be insufficient (Hellwig 2012). According to the FSB, resolution strategies and plans should be in place by June 2013 for all G-SIFIs designated in November 2011 (FSB 2013a). The thematic peer review on resolution regimes conducted by the FSB in 2013 has shown progress in a number of countries, but also revealed a number of "remaining challenges" detailed in its report to the G20 (FSB 2013b).

Already in September 2009, the G20 Leaders had agreed in Pittsburgh on a substantial reform of OTC dealing in derivatives. All standardized OTC derivative contracts were to be traded on exchanges or electronic trading platforms; they were to be cleared through central counterparties and reported to trade repositories; for non-centrally cleared contracts, higher capital requirements were to be required. Of all international regulators, IOSCO in particular has dealt, among other things, with the regulation of OTC derivative trading. Following the G20 mandate, IOSCO has proposed principles for mandatory clearing, disclosure, and reporting of OTC derivatives trading (2012). In April 2012, IOSCO published a set of international standards for payment, clearing, and settlement systems that apply to OTC derivatives markets; IOSCO members are committed to the adoption of these principles. The anticipated deadline for the implementation of the G20 commitments with respect to OTC derivative market regulation was the end of 2012. In April 2013, the FSB report stated that the implementation of agreed OTC reforms "is still progressing after the end-2012 deadline"; by this time, final legislation or rules concerning central clearing, reporting, and trading on platforms had been adopted in most jurisdictions, though they were mostly not yet in force (FSB 2013c: 1).

The European Parliament approved EMIR, the EU act for the regulation of the so-called market infrastructure that includes OTC derivatives, in March 2012; EMIR introduces, among other things, a reporting obligation for OTC derivatives, a clearing obligation for eligible OTC derivatives, and measures to reduce counterparty credit risk. The European Banking Authority (EBA) has meanwhile published draft technical standards on capital requirement for central counterparties, and the Commission developed a proposal for the regulation of central securities depositories; the technical standards that are needed for the implementation of EMIR have been submitted to the Commission and were approved on 19 December 2012 (European Commission 2012b).

The OTC derivative markets form part of the shadow banking system, which also includes money market funds, private equity funds, and hedge funds. Shadow banking "refers to activities related to credit intermediation and liquidity and maturity transformation that take place outside the regulated banking system" (ECB 2012: 4). Neither the entities nor the transactions in the shadow banking system are per se illegal, but being by definition unregulated, the shadow banking system offers opportunities for illegal transactions. It is, however, the unobserved risk generated by transactions within the shadow banking system that poses the main regulatory challenge. Regulation of the shadow banking system is a daunting issue. The size of the global shadow banking system is estimated to represent 25–30% of the total financial system and half the size of bank assets (European Commission 2012a: 4). But its existence is not generally considered to be dysfunctional, since it provides an important alternative source of credit widely used by the real economy. The task therefore is to regulate, not eliminate, the so-called shadow banking sector. Efforts at regulation, however, meet with a severe problem, that is, the absence of relevant information. In contrast to the regulated financial sector, no reliable data are available concerning the entities and activities in the shadow banking sector. For example, "[m]ore than 60% of the assets that are considered part of shadow banking activities in the euro area are linked to financial institutions for which high frequency statistical information is not available" (ECB 2012: 6).

It is, therefore, not surprising that the shadow banking sector as a whole has become the target of regulation relatively late; only hedge funds, a small part of the sector, were singled out early (see Figure 7). On 27 October 2011, the FSB published an initial set of recommendations, subsequently endorsed by the G20, for the future regulation of this sector. A year later the FSB started five work streams to analyze, in cooperation with IOSCO and BCBS, different segments of shadow banking (e.g., money market funds), and published a revised set of recommendations for its regulation (FSB 2012). These recommendations were offered for consultation and will presumably be refined on the basis of the feedback received. At the international level, the IMF, too, has been concerned with shadow banking (IMF 2011). The EU, in turn, has published a Green Paper on shadow banking (EU 2012), and there have been initiatives on certain aspects of this sector. Thus in November 2011, the European Securities Markets Agency (ESMA) issued "final advice" concerning the implementation of the Alternative Investment Fund Managers Directive (AIFMD), a directive in force since June 2011 (agreed upon in November 2010) that concerns, among other things, the regulation of hedge funds.

As for those aspects of financial regulation that had already been addressed before the sovereign debt crisis came to preoccupy policy makers, the stepwise reform process has continued. The Basel Committee has been concerned with fine-tuning Basel III, originally published in late 2010 (see, for instance, BCBS 2011a), and with banking supervision. Some rules that were found to be too restrictive were modified. Thus the originally formulated liquidity ratio was revised in January 2013 (BIS 2013b). The capital requirements of Basel III are to be implemented by the end of 2013; phasing in rules on liquidity and leverage may take until 2019. As of the end of March 2013, all Basel committee

Figure 7 Quarterly publication frequencies in hedge fund and shadow banking regulation

	2009				2010				2011				2012				2013		Total
Shadow banking	–	–	–	–	–	–	–	–	–	1	–	1	1	6	–	7	2	1	19
Hedge funds	1	2	1	–	1	–	1	–	–	–	–	–	1	–	1	–	–	–	8

Source: Own databank for publications on financial regulation. Quarterly aggregated results: 1st quarter of 2009 – 2nd quarter of 2013.

member jurisdictions had at least "initiated significant action" to put in place the Basel III rules, while 11 out of the 27 jurisdictions had already implemented them (BCBS 2013). Since then also the EU, a laggard with respect to the adoption of Basel III rules, has incorporated them into its revised Capital Requirement Directive (CRD) IV, which will go into force on 1 January 2014.

Work has also continued slowly with respect to the regulation of rating agencies (RA). In March 2011, the EU amended the (already existing) regulatory framework for RA and charged ESMA, the new European Securities and Markets Authority, with the task of registration and direct supervision of RA in the EU. In November 2011, the EU Commission published a legislative proposal on RA, and in May 2013, the EU Council adopted a directive and regulation that aims to reduce investors' over-reliance on external credit ratings, mitigate the risk of conflicts of interest in credit rating activities, and increase transparency and competition in the sector. It seems unlikely, however, that the new directive will have a substantial impact on the work of rating agencies and their role within the financial system. The debate about the desirability of creating a publicly financed European rating agency is still going on.

Where stalemate obstructed desired regulatory reforms before attention shifted to the sovereign debt and euro crises, no decisive progress has been made since. An example is the formulation of new international accounting standards. Following the outbreak of the financial crisis, the IASB amended its International Financial Accounting Standards (IFRS), for instance, giving clearer guidance on Fair Value measurement which was accused of having spurred the crisis. But the convergence of IFRS and the American FASB standards demanded by the G20 has still not been achieved. Concerned about the delay in convergence, the FSB has lately recommended setting up at least a "roadmap" for convergence by the end of 2013 (FSB 2013a). Waiting for an agreement, the EU has so far put off adopting new international accounting standards.

3 Analysis

To trace the regulatory activities of different bodies with respect to a number of specific targets over time clearly scratches only at the surface of the multi-faceted process of financial market reform that has been unfolding at different political levels since 2008.

The limited manpower of the project I conducted as well as access restrictions did not permit the detailed reconstruction of the negotiations taking place within the different regulatory bodies; the substantive content of regulatory proposals and enacted reforms thus remains unexplained. Nor was it possible to reconstruct in detail the power plays involved in the adoption or non-adoption of specific reforms by specific jurisdictions. To be able to say whether new domestic and European regulations are generally softer or stricter than the internationally formulated, non-binding standards would have required a systematic comparison of hundreds of documents, a task that was beyond the scope of this project. This holds even more for the question about the effects that regulatory reform, once implemented, will have on financial markets and the structure of the financial industry. In the course of monitoring the implementation of specific, agreed reforms, efforts have been made to demonstrate their impact (e.g., the impact of the higher capital requirements of Basel III on bank capital, BCBS 2010), and specific changes, such as the post-crisis trends in bank funding, are being studied (BIS 2013a). Incidental remarks in the media also suggest that some banks have reduced their personnel and their investment activities. But since implementation of agreed reforms is not complete and important reforms are still undecided, the impact regulatory reform will have on the financial system cannot yet be assessed. There is, however, widespread agreement that financial market reform has remained insufficient to prevent another major crisis. In this context it is also worthwhile to remember what Max Weber said nearly a hundred years ago about the limits of changing reality by way of regulation: the "possible and unintended" effects of legal rules largely escape prediction on the part of rule-setters and can be subverted by individual interest so as to produce the exact opposite of their intended effect (Weber 1956: 254).[5]

Modest as its explanatory scope may be, the preceding account does allow us to draw a few conclusions that may be of more general interest for a theory of planned institutional change. Obviously a reform process must not stop abruptly if the situation that triggered it changes. Financial market reform, responding to the financial crisis of 2007/2008, has continued to this day. The increasing attention claimed by the sovereign debt and currency crises and the danger of a global recession did not stop financial market reform. But neither did the new crises give regulatory reform an added push. Though the financial crisis undoubtedly contributed to the sovereign debt crisis, its proximate cause did not lie in the financial market, but in the perennial inclination of governments towards debt-financing – of wars, infrastructures, or the welfare state (Holtfrerich 2013). The focus of reform politics thus became government debt. But this shift of political attention did not occur uniformly in all institutions that had become active in the early phase of financial market reform; it has been particularly pronounced

5 "In einer auf universeller Marktverschlungenheit ruhenden Wirtschaft entziehen sich namentlich die möglichen und ungewollten Nebenfolgen einer Rechtsvorschrift weitgehend der Voraussicht der Schöpfer der letzteren, weil sie ja in der Hand privater Interessen liegen. Gerade sie können aber den beabsichtigten Zweck der Vorschrift im Erfolg bis zur Umkehrung ins gerade Gegenteil entstellen, wie dies so oft geschehen ist."

in institutions with a wider political mandate (G20, IMF, OECD). In contrast, international standard-setting organizations as well as the FSB, successor to the FSF that had been designed to coordinate their work, continued small step by small step with financial market reform – elaborating regulatory frameworks, making extant rules operational, and starting work on more complex features of the financial system recognized as crisis causes, but not yet approached. Organizational identity serves as a filter for the impact of challenges arising in their environment on the activity of regulatory institutions. This also held at the regional and the national levels.

Given the nature of the financial system, reform initiatives were started simultaneously at all political levels. Substantively this multi-level reform process has a clear time profile: there has been a movement from simple to complex reform challenges. When the financial crisis put financial regulation on the political agenda, politicians had little exact knowledge of the structure and dynamics of the financial system. Unsurprisingly in this situation, and in spite of the fact that the crisis was quickly seen as a macro-prudential, systemic problem, the reform approach was micro-prudential at first, targeting individual banks and the financial incentives seducing bankers to engage in increasingly risky trades. Higher capital requirements were another easily understandable measure against risk taking by banks. Since bank runs threatened, increased deposit insurance was called for and enacted, and consumers – the typical small investors – were to receive better information about the risks attendant on specific investments. Concrete measures addressing OTC derivatives markets, SIFIs, and G-SIBs started later. Obviously, causal factors that are, first, easy to identify and, second, relatively easy to manipulate are addressed first in a crisis-triggered reform, before measures to tackle more complex aspects of the problem are considered. It is easier to devise rules controlling the behavior of (certain categories of) actors, individual or corporate, than to address complex structures, intricate interconnections, and kinds of transactions difficult to keep track of.

The reform process has also remained selective, if judged against a complete model of the factors contributing to the financial crisis. The agenda for financial market reform was set at the very beginning and was not significantly revised, let alone extended, when attention shifted to different problems. The initially formulated agenda has circumscribed the issues to be dealt with by the FSB and international standard-setting organizations, by the European Union, and by individual governments. Potential reform topics that were not on this agenda have not been taken up. This holds in particular for issues of taxation, the liability of bankers for the consequences of bank activities, and complex forms of securitization, the so-called innovative financial instruments.

The only tax measure discussed off and on at various levels, without a chance to find international approval, is the Financial Transaction Tax (FTT). Other tax issues, such as the possibility for banks to deduct bonus payments from tax, have been occasionally mentioned, but only now and only in individual countries are they being haltingly approached. A similarly neglected reform issue is the disconnect between causal responsibility and legal accountability of bankers. Banks have been held legally accountable for knowingly selling securities they expected to cause losses for their unwitting buyers, but not for the damage caused by risky policy decisions. The liability of managers is generally regulated by corporate law, for instance, in the UK by precedence and the Companies Act, and in Germany by three different laws (GmbHG, AktG, GenG; see Lutter 2011). In general, managers are legally bound to act in the interest of the corporation and to comply with existing law, but there is a tendency not to constrain entrepreneurial initiative too much by legal restrictions. In May 2013, the German parliament passed legislation that would, among other things, define more strictly the legal liability of bank CEOs for the consequences of their decisions. The difficulty of introducing clauses specifically targeting banks and bankers into legal regimes of a much wider scope may have inhibited reforms in tax and liability issues.

The obstacles to the regulation of the so-called innovative financial instruments like ABS, CDO, CDO of CDO, and CDS, are of a different nature. For one thing, this is a particularly complex subject matter. At the same time, however, the use of "innovative" forms of securitization is considered to be not only profitable for banks, but also useful for investors and the real economy. OTC derivatives reform thus stops at requiring registration and standardization; only the practice of short selling has suffered occasional restrictions. The widely diffused repo practice, where for instance a given government bond is passed along as security in a long sequence of credit transactions, has clearly contributed to the domino effect produced by a single failure. The repo practice has not been directly addressed by regulators, though it will be curbed, inadvertently as it were, by the introduction of the FTT (Karl/Schäfer 2012).

Another observation based on the preceding reconstruction of regulatory activities refers to the recursive character, the negative feedback loops built into the formulation of financial market reforms. Uncertainty about the effect of planned regulation, whether public or private, makes would-be reformers cautious and gives opponents an opportunity to argue against a new rule before it is made binding. In addition to the resistance of the financial industry and to the ambivalence of politicians with respect to stricter regulation, this uncertainty is an important factor constraining the reform impetus and shaping reforms substantively. As policy is cast into the form of specific rules, the possibility of undesirable remote and side effects becomes evident. The fear of such undesirable effects grows with the insight into the complexity of the object of regulation, the financial system, and its causal connectedness not only with the real economy, but also with a wide range of other political concerns. In reaction to this challenge, the institutions actively involved in the reform process have made efforts to anticipate the impact of new or reformulated rules. This has been done both by way of prospective impact studies, such as the BCBS has offered when formulating the Basel III rules (BCBS 2010), and by the practice of offering planned interventions to public consultation. It has become a prominent feature of the reform process to publish draft rules, rule elaborations, and rule amendments for comment; in fact, a large part of the activities tabled by the aforementioned GFMA in its weekly reviews concern such consultations – an opportunity used last but not least by the organizations of affected interests.

Observing the sequence of regulatory outputs of the different institutions over time evidences yet another feature of the reform process – the increased concern with the technical details of intended reforms as initial reform demands become operationalized in the form of concrete rules. Policy development is generally characterized by increasing specialization as comprehensive reform demands are broken down and translated into specific plans. As evidenced by the recent publications of international standard setters, concern is now increasingly focused on technical details and issues of classification arising in the formulation of new rules. The BCBS, for instance, took pains to define precisely the criteria for what assets count as common equity tier 1 capital and how to apply § 75 of Basel III rules to derivatives (BCBS 2011b, 2011c, 2011e). To give another example: the regulation of the so-called alternative investment funds in a new directive confronts European regulators with the difficult task to define practically applicable criteria for the classification of the huge variety of such entities into categories subject to specific requirements (Möllers et al. 2011). The tendency to formulate ever more detailed rules is a reaction to the often explicitly recognized propensity of profit-seeking financial institutions to evade compliance by making use of regulatory gaps and of terms open to interpretation. Where regulatory institutions, in recognition that a proposed regulation will be applied under widely different conditions, formulate general principles rather than detailed rules, they either expect lower level legislators to translate the principles into appropriate rules, or they do so in the often vain hope that supervisory institutions will insist on compliance not with the letter, but the spirit of a given principle (Mayntz 2012b). The felt need to formulate technical standards, or guidance as it is also called, obviously causes delays in the specification and ratification of rules and slows down the reform process.

A final observation concerns the question whether over time the multi-level process of financial market regulation leads to a more coherent regulatory architecture. Coherence, of course, does not necessarily imply regulatory convergence at the national level, but it does imply coordination. In the multi-level process traced in this paper, the international bodies mainly served as promoters of reform, being largely limited to produce recommendations for cooperation and rules that are not binding for their targets. At the regional level of the EU, a "jurisdiction" with power to issue binding rules, the relevant institutions have taken up, piece by piece in a rather disjointed manner, most points of the G20 reform agenda, especially where these were translated into rules by international standardization organizations like the BCBS. Adoption by the EU has, however, often involved not only delays, but also modifications. In turn, EU member countries have by and large adopted EU rulings; in this way reforms have trickled down from the international over the regional to the national level – a process that has often, but by no means always, meant softening originally intended demands on banks and restrictions on financial transactions. Germany, for instance, will adopt a stricter version of the EU directive dealing with alternative investment funds (AIFM) implementing an early G20 demand (Handelsblatt, FAZ , both 25 April 2013). Some countries, including the United States (FAZ, 5 April 2013), also consider introducing higher capital requirements than are demanded in Basel III. There are, then, limits to the harmonization of financial market regulation that will be achieved.

Without an analysis that is beyond the scope of this paper it cannot be said whether financial market regulation at the national level has converged or rather diverged in the course of global reform efforts. There is clearly some convergence among EU member states, but the United States seems to pursue its own reform strategies based on the Dodd–Frank Act, and no comprehensive analysis of the reforms undertaken in the BRIC countries is yet available. Already in 2010, the Transatlantic Council, a non-partisan network of US American and European leaders, warned of "the danger of divergence" in financial reform (Transatlantic Council 2010). With the feeling that the worst of the financial crisis *strictu sensu* has passed, an increasing penchant for protectionism has become visible in G20 negotiations (Bremmer/ Roubini 2011). The expansion of the G20 agenda beyond financial market regulation seems to have reinforced the divisive force of diverging national interests. Helleiner and Pagliari (2011) in fact suggest that official international standards of financial regulation may weaken instead of strengthen in the post-crisis world, because the broadening representational basis of the most important international regulatory bodies makes consensus harder to reach. Indeed, it is plausible that the greater economic and political diversity among states participating in international negotiations will lead to an increasing heterogeneity of policy preferences. But this does not mean that regulation will generally become more permissive. Regulation at the national level will be stricter than it was before the crisis, but there may be increasing divergence between states. The failure to achieve international regulatory harmonization, combined with the tendency toward stricter national or regional (EU) regulation, may reflect a shift from the self-perception of national power in terms of influence to the perception of "power as autonomy" (Cohen 2006, quoted by Helleiner/Pagliari 2011), the insistence on policy independence; this insistence may be a direct reaction to the increasing drive for financial regulation that is both strict and international.

The politicization of financial regulation following the financial crisis of 2007/2008 has increased rather than decreased the tendency for protectionism and beggar-thy-neighbor strategies in international negotiations. Political leaders are expected, more so than is true of technical experts, to act in what they define as the interest of their country. Given the importance of banks both for the national economy and for the debt financing of national budgets, it is not surprising that politicians "align themselves with bankers because they want to promote their countries' banks' interests in international competition. In international negotiations they fight for their countries' banks, even if the rules they fight for might endanger financial stability" (Admati/Hellwig 2013: 193). As long as political leaders identify with the interests of their country and as long as national interests are diverse and often conflict, parametric adjustment rather than positive coordination and collective problem-solving will be the dominant mode of decision making. This touches on a far-reaching and often discussed theoretical question, that is, whether it is the capitalist mode of economic organization or the political organization into separate states that feeds international competition. Kenneth Waltz ([1954]2001), for one, doubts that in a world of socialist states there would be no violent conflicts, since the reasons for such conflict rest in the nature of states and are independent of their political economy. If this is so, the hope to arrive at an internationally regulated financial system is vain.

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