Private International Law-Making for the Financial Markets

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Abstract

This Article argues that transnational financial transactions create new opportunities for private groups to influence legal and regulatory rules. Internationalization of the financial markets has led to harmonization of financial law. Much harmonization of financial law occurs through processes that are apparently public, state-centered, and transparent, but this Article describes three ways in which private and opaque processes have a significant influence on policy development in the area of financial law. These are private international law-making through private involvement in public rule-making processes, through contracting, and through the actions of private sector regulatory entrepreneurs.
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PRIVATE INTERNATIONAL LAW-MAKING FOR THE FINANCIAL MARKETS

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INTRODUCTION

In his 2004 Chorley lecture, Simon Roberts argued against the modern trend to “loosen the conceptual bonds between law and government.”1 Roberts is concerned that by expanding the range of what we call law we undermine the meaning of the descriptor.2 But he is also concerned that “under an onslaught of jural discourse and institutional design, [the] distinctive values of negotiated order, far from being celebrated, are actually effaced.”3

In financial regulation4 it is easy to subscribe to this distinction between state-centered law and negotiated rules, whether we describe them as “law” or not. It is common, for example, to distinguish between governmental and “self-regulatory” rules.5

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1. Simon Roberts, After Government? On Representing Law Without the State, 68 MOD. L. REV. 1, 1 (2005); see also id. at 17 (“If we try to represent law—or regulation—as other than a dimension of governing we are surely losing our way.”).

2. See id. at 24.

3. Id. at 23. Roberts describes the value of negotiated orders as follows: “Negotiated orders have their own rationalities: they involve a different orientation to the normative repertoire from those of state law; decision-making is through agreement, reached through cyclical processes of information exchange and learning, rather than the imposed order of a third party; different forms of trust are necessarily involved.” Id.

4. By focusing on the regulation of international financial activity (excluding informal financial transactions carried out through mechanisms such as hawala), I am necessarily focusing on regulation produced by actors from developed economies and, in particular, by actors from developed western economies.

5. See, e.g., JOHN BRAITHWAITE & PETER DRAHOS, GLOBAL BUSINESS REGULATION 28 (2000) (“The last two decades of the twentieth century saw the rise of a ‘new regulatory state,’ where states do not so much run things as regulate them or monitor self-regulation. Self-regulatory organizations frequently become more important than states in the epistemic communities where debates over regulatory design are framed.”).
But this apparent sharp distinction between governmental and self-regulation soon breaks down: self-regulatory organizations often derive—or appear to derive—their [quasi] regulatory authority from the State.\(^6\) Members of a Self-Regulatory Organization ("SRO") may find that they have to look beyond their SRO to assess the risk that they will be subject to enforcement action.\(^7\) Self-regulatory rules may be introduced in order to fend off formal governmental regulation. At the same time, governmental regulation may look very much like a negotiated order and may give effect to private agendas.

The debate in financial regulation about the respective weights that should be accorded to governmental and self-regulatory rules is a live one. At the end of 2004, the United States Securities and Exchange Commission ("SEC") published a concept release on self-regulation,\(^8\) and proposed new rules to apply to SROs.\(^9\) Governments\(^10\) and international organizations\(^11\) have

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   In several jurisdictions around the world, effective self-regulation existed before statutory regulation. As markets developed, market participants recognized that regulation was necessary in order to protect the integrity of the market. Industry participants recognized that those who were most familiar with the customs and practices of a particular trade were best suited to create rules related to that trade, to enforce those rules and to resolve the disputes that arose from those rules. Moreover, the familiarity with the concepts involved ensured that such disputes were quickly resolved and that the rules for commerce in that particular market continually and quickly adapted to the evolutions in the manner in which trade was conducted.

Id.


10. See, e.g., TASKFORCE ON INDUS. SELF-REGULATION, INDUSTRY SELF-REGULATION IN
examined how self-regulation does and can work in financial markets. In recent years, SROs have been criticized for being ineffective as regulators of financial market participants. In January 2005, Charlie McCreevy, the European Union’s internal market commissioner, noted that governance of international standard-setters was “becoming a subject of heated public debate.” Credit Rating agencies, hitherto unregulated, may be subject to some form of regulation in the future.


Self-regulation is increasingly being used as an alternative to quasi-regulation and government legislation and there is some overlap between them. Identifying best practice in self-regulation, and identifying the limits of self-regulatory schemes, has important implications for the government’s approach toward a more efficient regulatory framework for both businesses and consumers. The role of government in encouraging self-regulation also has an impact on compliance costs, flexibility and the coverage of self-regulation.

Id. at v. The report also stated that “[t]he Government also has the objective that industry should take increased ownership and responsibility for developing efficient and effective self-regulation where it is the most appropriate regulatory response.” Id.

11. See, e.g., MODEL FOR EFFECTIVE REGULATION, supra note 6.


[T]he disclosures that led to the resignation of Richard Grasso as the NYSE’s Chairman and Chief Executive Officer have revealed that some of the problems that precipitated the market crisis of the past two years are reflected in the conduct of the NYSE itself. It is clear that there is a need for fundamental, urgent, and sweeping reforms at the NYSE, to restore the faith and confidence of investors.


14. See, e.g., Definition of Nationally Recognized Statistical Rating Organization, 70
The argument that domestic financial regulation is influenced by private sector groups through lobbying and capture is not new. Commentators have argued in the past that harmonization of regulation in the EU allows business groups to have a greater influence on the development of rules than they would at the domestic level. But the capture story is clearly not the only story about regulation. At the domestic level, particularly in an environment with competing regulators, regulators may seek to appeal to different constituencies. State banking regulators in the United States are now arguing against the Office of the Comptroller of the Currency ("OCC")'s actions on preemption by emphasizing that the state regulators protect individual consumers of banking services more effectively than the OCC can. Financial firms do not always succeed in protecting themselves from liability even where they are only doing what other similar firms are doing.


15. See, e.g., George Stigler, The Economic Theory of Regulation, 2 Bell J. Econ. & Mgmt. Sci. 3 (1971) ("A central thesis of this paper is that, as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit."); see also Jean-Jacques Laffont & Jean Tirole, The Politics of Government Decision Making: A Theory of Regulatory Capture, 106 Quarterly J. Econ. 1089 (1991). Cf. John P. Burke, Comm'r of Banking, State of Connecticut, Comments to the National Conference of State Legislatures Annual Meeting, Salt Lake City, Utah (July 22, 2004), available at http://www.csbs.org/pr/speeches/2004/JackBurke_NCSL_Address_072204.pdf ("[T]he amassing of control by Washington insiders is being compounded by the Securities and Exchange Commission talking about additional centralization and a push by the insurance industry to have a national charter not subject to state oversight or regulation.").


17. See, e.g., Burke, supra note 15, at 2-3. The Conference of State Bank Supervisors, which describes itself as the "Champions of the State Banking System," includes the following language in its Statement of Principles: "Bank supervision is best conducted at the state level, where regulators are accessible and in tune with the local economy." Conference of State Bank Supervisors [CSBS], CSBS Statement of Principles (Dec. 2004), http://www.csbs.org (last visited Oct. 18, 2005).

18. See, e.g., Press Release, SEC, Federal Court Approves Global Research Analyst...
This Article argues that transnational financial transactions create new opportunities for private groups to influence legal and regulatory rules. Internationalization of the financial markets has led to harmonization of financial law.\textsuperscript{19} Much harmonization of financial law occurs through processes that are apparently public, state-centered, and transparent,\textsuperscript{20} but this Article describes three ways in which private and opaque processes have a significant influence on policy development in the area of financial law. These are private international law-making through private involvement in public rule-making processes, through contracting, and through the actions of private sector regulatory entrepreneurs.

I. PRIVATE INVOLVEMENT IN PUBLIC RULE-MAKING PROCESSES

Rules that affect participants in international financial transactions may be adopted at the supranational level or at the domestic level. Increasingly, supranational bodies are developing harmonized rules or principles of financial regulation.\textsuperscript{21} Even where supranational rule-making occurs, domestic legislation or rule-making may be necessary for implementation.\textsuperscript{22} It is necessary, therefore, to distinguish between private involvement in the work of supranational or transnational public rule-making processes and private involvement in domestic public rule-making processes. At the same time, developments at the supranational level may have significant impact.\textsuperscript{23}


\textsuperscript{20} Note, however, that legislators often feel distanced from the harmonization process. See, e.g., Int'l Monetary Fund [IMF], \textit{IMF Deepens Dialogue with Central American Legislators}, 34 IMF Survey 178 (June 20, 2005), available at http://www.imf.org/external/pubs/ft/survey/2005/062005.pdf.


International level can have a significant impact on domestic rule-making (and vice versa).\textsuperscript{23} Regulatory developments in one domestic jurisdiction may have an impact on rule-making in another.\textsuperscript{24}

As the volume and impact of supranational rules and principles has increased, financial firms and their trade associations have begun to try to influence the development of these rules and principles at the supranational level.\textsuperscript{25} Processes which were

\textsuperscript{23} For example, the IMF has become more involved in recent years in issues of financial regulation. See Independent Group to Review IMF's Financial Sector, Capital Markets Work, 34 IMF Survey 169, 172 (June 20, 2005), available at http://www.imf.org/external/pubs/ft/survey/2005/062005.pdf. The IMF's biweekly magazine recently stated that:

The rising importance of private capital flows and of a stable and well-functioning financial sector have led to a greater emphasis on these areas in the IMF's work. 'It is now time,' [IMF Managing Director Rodrigo] de Rato said, 'to review the ways in which the IMF has adapted.' Also, as part of an ongoing strategic review of the IMF, the organization's Executive Board has asked that increased attention be given to financial regulation and oversight and to the determinants of capital flows and their regulation. 'This increased attention would mean that in Article IV surveillance, IMF missions would increasingly examine the regulations and environment in which domestic financial institutions and private capital markets operate, with attention to factors governing inward and outward flows of lending, equity investment, and direct foreign investment,' de Rato stated.


In spite of the many ongoing regulatory dialogues, too often regulators develop and implement rules, regulations and requirements on business in relative isolation. Since regulators are subject to entirely separate legal mandates and legislative oversight, it is difficult for both business and administrations to ensure that their concerns are heard. We respect that sovereign prerogatives and legislative mandates must be taken into account, but we are concerned that, if regulations continue to be developed on both sides of the Atlantic without regard to the impact on the transatlantic market, divergent approaches will emerge which will negatively affect the ability of business to expand trade, investment and innovation. Recent regulatory actions (such as Sarbanes-Oxley in the U.S., and the chemicals regulation in the EU) have highlighted the need for regulators and legislators to consider the external implications of their actions. It is vital to have a clear structure and process across the transatlantic regulatory landscape, not just in a few sectors.

originated as mechanisms of cooperation between domestic regulators have begun to look more like domestic regulatory processes with increased input from non-State agents. These developments have occurred during the same period in which the anti-globalization movement has motivated the international financial institutions to focus on increasing the transparency of their actions. Supranational actors seek to increase their apparent legitimacy by involving “stakeholders” or “civil society” in their work. Observers monitor governance in these supranational organizations.

In the absence of generally agreed-upon procedures for supranational governance, standard-setters and those whose ac-


Government policies and behaviors play a key role in shaping the investment climate. While governments have limited influence on factors such as geography, they have more decisive influence on the security of property rights, approaches to regulation and taxation (both at and within the border), the provision of infrastructure, the functioning of finance and labor markets, and broader governance features such as corruption. Improving government policies and behaviors that shape the investment climate drives growth and reduces poverty.
tivities their standards may affect are negotiating principles of governance. Financial trade associations argue that regulation in the global capital markets should be transparent. For example, the Securities Industry Association ("SIA") says that: 1) rules should be adopted only for legitimate public policy objectives; 2) they should be enforced fairly, and not retrospectively; 3) they should be publicly available; and 4) they should be "clear and understandable." None of these claims appears to be controversial, although there is scope for debate about when a rule is or is not adopted for legitimate public policy objectives, or when rules are "clear and understandable."

Financial firms and their trade associations have a clear incentive to participate in negotiations about governance procedures in supranational standard setting bodies. The Basel Capital Accord taught banks that they needed to pay attention to supranational standards because these standards could affect their bottom line. The EU’s financial market integration project also gives financial firms incentives to pay attention to supranational rules. But other groups, such as financial firms' customers, do not have such immediate incentives to participate in these processes. Moreover, they often lack the resources to participate effectively. Effective participation in consultations about financial regulation requires time and expertise. It also usually re-


30. See, e.g., infra note 64 and accompanying text.
31. See, e.g., SIA, supra note 25, at 2-3.
33. See, e.g., infra note 121 and accompanying text.
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requires a good knowledge of English. Financial regulation is often highly technical and detailed, and, at the supranational level, as at the domestic level, the stakeholders who speak loudest and most frequently are regulated financial firms and their trade associations.

Because harmonization of financial regulation occurs at different levels—supranational, national, sub-national—or layers, through processes of agreement and implementation of standards, and because each level of decision-maker is likely to invite public comment on its work, the harmonization process multiplies the possibilities for well-resourced organizations to influence rule content. A large financial firm or financial trade association is more likely than a small firm to know what proposals exist around the world which may ultimately affect its (or its members’) business, and it is more likely than a smaller organization to have the resources to try to affect the development of the rules. Large well-resourced organizations adopt complex strategies of working together and separately in order to maximize the effectiveness of their voices. Smaller firms’, investors’, and depositors’ voices may be lost in the hubbub around rule-making created by larger firms and their trade associations.

35. See infra notes 135-38 and accompanying text.

36. Cf. Section for External Relations, European Econ. & Soc. Comm., Opinion on The Social Dimension of Globalisation—The EU’s Policy Contribution on Extending the Benefits to All, at ¶ 1.5 (2005) (referring to “the findings of the World Commission on the Social Dimension of Globalization (WCSDG) that market-opening measures and financial and economic considerations have predominated, neglecting their social consequences so far and that these rules and policies are the outcome of a system of global governance insufficiently responsive to the interests and needs of the less powerful players”). See also Communication from the European Commission, European Governance: Better Lawmaking, at 3 (June 5, 2002), available at http://europa.eu.int/eur-lex/en/com/cnc/2002/com2002_0275en01.pdf (“Are the Smallest Voices Really and Always Heard?”).
A. Transnational Rule-Making

Transnational standard-setting bodies such as the Basel Committee on Banking Supervision, International Organization of Securities Commissions ("IOSCO"), the Organization for Economic Cooperation and Development ("OECD"), and the International Association of Insurance Supervisors ("IAIS") involve technocratic networks of regulators from different States working together to develop harmonized standards for banking, securities and insurance regulation. Other principles that affect financial firms relating to money laundering and terrorist financing controls are developed by the Financial Action Task Force on Money Laundering ("FATF"), a body established by the G7 nations in 1989. By definition, such inter-governmental bodies operate at a distance from national democratic processes. The Basel Committee, the OECD, and the FATF are


38. IOSCO is the International Organization of Securities Commissions, a forum for coordinating approaches to securities regulation. IOSCO's web site is at http://www.iosco.org. For a discussion of IOSCO's Principles of Securities Regulation, see Pistor, supra note 19, at 116-20.


40. IAIS is the International Association of Insurance Supervisors, a cooperative organization of insurance supervisors. The IAIS website is at http://www.iaisweb.org.


43. See generally http://www.fatf-gafi.org (describing the Financial Action Task Force on Money Laundering ("FATF") as "a policy-making body, which works to gener-
bodies with limited memberships, composed of representatives from a relatively small number of States.\textsuperscript{44} Even IOSCO and IAIS, which have more inclusive membership arrangements, tend to be dominated by members from northern, economically developed States.\textsuperscript{45} The actions of these supranational standard-setters are not subject to the sort of controls that apply to domestic administrative agencies.\textsuperscript{46} Firms and people who may be affected by their pronouncements do not have opportunities to challenge these pronouncements in court.\textsuperscript{47}

The International Monetary Fund ("IMF") and the World Bank encourage States to comply with the standards that bodies such as the FATF, the Basel Committee, and IOSCO produce,\textsuperscript{48} so that the standards may have significant practical impact although they are not formally binding.\textsuperscript{49} On the other hand,

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\textsuperscript{44} See Kovach et al., supra note 28, at v (noting that the Group of Ten (G10), whose members form the Basel Committee, is "made up of a few privileged BIS members, located within the BIS but not ultimately accountable to it and its fifty members").


\textsuperscript{46} See id. at 1 ("This transformation has removed the regulation of goods and services from domestic rulemaking and transformed it into a matter for supranational agreement. It has taken review away from the courts and made administration an exercise in bureaucratic collaboration.").

\textsuperscript{47} Cf. European Commission, Towards a Reinforced Culture of Consultation and Dialogue—General Principles and Minimum Standards for Consultation of Interested Parties by the Commission, at 10, COM (2002) 704 final (Dec. 11, 2002), available at http://europa.eu.int/eur-lex/en/com/cnc/2002/com2002_0704en01.pdf ("[T]he Commission remains convinced that a legally-binding approach to consultation is to be avoided, for two reasons: First, a clear dividing line must be drawn between consultations launched on the Commission's own initiative prior to the adoption of a proposal, and the subsequent formalized and compulsory decisionmaking process according to the Treaties. Second, a situation must be avoided in which a Commission proposal could be challenged in the Court on the grounds of alleged lack of consultation of interested parties. Such an over-legalistic approach would be incompatible with the need for timely delivery of policy, and with the expectations of the citizens that the European Institutions should deliver on substance rather than concentrating on procedures.").


\textsuperscript{49} See, e.g., Articles of Agreement of the International Monetary Fund, http://
standards established by the FATF, the Basel Committee, or IOSCO will typically produce a direct impact on firms only when they are implemented within a domestic regulatory system.\textsuperscript{50} A domestic regulator is subject to the rules that normally apply to administrative action within its domestic system when it considers how to implement supranational rules domestically.\textsuperscript{51} However, whether because of urging by the international financial institutions or by financial firms, rules developed in transnational standard-setting bodies may benefit from a presumption of acceptability when they are considered by a domestic legislator or regulator. It is also probably easier for regulators from the countries that make most of the international standards than for regulators from the countries that do not to decide to adjust the standards for domestic conditions.\textsuperscript{52} Thus, it is possible that people and firms who did not participate in consultations by the international standard-setting organizations may have more opportunity to express their views on a proposed domestic implementation in some countries—the more powerful countries—than in others.\textsuperscript{53}

The EU’s program for developing harmonized financial regulation differs from the activities of the Basel Committee and IOSCO in a number of ways.\textsuperscript{54} First, the EU’s harmonized rules

\textsuperscript{50} See Zaring, supra note 45, at 10 (“For example, American banking regulators have generally treated the Committee’s theoretically voluntary proposals as the basis for quick domestic regulatory action.”).

\textsuperscript{51} Cf id. at 10-11 (describing how U.S. bank regulators have implemented Basel Committee amendments).


\textsuperscript{53} Cf Zaring, supra note 45, at 11 (“Recently, the Fed, the OCC, and other domestic banking agencies with memberships on the committee act in unison, with one comment period, a collective response, and quick domestic implementation of the international rule.”).

\textsuperscript{54} The EU and the United States are discussing enhanced regulatory cooperation. See, e.g., Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee—A Stronger EU-U.S. Partnership and a More Open Market for the 21st Century, COM (2005) 196 final (May 18, 2005).
are binding on the EU Member States. Member States may not have much discretion about how they go about implementing the rules agreed upon in EU directives. In addition, the EU Parliament has, and exercises, the right to be involved in the development of the EU’s harmonized rules for financial regulation. Thus, the EU’s measures have a more binding quality, and more democratic input, than harmonized rules or principles developed in other fora.

International and regional organizations that develop rules and standards for international financial activity have recently been taking steps to enhance the transparency of their processes. The FATF may be distinguished from other financial standard-setters, because although it publicizes its work through its website, it does not use the website to seek public comments on its work. The development of money-laundering and terrorist-financing controls is treated as an aspect of law enforcement rather than as an aspect of financial regulation even

55. See generally Comm. of Wise Men, Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, 28 (Feb. 15, 2001) [hereinafter Lamfalussy Report], available at http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussyen.pdf. The EU’s harmonization measures are now separated into framework measures and more detailed implementing measures. The idea is that the more detailed implementing rules could be changed more easily, thus ensuring that the rules could adjust to changing circumstances. This new arrangement was introduced after the Lamfalussy Report.


58. The EU is more democratic in its processes than it was, and more democratic than other international organizations. See, e.g., id. at ¶ 4 (noting “the importance of ensuring that the proposed Regulators and Securities Committees are democratically accountable”).


60. See, e.g., FATF, METHODOLOGY FOR ASSESSING COMPLIANCE WITH THE FATF 40 RECOMMENDATIONS AND THE FATF 9 SPECIAL RECOMMENDATIONS, at 2 (Feb. 27, 2004), available at http://fatf-gafi.org/dataoecd/45/15/34864111.pdf (arguing that an effective anti-money laundering system and the combating of the financing of terrorism require laws that create money-laundering and terrorist-financing offenses and provide for the freezing, seizing and confiscation of criminal proceeds and terrorist funding).
though much of the burden of implementing the resulting rules is borne by financial firms.\footnote{See generally id. (calling for laws that impose the required obligations on financial institutions and designated non-financial businesses and professions).} As money-laundering and terrorist-financing control is an enterprise of law enforcement, the expertise that is valued in the process of developing standards is law enforcement and regulatory expertise rather than financial sector expertise.\footnote{See, e.g., FATF ANNUAL REPORT FOR 2003-2004, supra note 42, at 3 ("The delegations of the Task Force’s members are drawn from a wide range of disciplines, including experts from the Ministries of Finance, Justice, Interior and External Affairs, financial regulatory authorities and law enforcement agencies.").}

In contrast to the FATF, the Basel Committee, IOSCO, and the IAIS all publish documents including their proposed rules and standards through their websites in order to publicize their work and also to invite public comment.\footnote{See supra note 41.} Financial trade associations welcome moves to greater public consultation.\footnote{See, e.g., Int’l Sec. Mkt. Ass’n [ISMA], Int’l Primary Mkt. Ass’n, Danish Sec. Dealers Ass’n, London Inv. Banking Ass’n, Swedish Sec. Dealers Ass’n, PUBLIC COMMENTS BY THE ABOVE ASSOCIATIONS ON IOSCO’S CONSULTATION REPORT ON CODE OF CONDUCT FUNDAMENTALS FOR CREDIT RATING AGENCIES (Nov. 2004), available at http://www.iosco.org/pubdocs/pdf/IOSCOPD177_25.pdf ("We also recognize that publication of the Code for consultation is part of IOSCO’s evolving policy of greater public consultation, the objectives of which, as set out in IOSCO’s recent draft Statement of Consultation Policy, we endorse and on which we will comment in due course.").} However, although some international standard-setters have worked to increase the transparency of their processes,\footnote{See, e.g., EXECUTIVE COMM. OF THE INT’L ORG. OF SEC. COMM’RS, IOSCO CONSULTATION POLICY AND PROCEDURE 2 (Apr. 2005), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD197.pdf (stressing that IOSCO aims to “continue to increase transparency regarding IOSCO’s activities”).} there is as yet no one method of encouraging public participation, or even of describing the results of a consultation exercise.\footnote{See id. at 3 (“IOSCO will maintain a flexible approach to public consultations.”).} This is not surprising given that domestic rules regulating the rule-making activities of regulatory agencies vary,\footnote{See, e.g., Richard B. Stewart, Remarks at the Conferment of an Honorary Degree in Jurisprudence from the University of Rome, La Sapienza (June 13, 2005), available at http://www.law.nyu.edu/newscalendars/faculty/2004_2005/stewart/lasapienza.html (last visited Oct. 18, 2005) (noting that “one can speak of a French-Italian model of administrative law, a German model, an Anglo-Commonwealth model, [or] a U.S. model”).} and the international standard-setters include members from different jurisdictions.
with different approaches to administrative procedure.\textsuperscript{68} A growing literature focuses on examining and critiquing administrative procedures for global governance,\textsuperscript{69} but there is as yet no global standard for supranational administrative procedures.\textsuperscript{70}

Documents on very technical subjects may produce limited numbers of comments. For example, when the Basel Committee sought information and views on credit risk modelling it received twenty-two responses.\textsuperscript{71} Of these responses, nine were from individual banks or industry associations, five from academics or academic organizations and five from representatives of the consulting, accounting or risk management professions.\textsuperscript{72} This Summary of Responses does not name any of the respondents.\textsuperscript{73} In some cases, it may be difficult to discern from the standard-setter’s description of the results of consultations not only who commented on a publication or proposal but even how many people and firms commented.\textsuperscript{74} In other cases, the standard-setter may publish the text of comments received on its web pages.\textsuperscript{75}

The Basel Committee’s work is carried out by representatives of banking regulators and central banks from the G10 countries.\textsuperscript{76} IOSCO has a much larger,\textsuperscript{77} tripartite membership,

\textsuperscript{68} See id. (pointing out that a "congeries of different actors—international and domestic, public and private—interact in a kaleidoscope of different configurations, together forming a variegated 'global administrative space' that resembles nothing so much as a Jackson Pollock painting").


\textsuperscript{70} See id. ("[T]he past several decades have witnessed an explosive development of a great variety of international economic and social regulatory regimes.").


\textsuperscript{72} See id.

\textsuperscript{73} See id.

\textsuperscript{74} See, e.g., IOSCO TECHNICAL COMM., \textit{Principles on Outsourcing of Financial Services for Market Intermediaries, Notice of Final Report, Survey and Summary of Comments} (Feb. 2005), available at http://www.iosco.org/pubdocs/pdf/IOSCOPD186.pdf. Such an approach is consistent with the view that in the context of regulatory processes it is the ideas, rather than their level of support, which matter.


\textsuperscript{76} For background information on the Basel Committee, see http://www.bis.org/about/factbcbs.htm (last visited Oct. 18, 2005).

\textsuperscript{77} See, e.g., Philippe Richard, IOSCO Sec'y Gen., \textit{Report From the Secretary-General,}
including ordinary members, associate members, and affiliate members. IOSCO's ordinary members are securities regulators. Only ordinary members have the right to vote, although associate members participate in IOSCO's President's Committee and affiliate members which are SROs participate in IOSCO's SRO Consultative Committee. The associate members and affiliate members contribute through their membership fees to IOSCO's finances. IOSCO's affiliate members include financial exchanges, non-exchange SROs, and international organizations. IOSCO says that it "recognizes the importance of maintaining a close dialogue with the SROs and international organizations that make up its affiliate membership and of allowing them to make a constructive input in the work of the Organization.

The IAIS also has a large membership, including insurance supervisors and regulators from over one hundred and sixty jurisdictions where there is no governmental regulatory body, an SRO may be allowed to become an ordinary member of IOSCO. See IOSCO ANNUAL REPORT FOR 2004, supra note 77, at 24.

78. See id. at 23.


80. IOSCO ANNUAL REPORT FOR 2004, supra note 77, at 21. The SRO Consultative Committee works with IOSCO's Technical Committee. See id. ("The SRO Consultative Committee has designated contact persons with the Technical Committee Standing Committees and Project Teams and is therefore able to provide substantive input related to their regulatory initiatives.

in IOSCO ANNUAL REPORT FOR 2004, 16, 18 (2004), available at http://www.iosco.org/annual_report/ (last visited Oct. 24, 2005) (noting that IOSCO's membership currently totaled 174, and that the comprehensive extent of its membership clearly demonstrates "that it truly represents the international community of international securities regulators and that it is the international standard setter for securities marketers").

risdictions. The IAIS also has a special membership category for "observers," that includes private-sector entities. The IAIS seeks to involve observers in the work of its Technical Committee. IAIS observers generate significant amounts of revenue for IAIS, which may be important given that the organization has suffered from a mismatch between revenues in U.S. dollars and expenses in Swiss francs in recent years.

In contrast to the Basel Committee, which does not depend on the private sector for its financing, both IOSCO and the IAIS are partly dependent on financing from non-governmental entities which participate in their standard-setting processes. In the case of IOSCO, the non-governmental entities are SROs, so they perform combined functions of regulation and member interest representation. In the case of IAIS, the non-governmental members include insurance companies, accounting firms, and law firms. IOSCO's accounts do not identify the relative contributions of SRO and governmental members, but

83. See IAIS ANNUAL REPORT FOR 2003, supra note 80, at iv.
84. See id. (noting that "more than 70 organizations and individuals are observers" and that ":[t]hey represent professional associations, insurance and reinsurance companies, international financial institutions, consultants and other professionals").
85. See id. at 8 ("During the year the Technical Committee working parties have continued to receive substantial support from IAIS observers. They have been generous in providing input and comments on a range of issues when requested and respectful of supervisory concerns. Each working party has developed a unique relationship with the observer community that suits both its needs and operating style. This partnership has been productive and has served to improve the quality and relevance of the output.").
86. See id. at 16 (showing that in 2003, observer membership fees were US$355,000 and member fees were US$655,000); see also id. at 13.
88. See IOSCO ANNUAL REPORT FOR 2004, supra note 77, at 23, 36-43 (listing ordinary members which include non-governmental bodies); see also IAIS website, http://www.iaisweb.org (last visited Oct. 18, 2005) (listing IAIS member organizations).
89. See, e.g., IOSCO ANNUAL REPORT FOR 2004, supra note 77, at 15, 21, 23, 41-42.
90. See generally IAIS website, supra note 88.
IAIS's accounts show that it benefits financially from the participation of non-governmental entities in its membership.\footnote{See generally IAIS ANNUAL REPORT FOR 2003, supra note 80.} The International Financial Standards Board, which is a non-governmental entity rather than an inter-governmental or inter-regulatory entity, has been criticized on the basis that its reliance on private sector financial resources might create conflicts of interest.\footnote{See, e.g., McCreevy, supra note 13, at 5 (“The standard setters are currently sponsored by voluntary contributions from contributors ranging from central banks to listed companies, which raises potential issues of conflict of interest. I therefore welcome the Board of Trustees of the IASB’s intention to change this.”).}

Consultation procedures may be more or less formalized and/or theorized. Whereas the Basel Committee has not articulated in any formal way what principles it applies in the context of its consultations with interested parties,\footnote{See Basel Comm. on Banking Supervision, About Basel Committee, http://www.bis.org/bcb/aboutbcbs.htm (last visited Oct. 18, 2005) (stating broadly that the “Committee has always encouraged contacts and cooperation between its members and other banking supervisory authorities,” without specifying any specific procedure).} IOSCO published a consultation document about its consultation procedures in November 2004.\footnote{See IOSCO, IOSCO CONSULTATION POLICY AND PROCEDURES, DRAFT FOR PUBLIC CONSULTATION (Nov. 2004) [hereinafter IOSCO DRAFT CONSULTATION POLICY], available at http://iosco.org/library/pubdocs/pdf/IOSCOPD175.pdf.} IOSCO's document suggested that it was concerned with a broadly defined group of interests.\footnote{See id.} In describing its objectives in consulting, IOSCO said that it wanted:

To benefit from the expertise of market intermediaries, exchanges and other market operators, securities clearing and settlement system service providers, end-users and consumers, auditors and auditing companies, and other public authorities, international standard setters, international financial institutions, and regional development banks, when assessing and analyzing regulatory issues.\footnote{Id. at 2.}

IOSCO’s draft also described the advantages IOSCO saw in increasing the transparency of its operations as being “to enhance the perceived fairness and openness of IOSCO’s decision-making process and the visibility and acceptability of its results.”\footnote{Id.} IOSCO also suggested that it has an interest in ensuring...
consistent approaches to common concerns. Finally, the document suggested that IOSCO would usually publish comments in an anonymous format on its website. In February 2005, IOSCO published the full text of nine comments on this consultation document. Commenters asked for more information about IOSCO’s priorities and agenda, more time to react to IOSCO’s proposals, and opportunities to be involved in discussing ideas before a formal consultation. The International Bar Association argued that IOSCO should not publish comments anonymously:

[W]e submit that IOSCO should not permit any consultations to take place with comments which are anonymous to the public. We understand that internal regulatory deliberations must and should be confidential. Once any proposal is posted for consultation, however, all comments, both formal and informal, should be made in full transparency with attribution, and the extent to which IOSCO is meeting with or receiving information from interested companies, lobbyists or groups should be apparent to all. We therefore recommend that all submissions after the publication of the consultation should be public and easily accessible.

In April 2005, IOSCO published a report on its Consulta-

98. See id.
99. See id. at 4.
100. See IOSCO PUBLIC COMMENTS, supra note 29.
101. See, e.g., id. at 5-6, 8, 15 (Comments by the Assogestioni, European Fund and Asset Management Association (“FEFSI”), and International Banks and Securities Association (“IBSA”) on IOSCO’s Draft Consultation Policies and Procedure).
102. See, e.g., id. at 6, 8, 23-24 (Comments by the Assogestioni, FEFSI, and London Investment Banking Association (“LIBA”) on IOSCO’s Draft Consultation Policies and Procedure).
103. See, e.g., id. at 11. The International Council of Securities Associations comments on IOSCO’s Draft Consultation Policies and Procedure stated that:

The period prior to a formal consultation is a critical and often underappreciated stage in the consultation process. Therefore, we urge IOSCO to place greater stress on consulting with market participants and other informed parties prior to beginning work on a consultation document in order to determine the need for regulatory action and, if such a need exists, what action would be appropriate. Contacts with market participants and other informed parties during this preparatory phase would help focus the debate on the most important and material issues.

Id.
104. Id. at 18 (Comments of the International Bar Association on IOSCO’s Draft Consultation Policies and Procedure).
tion Policy and Procedure. Strikingly, while the November 2004 draft referred to IOSCO’s interest in benefiting from the expertise of a wide range of potential consultees, including consumers, the April 2005 Report refers merely to its objective of benefiting from “the expertise of the international financial community.” Although the Report refers more than once to the “public,” the word “consumer” appears nowhere. The April Report also suggests that IOSCO will consider engaging in “pre-consultations,” and that comments will be published unless “anonymity is specifically required.”

The EU adopts binding rules of financial regulation as directives. Under the Lamfalussy approach, EU financial regulation directives should be framework measures, and the detailed implementing rules should be adopted through a comitology procedure involving CESR. The EU’s legislative process takes account of the views of civil society through the participation of the Economic and Social Committee.

106. See IOSCO DRAFT CONSULTATION POLICY, supra note 94, at 2.
107. EXECUTIVE COMMITTEE REPORT, supra note 105, at 2.
108. See id.
109. Id. at 4.
110. Id.
111. See About EU Law, Process and Players, ¶ 1.3.3, http://europa.eu.int/eur-lex/lex/en/droit_communautaire/droit_communautaire.htm (last visited Nov. 4, 2005) (“Adopted by the Council in conjunction with the European Parliament or by the Commission alone, a directive is addressed to the Member States. Its main purpose is to align national legislation. A directive is binding on the Member States as to the result to be achieved but leaves them the choice of the form and method they adopt to realise the Community objectives within the framework of their internal legal order.”); see also Consolidated Version of the Treaty Establishing the European Community art. 294, O.J. C. 325/1 (2002), at 132 (“A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.”).
112. See CHARLIE McCREEVY, EUROPEAN COMM’R FOR INTERNAL MKT. & SERVS., BETTER REGULATION AND THE FINANCIAL SERVICES SECTOR 4 (June 21, 2005), available at http://europa.eu.int/comm/commission_barroso/mccreevy/docs/speeches/2005-06-21/regulation_en.pdf (“A clear legal framework is necessary for the efficient operation of both financial market participants and their regulators and supervisors... full cooperation among the supervisory committees (CEBS [the Committee of European Banking Supervisors], CEIOPS [the Committee of European Insurance and Occupational Pensions Supervisors] and CESR [the Committee of European Securities Regulators]) is also needed to ensure consistent and coherent application of European rules.”) (alteration added).
113. See The Role of EU Consultative Bodies, Economic and Social Committee,
EU Commission has been making consistent efforts to ensure that the views of businesses in particular are taken into account in the regulatory process by setting up a European Business Test Panel.\textsuperscript{114}

In theory, the EU directives should set the general framework within which the EU’s detailed implementing rules should operate.\textsuperscript{115} The EU’s legislative process for producing the framework directives is often a lengthy one involving many opportunities for interested parties to express their views on proposals. For example, the Markets in Financial Instruments Directive (“MiFID”) adopted in 2004\textsuperscript{116} replaces the Investment Services Directive of 1993.\textsuperscript{117} In 2000, the Commission published a Communication on revising the Investment Services Directive in which it sought comments on a number of issues.\textsuperscript{118} Forty-two respondents, including regulators and market participants, commented on this Communication.\textsuperscript{119} The Commission followed up with a larger consultation exercise, including an open hearing.\textsuperscript{120} This second consultation produced sixty-nine comments almost entirely from market participants and regulators, with one comment from the “shareholder/investor” constituency.\textsuperscript{121} The Commission’s descriptions of the comments do

\begin{itemize}
\item \textsuperscript{114} See supra note 55.
\item \textsuperscript{118} See European Commission, \textit{Evaluation of the European Business Test Panel} (2002), \textit{available at} http://europa.eu.int/comm/dgs/internal_market/evaluation/2002-ebtp_en.htm (last visited Oct. 18, 2005); \textit{see also} McCreevy, supra note 112, at 3 (“We have also developed interactive tools such as the European Business Test Panel. It allows us to consult directly more than 3,000 businesses across the EU.”).
\item \textsuperscript{119} See supra note 55.
\end{itemize}
not identify commentators by name and do not generally identify particular comments with particular categories of respondent.122 A second consultation took place in 2002,123 and a proposed directive was published in November 2002.124 Soon after the MiFID was adopted in 2004, the Commission asked the Committee of European Securities Regulators ("CESR") to provide advice on possible implementing measures.125 The Commission does not necessarily follow all of CESR’s recommendations in making proposals for measures to implement the level one directives.126

Unlike the Basel Committee, IOSCO and the IAIS, the EU’s CESR127 operates in the context of a legal framework where participants have developed expectations about consultation.128

122. See id.

123. By the time the second consultation was announced the Commission said it had received 77 responses to the July 2001 consultation. See DG INTERNAL Mkt. & SERVS., EUROPEAN COMMISSION, REVISION OF INVESTMENT SERVICES DIRECTIVE, SECOND CONSULTATION, OVERVIEW PAPER, at 2, available at http://europa.eu.int/comm/internal_market/securities/docs/isd/2nd-overview-paper_en.pdf.


127. CESR, the Committee of European Securities Regulators, was established by Commission Decision No. 2001/527 of June 6, 2001 Establishing the Committee of European Securities Regulators. See O.J. L 191/43 (2001). CESR is intended to "serve as an independent body for reflection, debate and advice for the Commission in the securities field." Id. at Recital No. 8. It also has a role in encouraging implementation of EU securities measures. See id. at Recital No. 9. CESR is composed of representatives of securities regulators from the Member States. Id. at Recital No. 6.

128. See, e.g., Towards a Reinforced Culture of Consultation and Dialogue, supra note 47, at 5:

By fulfilling its duty to consult, the Commission ensures that its proposals are technically viable, practically workable and based on a bottom-up approach. In other words, good consultation serves a dual purpose by helping to improve the quality of the policy outcome and at the same time enhancing the involve-
CESR's Charter states that:

The Committee will use the appropriate processes to consult (both ex-ante and ex-post) market participants, consumers and end users which may include inter alia: concept releases, consultative papers, public hearings and roundtables, written and Internet consultations, public disclosure and summary of comments, national and/or European focused consultations. The Committee will make a public statement of its consultation practices.\textsuperscript{129}

The Charter also states that "[f]or the purpose of facilitating the dialogue with market participants, consumers and other end users of financial services, the Committee will establish working consultative groups, whenever appropriate."\textsuperscript{130} Rather than merely inviting comments on its proposals, CESR involves market participants in its formal processes through a committee of market representatives.\textsuperscript{131} In addition, CESR has established a number of Expert Groups on the various issues it is responsible for.\textsuperscript{132} There are three Expert Groups for the MiFID, which focus on market transparency, intermediaries and co-operation and enforcement.\textsuperscript{133} CESR has not as yet established a committee of consumer representatives, although in May 2005 CESR held a "Consumer Day" on the MiFID and acknowledged the need to interact with consumer groups in the future:

The importance CESR attaches to receiving comments on its advice from representatives of retail clients and consumers was stressed and CESR expressed its concern that the responses received to previous consultations carried out on the consultation process of interested parties and the public at large. A further advantage is that transparent and coherent consultation processes run by the Commission not only allow the general public to be more involved, they also give the legislature greater scope for scrutinizing the Commission’s activities (e.g., by making available documents summarizing the outcome of the consultation process).

\textit{Id.}

\textsuperscript{129} CHARTER OF THE COMM. OF EUROPEAN SEC. REGULATORS, art. 5.10, available at \url{http://www.cmvm.pt/cooperacao_internacional/docs_cesr/cartaRESCO.pdf}.

\textsuperscript{130} \textit{Id.} art. 5.11.

\textsuperscript{131} CESR has a Market Participants Consultative Panel. \textit{See} CESR, How it Works, \url{www.cesr-eu.org/contenu_howitworks.php}. Similarly, the Committee of European Banking Supervisors ("CEBS") has established a Consultative Panel of representatives of market participants to act as a sounding board. \textit{See} CEBS, Consultative Panel, \url{http://www.c-ebbs.org/consultativepanel.htm} (last visited Oct. 18, 2005).

\textsuperscript{132} \textit{See generally} CESR, How it Works, supra note 131.

\textsuperscript{133} \textit{See} CESR, Expert Groups, Markets in Financial Instruments Directive [MiFID], \url{http://www.cesr-eu.org} (last visited Oct. 18, 2005).
MiFID, had not reflected sufficiently this set of stakeholders. CESR made it known that it intended to organise similar meetings in the future to continue and develop this dialogue further.\(^{134}\)

The consumer groups that attended this meeting pointed out that they did not necessarily have the resources in terms of knowledge and staff to be able to prepare “considered responses” to consultations.\(^{135}\) They also suggested that it would be helpful if consultation papers were more “reader-friendly” and if they were translated from English into the different national languages.\(^{136}\) English is the dominant language in the international financial markets,\(^{137}\) but financial regulation does not only affect professional market participants. Publishing consultation papers only in English tends to favor people in the United Kingdom, and members of the elite who either read English or can afford to pay for translators.\(^{138}\) That CESR operates in English is particularly unusual in the context of the EU, which from the very early days was committed to the principle that citizens should be able to communicate with the institutions in their own language.\(^{139}\)


\(^{135}\) Id.

\(^{136}\) See id.


\(^{138}\) The EU currently comprises twenty-five Member States with over twenty official languages. The United Kingdom is the only country where English is the official language. See Europa, Languages of the European Union, http://europa.eu.int/comm/education/policies/lang/languages/index_en.html (last visited Nov. 21, 2005) (note that Irish is scheduled to become the twenty-first official language of the European Union starting January 1, 2007).

\(^{139}\) See Directorate-Gen’l for Translation of the European Commission, Translating for a Multi-Lingual Community 3 (Mar. 2003), available at http://www.europa.eu.int/comm/dgs/translation/bookshelf/brochure_en.pdf (“The European Union institutions have to be as accessible and open as possible to the general public as well as to the government departments and official and unofficial interest groups of all kinds. The Commission sees it as its duty to foster a democratic entity in which individual, local, regional and national characteristics are respected and safeguarded.”). See also id. (noting that, under Regulation No. 1, all EU residents have the right to communicate with the institutions in their own language). This language policy has been sub-
CESR publishes comments on its proposals on its website. Financial firms and their trade associations are active commenters on CESR’s proposals. Trade associations may file joint comments on CESR proposals, and they may refer to each other’s comments in their own responses. Consumers and consumer organizations do not have the resources of time or expertise to participate as effectively in consultations. Europeans have expressed concern about a lack of transparency in the EU’s governance, and Siim Kallas, the Commissioner for Administrative Affairs, Audit and Anti-Fraud announced an EU Transparency Initiative in March 2005, although the promised White Paper has not yet been published.

The financial firms and trade associations that comment on CESR’s proposals are not limited to firms and trade associations from the EU Member States. Rather, multinational firms and trade associations that represent such firms also comment on CESR’s proposals reflecting the international characteristics of financial activity. For example, when CESR issued its Statement on Consultation Practices in 2001, the Securities Industry Association commented that it was “supportive of CESR’s project to stress as a result of enlargement. See id. (“In the interests of cost-effectiveness, the Commission conducts its internal business in English, French and German, going fully multilingual only when it communicates with the other EU institutions, the Member States and the public.”).

141. See id.
143. See, e.g., id. at 3 (“We have seen, and support, ISDA’s response to the consultation.”).
144. See, e.g., CESR, MiFID CONSUMER DAY, supra note 134, at 1.
posed ‘Consultation Practices’ as an excellent first step towards implementing a fully effective consultation process . . . such a process best serves all market participants, and is the foundation for deep, liquid and efficient markets.” 148 The SIA urged CESR to consult not just at the EU level but also at the international level. 149 Financial trade associations based in the United States seek to inform their members about developments outside the country. 150 The Bond Market Association’s News Bulletins regularly inform Association members about regulatory initiatives in the EU as well as in the United States. 151 In April 2005, the Bond Market Association, the IPMA and the ISMA announced that they would integrate their European activities in the International Capital Market Association (“ICMA”) in order “to ensure consistent and coordinated global representation of the capital markets and to fully leverage the respective associations’ resources and expertise in support of their members.” 152

The increasing amount of international harmonization of standards for the financial markets is in part a response to concerns about how divergent approaches to regulation may interfere with cross-border financial activity. However, harmonization occurs in different fora, in regional organizations and in international organizations. 153 International banking organizations need to focus not only on the Basel committee’s work on capital adequacy, but on the EU’s implementation of the Basel standards—in addition to domestic implementation in the different jurisdictions where they are licensed. Some lobbying energy is focused on persuading harmonizers to use the same ap-

148. Id. at 1.
149. See id. at 3.
151. See id.
approaches to particular issues that have been adopted elsewhere.\textsuperscript{154} For example, in commenting on CESR proposals, the SIA has urged CESR to copy the approach of U.S. regulators.\textsuperscript{155}

In the context of the EU, some commentators have suggested that market participants like a situation where rule-making is centralized so that they can focus their lobbying efforts.\textsuperscript{156} Thus, financial firms might prefer not to have to deal with CESR as well as with the Commission.

Transnational standard-setting creates needs for new trade associations, or at least new jobs in existing trade associations. Trade associations need to coordinate their actions with trade associations established in other jurisdictions for maximum impact.\textsuperscript{157} Large multinational, multi-function financial firms will belong to a number of different trade associations, and may well make their own separate submissions as part of consultation ex-

\begin{itemize}
  \item \textsuperscript{155} See id. The SIA commented that:
    In marked contrast to reactions of the banking community in Europe to the ESCB-CESR Standards, U.S. banking institutions were broadly supportive of the Interagency White Paper recommendations. The reasons for this are clear. In their approach, U.S. regulators did not attempt to impose additional regulations on firms considered to play significant roles in critical markets. Rather, they tried to ensure the promulgation of best practices, used market-led initiatives to ensure a robust communications infrastructure, and fostered competition as a means to reduce concentration of risks. We believe a combination of these approaches in Europe would not only fulfill the objective of risk reduction, but also benefit market participants by avoiding the cost of excessive regulation, preserving choice, and encouraging innovation. \textit{Id.}
  \item \textsuperscript{156} See, e.g., CTR. FOR EUROPEAN POLICY STUDIES [CEPS], PROSPECTUS FOR CEPS TASK FORCE ON EU FINANCIAL REGULATION AND SUPERVISION BEYOND 2005, AN AGENDA FOR THE NEW COMMISSION 2 (2004) [hereinafter CEPS PROSPECTUS], \textit{available at} http://ceps01.link.be/files/ProspectusBeyond2005.pdf ("[W]hile market practitioners often preach the virtues of delegation, most appear more comfortable of their capacity to ensure suitable outcomes if legislative power is kept at level 1. In short, while there is a general agreement that delegation is important, all have significant interests in keeping detailed rule-making power at the centre.").
  \item \textsuperscript{157} See, e.g., Helen Banks, \textit{It's Only Just Begun . . .}, APCIMS REV., Spring 2005, at 13, \textit{available at} http://www.apcims.org/public/publications/qreview/Spring%202005.pdf (noting that the Association of Private Client Investment Managers and Stockbrokers ("APCIMS") "continues to work in cooperation with trade associations representing investment firms within ten European countries, to try and improve the position for this sector").
\end{itemize}
ercises. Smaller firms with fewer human and financial capital resources have a quieter voice in the consultation process. But consumer groups are noticeably absent from many of the discussions about financial regulation, distanced from the discussions by lack of resources and by lack of “expertise.”

The practice of consultation and response in the context of supranational financial standard-setting and rule-making contrasts dramatically with ideals of bottom-up governance. Consultation processes that tend to exclude smaller firms and consumers are less legitimate than those that are more inclusive. As well as being less legitimate, such exclusive processes may produce different results than more inclusive processes. Financial firms and their trade associations tend to argue against rules and for non-legislative measures, they will argue for certainty for themselves (sometimes this will mean less certainty for others), and they will argue about the costs of regulation and the benefits of deregulation.


159. See, e.g., CEPS PROSPECTUS, supra note 156, at 3 (“The extended comitology process and the accompanying consultations place much demand on both market participants and member state authorities in terms of manpower and time. As this is costly, are larger institutions better placed to exercise influence? How can the influence of smaller institutions be ensured?”).

160. See id. (“Some interests are better organised than others. It is often noted that consumer associations are less present in the consultations and regulatory game having surrounded many of the FSAP-measures. If correct, how can a consumer say be stimulated?”).

161. See id.

162. See id.

163. See, e.g., ISMA ET AL., PUBLIC COMMENTS ON IOSCO’S CONSULTATION REPORT ON CODE OF CONDUCT FUNDAMENTALS FOR CREDIT RATING AGENCIES 2 (Nov. 2004), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD177_25.pdf (“One of the foundation stones of our discussions with legislators and regulators and in our responses to various legislative and regulatory initiatives in recent years has been our strong advocacy of the use of non-legislative measures unless there is evidence of a market failure which industry participants are unable or unwilling to correct.”).

164. See, e.g., ISMA ET AL., supra note 142, at 4 (“It is important to recognise that supervisors must be accountable to national authorities who work within the international legal framework that is set up in a process of full democratic accountability. Equally it is essential to recognise that it would not be practical or desirable to submit every individual supervisory action to democratic scrutiny and legislative control. This would also not be consistent with any drive towards deregulation.”).
B. Domestic Rule-Making

Domestic financial regulators sit, sometimes uncomfortably, between the supranational bodies that produce international standards and regulated firms.\(^{165}\) This may lead them to publish documents explaining their role in these international networks.\(^{166}\) When domestic regulators work together in networks, such as the Basel Committee, they may seek comments at home on proposals for harmonization as they would on purely domestic initiatives.\(^{167}\) Thus, domestic consultation procedures, involving market participants may influence supranational regulatory initiatives.\(^{168}\) At other times, domestic regulators seek comments on their proposed implementations of supranational harmonized rules.\(^{169}\) But, as the International Bar Association has pointed out, supranational standards may not benefit from as much discussion and consultation at the domestic level as proposed standards which originate domestically:

It seems increasingly clear that the essential discussion of standards will take place at the IOSCO level rather than later at the home country level and that home country regulators will increasingly take the position that the standards adopted by IOSCO foreclose further discussion in the home country of the topics covered by these standards. This process is legitimate in democratic rulemaking when, and only when, those same principles have been fully vetted in a public manner at


\(^{168}\) Participation in supranational processes may also affect domestic regulators’ actions at home. Cf. Stephen Shaffer, Reconciling Trade and Regulatory Goals: The Prospects and Limits of New Approaches to Transatlantic Governance Through Mutual Recognition and Safe Harbor Agreements, 9 COLUM. J. EUR. L. 29, 71 (2002) (“A central normative goal of transgovernmental regulatory cooperative efforts is to create frameworks that conduce national regulators to reflexively take into account the impact of their actions on affected, but otherwise unrepresented, foreign constituents, while remaining deferential to distinct national values and priorities.”).

\(^{169}\) See generally, e.g., FSA, The Listing Review, supra note 56.
Domestic consultations may generate responses from a wider range of participants than consultations by supranational standard-setters.\textsuperscript{171} In part, this is because consultation procedures at the domestic level may be more inclusive than consultation procedures at the supranational level.\textsuperscript{172} The U.K.'s Financial Services Authority has a Consumer Panel\textsuperscript{173} and a Small Business Panel as well as a Practitioner Panel.\textsuperscript{174} These structures contrast with CESR's emphasis on ensuring only the participation of market participants, and not the participation of consumers of financial services, in its processes.\textsuperscript{175} The consumers' interests are not ignored in the context of CESR's actions.\textsuperscript{176} For example, the Financial Services Authority says that it takes account of the interests of consumers, particularly when it implements international standards.\textsuperscript{177} If, however, CESR itself does not take active steps to encourage consumer participation, the consumers' voices are muted compared to business voices and actions by domestic regulators in the process of implementing supranational rules may not be adequate amplifiers of the silenced consumer voices.

Transnational financial activity increases the incentives for foreign firms to try to influence domestic rulemaking through campaign contributions\textsuperscript{178} and commenting on proposed do-

\textsuperscript{170} IOSCO Public Comments, \textit{supra} note 29, at 18 (Comments of the International Bar Association).

\textsuperscript{171} Consumer groups could perhaps be more effective lobbyists in the context of domestic regulatory initiatives than they are. See Julie L. Williams, Acting Comptroller of the Currency, Remarks Before Women in Housing and Finance and The Exchequer Club, at 7 (Jan. 12, 2005), \textit{available at} http://www.occ.treas.gov/ftp/release/2005-1a.pdf ("[W]hat seems to be absent in the dialogue with consumer organizations is a discussion of the interplay of how to better inform consumers by disclosing better, but not necessarily more, information, and the impact of regulatory disclosure burdens on banking institutions. And why aren't consumer organizations berating us to do consumer testing to find out what consumers really want and think is important?").

\textsuperscript{172} See id.


\textsuperscript{176} See, e.g., FSA, \textit{supra} note 166, at 11.

\textsuperscript{177} See id.

\textsuperscript{178} A number of political action committees ("PACs") operating in the United
For example, in 2002, the U.S. Congress enacted the Sarbanes-Oxley Act, which applies to foreign firms whose securities are traded in the U.S. markets. The statute would have required some foreign companies to have audit committees composed of independent directors, conflicting with requirements in their home jurisdictions. After receiving more than 185 comments on the audit committee independence proposal, the SEC adopted final rules which sought to accommodate the difficulties of foreign issuers. The SEC has also adopted regulations specifying that the Sarbanes-Oxley Act's prohibition on loans to directors, which under the provisions of the statute were specified not to apply to insured depositary institutions in the United States (a term which could not apply to a foreign bank), would not apply to foreign banks. The SEC has shown itself to be much more willing to work with regulators from other jurisdictions than the U.S. Congress, and than the SEC was itself only a few years earlier. As commentators noticed that regulations make it easier for U.S. issuers than for foreign issuers to avoid the application of Sarbanes-Oxley regulations by deregistering their securities, SEC officials suggested that the SEC would make it easier for foreign issuers to deregister their securities in the United States.


179. See, e.g., Standards Relating to Listed Company Audit Committees, 68 Fed. Reg. 18,788, 18,802 (Apr. 16, 2003) [hereinafter SEC Committee Standards] (noting that several foreign issuers had expressed concerns about the possible application of Exchange Act section 10A(m)).


181. See SEC Committee Standards, supra note 179, at 18,797.

182. See generally id. The EU-U.S. financial markets dialogue is an attempt to resolve issues like this for the future.


185. See, e.g., SEC Staff Likely to Recommend Rule To Ease Deregistration for Foreign Firms, 36 SEC REc. & L. Rep. (BNA) 2050 (Nov. 22, 2004). U.S. issuers can deregister if there
The enactment of the Sarbanes-Oxley Act and its aftermath illustrate that domestic legislatures may be insensitive to the impact of domestic rules on multinational businesses. Whereas the U.S. Congress enacted a statute that imposed significant burdens on foreign firms, the SEC has been responsive when these firms have raised their concerns. The Transatlantic Business Dialogue has suggested that legislators from the U.S. Congress and the European Parliament should develop a dialogue to avoid such problems for the future.  

Even where domestic rule-making proposals seem to affect domestic rather than cross-border interests, firms and their trade associations may argue that the proposals threaten domestic financial markets, with the explicit or implicit suggestion that they might lose business overseas.  

II. CONTRACTING

Transnational financial activity is accomplished through contracts. Contracts are the core mechanism whereby the market regulates itself. The relationship between contracts and

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187. Cf. Letter from the Bond Mkt. Assoc. to Eric Solomon, Deputy Ass't for Regulatory Affairs, U.S. Dept. of the Treasury, and Donald L. Colb, Chief Counsel, IRS, Circular 230—Impact of Section 10.35 on the U.S. Capital Markets (June 17, 2005), available at http://www.bondmarkets.com/assets/files/Circular_230_Comment_Letter.pdf. The Bond Market Association commented that: The U.S. capital markets are recognized as the most efficient and liquid capital markets in the world. These attributes derive, in part, from the established practices and expectations of the participants in these markets and also from the ability of federal securities regulators to adapt the regulatory structure as needed to keep pace with the evolution of capital markets practices. Issuers and investors view our capital markets as appropriately balancing the competing interests of providing ready access to the markets while at the same time affording investors with appropriate protections for their investments. Id.

Id. Argue about the impact of regulation on competition are a feature of lobbying in the EU. See, e.g., APCIMS, "Group of Eleven" Seek Urgent Changes to New Capital Requirements Directive (Apr. 18, 2005), available at http://www.apcims.org/public/news/releases/2005/Changes%20to%20New%20Capital%20Requirements.asp (last visited Oct. 18, 2005) (quoting Angela Knight, APCIMS' Chief Executive, as saying: "When eleven European trade associations work together to lobby the EU Commission, you know something is fundamentally wrong!").

188. In this section of the Article I contrast "regulation" and "contract," but I also want to suggest that contracts control behavior in ways that are similar to regulation. Cf.
(public) financial regulation in the international financial markets is complex and multi-faceted. Contracts involve risks that regulators need to address as part of evaluating risks that may damage financial stability. At the same time contracts may be used to limit or shift risks away from financial institutions. Regulations may specify the contents of contracts or may preclude the inclusion of certain provisions in contracts. This section addresses four themes in this complex relationship between regulation and contracts: Contracts are preferable to regulation; contracts function as regulation; contracts constrain regulation; and regulation constrains contracts.

A. Contracts Are Preferable To Regulation

Consistent with preferences for no regulation or for deregulation, financial market participants will often argue that contracts can be used more effectively or as effectively to achieve objectives for which regulatory solutions are proposed. The


[N]o market is ever truly unregulated. The self-interest of market participants generates private market regulation. Thus, the real question is not whether a market should be regulated. Rather, the real question is whether government intervention strengthens or weakens private regulation. If incentives for private market regulation are weak or if market participants lack the capabilities to pursue their interests effectively, then the introduction of government regulation may improve regulation. But if private market regulation is effective, then government regulation is at best unnecessary.

Id.


190. Cf. OECD, OECD GUIDELINES FOR INSURERS' GOVERNANCE, supra note 39, at 14 ("[R]egulatory authorities must be cautious not to impose highly restrictive rules and wide-ranging prohibitions that severely restrict the discretionary powers of corporate executives.").

191. This is only one of the preferences that financial firms articulate, and, in fact, rational firms would tend to prefer deregulation where rules interfere with their business and regulation where rules would interfere with the business of their actual or potential competitors. Cf. Stigler, supra note 15, at 5 ("We propose the general hypothesis: every industry or occupation that has enough political power to utilize the state will seek to control entry."). A firm's or trade group's preference for competition-reducing rules may not be articulated as such but rather as a preference for consumer protection or market integrity.

192. In some domestic jurisdictions, such as the United States, bankruptcy solu-
Euromarkets are often described as markets which came into existence offshore, avoiding the impact of regulations which applied to domestic markets.\textsuperscript{193} In the early days, relationships in the Euromarkets were governed by contract rather than by regulation.\textsuperscript{194} Not only did market participants in the Euromarkets avoid domestic regulatory authorities, they also avoided courts.\textsuperscript{195} Increasingly over time, participants in the Euromarkets have needed to worry about the impact—and potential impact—of regulation on their activities.\textsuperscript{196} Euromarket participants also now take their disputes to court.\textsuperscript{197} A market that seemed twenty-five years ago to be essentially regulated by non-legal norms is increasingly regulated through legal rules. Still, Euromarket participants work to carve out spaces for contract rather than regulation.

Market participants have argued for contracts rather than regulation in the context of sovereign debt. When officials at the IMF proposed to resolve problems associated with sovereign debtors defaulting on their debt through the introduction of a supranational equivalent to domestic bankruptcy proceedings,\textsuperscript{198} many commentators and market participants argued that a

tions are often negotiated solutions ("pre-packaged bankruptcies"). See, e.g., Gordon Bermant & Ed Flynn, Bankruptcy by the Numbers: Outcomes of Chapter 11 Cases: U.S. Trustee Database Sheds New Light on Old Questions, Am. Bankr. Inst. J., Feb. 1998, at 8, 32 n.8 (noting the prevalence of pre-negotiated, pre-packaged bankruptcies in Delaware). A sovereign bankruptcy regime need not, therefore, be a "regulatory" regime rather than a contractual regime. Opposition to the IMF SDRM proposals may suggest more about market participants' nervousness about the IMF's likely approach to a sovereign bankruptcy regime than about the idea of a sovereign bankruptcy regime as such.

193. See, e.g., Peter Krijgsman, A Brief History: IPMA's Role in Harmonising International Capital Markets 1984–1994 (1994), available at http://www.ipma.org.uk/pdfs/History\%20of\%20IPMA.PDF ("Originating as an offshore market, and not subject to the exclusive regulation of one government or group of governments, Eurosecurities initially benefited from the exploitation of inefficiencies in individual domestic markets.").

194. See id.

195. See id.


tractual solution would be preferable to this type of regulatory solution. Commentators argued that collective action clauses in bond documentation could solve the problem of holdout creditors in sovereign debt issues where the debtor is unable to meet all of its commitments.  

Collective action clauses bind creditors to a restructuring agreed to by a specified percentage of creditors. Without such clauses, holdout creditors may refuse to accept the terms of a restructuring and demand payment in full of money owing to them. Although bonds governed by New York law had not traditionally contained collective action clauses, more recent bond documentation for bonds issued by sovereigns subject to New York law has tended to include collective action clauses. However, although collective action


The view of the Working Group is that this clause is perhaps the most critical component of the package that is being proposed, because it provides flexibility in reaching agreement on the terms of a restructuring that debtors and creditors find to be in their collective interest. At the same time, use of this clause could ensure that the rights of the supermajority are respected and prevent a small minority of dissident creditors from pursuing disruptive litigation.

REPORT OF THE G-10 WORKING GROUP, supra note 199, at 3.

201. Vulture funds may also buy distressed debt with a view to pursuing such claims. See, e.g., Elliott Assocs. v. Banco De La Nacion, 194 F.3d 363, 372 (2d Cir. 1999) (interpreting New York law to hold that "the acquisition of a debt with intent to bring suit against the debtor is not a violation . . . where . . . the primary purpose of the suit is the collection of the debt acquired"); Elliott Assocs. v. Republic of Panama, 975 F. Supp. 332, 340 (S.D.N.Y. 1997) ("Although one could reasonably quarrel with the seamliness of . . . such 'vulture fund' tactics as investing in distressed companies or loans, . . . the purchase of a loan in the circumstances of this case surely does not rise to the level of criminal conduct.").

202. See, e.g., John Drage & Catherine Hovaguimian, Collective Action Clauses (CACs): An Analysis of Provisions Included in Recent Sovereign Bond Issues (Summary), FIN. STABILITY REV., Dec. 2004, 105, 105 ("While CACs have been common in several jurisdictions where sovereign bonds are issued (England, Luxembourg and Japan), they were uncommon in sovereign bonds issued under New York law"), available at http://www.bankofengland.co.uk/publications/fsr/2004/fsr17art7.pdf.

203. See, e.g., id. ("[T]he majority of foreign currency sovereign bonds issued in New York . . . now contain CACs").
clauses now seem to be standard in sovereign bond issues, bondholder voting thresholds vary.\textsuperscript{204}

As part of the strategy of arguing against the Sovereign Debt Restructuring Mechanism ("SDRM") and for collective action clauses, a group of financial trade associations, which has been called the "gang of six,"\textsuperscript{205} worked together to develop "a market-oriented process toward sovereign debt restructuring based on contractual arrangements."\textsuperscript{206} A participant in this process commented on "the breadth of the private sector groups that have come together to form this consensus."\textsuperscript{207} The gang of six developed standard form collective action clauses for inclusion in sovereign bond documentation.\textsuperscript{208}

A contractual solution to the problem of holdout creditors has attractive features: bondholders have notice when they invest that they are buying investments subject to rules which assume collective action in response to issuers' attempts to reschedule debt, and they are, as a result, bound by these arrangements. Thus, collective action clauses can help to ensure that no holders of a particular issue of bonds are treated better than any other holders of that issue. However, contractual ar-


\textsuperscript{205} See ROBERT GRAY, CHAIRMAN INT'L PRIMARY Mkt. Ass’n, COLLECTIVE ACTION CLAUSES: THE WAY FORWARD 2-3 (Feb. 2004), available at http://www.law.georgetown.edu/international/documents/Gray_000.pdf ("The International Primary Market Association (IPMA) together with five other trade associations (the "gang of six") took the lead in developing marketable CAGs suitable for inclusion in bond contracts governed by both New York and English law."). The "gang of six" was the Bond Market Association, the Emerging Markets Creditors Association, EMTA, the International Primary Market Association, the Institute of International Finance and the Securities Industry Association.


\textsuperscript{207} Id. The press release also states that "[o]ther private sector groups such as the EFFAS-European Bond Commission have also expressed support for the private sector principles and fully endorse this press release." Id.

arrangements typically bind only parties to the contracts.\textsuperscript{209} Thus, collective action clauses in the documentation for individual bond issues cannot produce a situation in which all creditors of a particular issuer receive equal treatment.\textsuperscript{210} Moreover, just as all contracts operate in a legal context that affects their viability, collective action clauses operate in the shadow of the IMF’s actions.\textsuperscript{211}

Although contracts do not bind non-parties, they can create positive or negative externalities for such parties.\textsuperscript{212} A contract between a trade association and its members may or may not mandate high standards of behavior that will benefit the members’ customers. The same contracts may harm potential competitors who are excluded from membership.\textsuperscript{213}

These are some of the reasons for subjecting SROs to statutory controls. But some commentators have pointed out that

\begin{itemize}
    \item \textsuperscript{209} See e.g., REPORT OF THE G-10 WORKING GROUP, \textit{supra} note 199, at 5-6.
    \item \textsuperscript{210} See, e.g., Krueger, \textit{supra} note 200 (“[E]ach bond issue would constitute a separate class and CACs would thus not solve intercreditor equity concerns and collective action problems across bond issues or between bonds and other creditors (most importantly banks).”). A report by the G-10 Working group also states that:
        \begin{quote}
        The Working Group believes that “aggregation” across a range of different types of creditors for voting purposes under the majority amendment clause, while desirable, is not practicable within a contractually based mechanism. However, it would appear to be legally and contractually possible to have debt instruments issued pursuant to a single master agreement such as a medium-term note programme providing for blended voting under certain circumstances. This approach has a great deal of potential, especially within the context of bonds issued under the laws of a single jurisdiction, and merits further exploration, as medium-term note programmes are increasingly used by emerging market borrowers. It is noted, however, that the Working Group has not focused on the technicalities of this approach in any detail.
        \end{quote}
    \item \textsuperscript{212} See, e.g., Stewart E. Sterk, \textit{Freedom from Freedom of Contract: The Enduring Value of Servitude Restrictions}, 70 IOWA L. REV. 615, 617 (1985) (arguing that contracts creating servitudes may create externalities that affect third parties).
    \item \textsuperscript{213} See, e.g., COMMODITIES FUTURES TRADING COMM’N, TECHNOLOGY ADVISORY COMM., MKT. ACCESS SUBCOMM., INTERIM REPORT, BEST PRACTICES FOR ORGANIZED ELECTRONIC MARKETS 5 (Nov. 27, 2001), available at http://www.cftc.gov/files/ac/acinterim-marketaccessreport.pdf (“The continued application of private sector rules, structures and processing conventions that were developed and presumably justified in an environment where market access was not global in scope and achievable at declining costs, may serve to perpetuate privileged market access by market participants or classes of market participants.”).
\end{itemize}
contracts operate across geographic boundaries—and thus jurisdictional boundaries—in ways that regulation does not.\footnote{214} The IOSCO SRO Consultative Committee has argued that self-regulation is useful because it can transcend national boundaries in ways that law and administrative rules cannot.\footnote{215} In 2000, Robert Glauber of the National Association of Securities Dealers ("NASD") announced a "new strategic initiative . . . to offer . . . regulatory services to other exchanges and regulators, again both here in the U.S. and abroad."\footnote{216} Ultimately, contracts depend on the possibility of enforcement through State processes,\footnote{217} but through contracts, markets may harmonize faster, and more effectively, than regulation.

Self-regulation through contract may not be as effective in practice as the IOSCO SRO Consultative Committee and NASD claim. Despite globalization, States still have at their disposal resources that they can invoke to impede the effectiveness of rules developed within epistemic communities without the involvement of state authorities.\footnote{218} Scandals may prompt legislatures to enact new tough rules.\footnote{219} Self-regulatory rules may be invalidated under competition laws.\footnote{220} The global rules, which as a

\footnote{214. See, e.g., Norman S. Poser, The Stock Exchanges of the United States and Europe: Automation, Globalization and Consolidation, 22 U. PA. J. INT’L ECON. L. 497, 538 (2001) ("These are not rules promulgated by a government agency, but by contractual arrangements among the participants. This suggests that self-regulation has the ability to finesse the problems of national sovereignty and differing legal systems that stand in the way of developing and enforcing common governmental regulatory standards.").}

\footnote{215. See generally Model for Effective Regulation, supra note 6.}


\footnote{218. See, e.g., Concept Release Concerning Self-Regulation, supra note 8 (describing the regulatory context within which SROs operate).}

\footnote{219. See, e.g., Roberta S. Karmel, Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance, 30 DEL. J. CORP. L. 79, 80 (2005) ("Congress has . . . reacted to scandals by giving the SEC greater power.").}

practical matter have some effect across national borders, are those which either do not, or do not seem to, involve public interest concerns, or which are produced in a manner which entails the consent of at least some States.

B. Contracts Function As Regulation

Contracts regulate the behavior of the contracting parties. The extent to which contracts function as the practical equivalent of regulations varies with the context. Contracts with larger numbers of parties, or contracts concluded in the same form with multiple other contracting parties, such as franchise agreements, tend to have more of a regulatory character than bilateral contracts. SRO rules operate through contract and are designed to function as regulations of their members' conduct. Standard form contracts have more of a regulatory character than individually negotiated agreements.

Financial trade associations have developed standard form contracts for the international financial markets. They have done so as part of their mission to help their members, and they combine efforts to develop standard documentation with the lobbying efforts described above. Financial trade associations may describe the purpose of their standard form contracts programs as being about risk reduction. Alternatively, or as well,
they may say that they are developing standard form documentation in order to facilitate the development of markets. The Loan Market Association ("LMA"), which has developed standard forms for syndicated loan agreements for the London market, was founded in 1996 "as a response to market conditions and to a perceived willingness on the part of the banking community to bring greater clarity, efficiency and liquidity to the relatively under-developed secondary market that existed at the time, and to enable more efficient loan portfolio management." The Loan Syndications and Trading Association in the United States, which has developed Model Credit Agreement Provisions for U.S. jurisdictions, states that it developed the model provisions "to promote liquidity and efficiency, increase legal certainty, reduce transaction costs in connection with origination activity, and limit legal review for primary and secondary sales to an 'exceptions' basis, reducing the time and expense of unnecessary negotiation of boilerplate and other mechanical


228. Cf. Karl Llewellyn, The Standardization of Commercial Contracts in English and Continental Law, 52 Harv. L. Rev. 700, 701 (1939) (Book Review) ("The 'general law' is much too general. It needs tailoring to trades and to lines of trading. Nothing can approach in speed and sanity of readaptation the machinery of standard forms of a trade and for a line of trade, built to meet the particular needs of that trade. They save trouble in bargaining. They save time in bargaining. They infinitely simplify the task of internal administration of a business unit, of keeping tabs on transactions, of knowing where one is at, of arranging orderly expectation, orderly fulfillment, orderly planning. They ease administration by concentrating the need for discretion and decision in such personnel as can be trusted to be discreet. This reduces human wear and tear, it cheapens administration, it serves the ultimate consumer.").

229. Loan Mkt. Ass'n, Multicurrency Term and Revolving Facilities Agreement in the Recommended Form of Primary Documents (July 2002) [hereinafter Primary Documents] (paper on file with author).


provisions."

When trade associations are successful in developing standard forms that market participants use, the standard forms can function like regulation in that they set standards for what is normal behavior in the markets. What is normal may influence a court’s interpretation of contracts, although it may not always be easy to determine what a standard contractual term actually means.

Normal contractual terms may also influence the behavior of market participants. It may be difficult for a borrower to negotiate contractual terms different from those specified in the standard form syndicated loan agreement. The LMA agreement has been designed “to balance the interests of borrowers and lenders.” The Association of Corporate Treasurers ("ACT"), which represents borrowers, says:

For many Borrowers, it is likely to be advantageous to use as a basis for negotiation a format which is becoming increasingly familiar in the market. It is hoped that this familiarity will make for greater efficiency in negotiation of the loan document and in the syndication process, leading to lower costs for the Borrower.

The ACT lists some of the potentially unattractive features of the LMA standard form, and also lists some "key points for

232. Id. at 2.
233. A court may decide whether a contract is ambiguous, for example, by considering the norms of a particular business context. See, e.g., In Re Okura, 249 B.R. 596, 603 (Bankr. S.D.N.Y. 2000) (holding that a phrase is ambiguous only if it is "capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business").
235. See, e.g., Ass'n of Corp. Treasurers (ACT), A Guide to the Loan Market Association Documentation for Borrowers [hereinafter ACT Guide], at 12 (2004), available at http://www.treasurers.org/technical/resources/lma_final.pdf ("It can be harder to negotiate a draft which is presented by lenders as a market standard than, for example, a draft which is the standard form of a law firm.").
236. Id. at 10. Cf. LSTA Model Credit Agreement Provisions, supra note 231, at 1 ("[E]very effort was made to balance the interests of all constituencies in the syndicated lending market: agents, investors and borrowers.").
238. See id. at 12-13.
negotiation." However, although the ACT lists the "increased costs clause" as a key clause affecting costs, it does not suggest that this is a provision that may be negotiated. The increased costs clause is designed to protect lending banks—and subsequent acquirers of their interests in any loan—from increased costs associated with changes in regulatory requirements, for example where capital adequacy requirements change over the life of a loan so that the lender has to have extra capital to cover the loan. The increased costs clause is designed to pass such costs on to the borrower, but because banks draft the clause and borrowers have limited opportunities to negotiate its terms, the clause does not give the borrower the benefit of any reduced regulatory costs. It is a one-way ratchet in favor of the lenders.

On the other hand, at least in market conditions where borrowers have advantages in negotiating favorable financial terms for syndicated loans they can also negotiate favorable covenants. Borrowers' lawyers have recently taken control of the drafting of some syndicated loan agreements, in part because the LMA standard forms exist.

Standard form contracts may develop a dominant position where the market benefits from standardization and/or where standard-setters and regulators encourage the use of standard forms as a form of risk management. In the international fi-

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239. Id. at 13-14.
240. Id. at 14.
241. See id. But see SJ BERWIN, BASEL II: THE IMPACT ON THE MARGIN 2 (2004), available at http://www.sjberwin.com/media/pdf/publications/banking/Basel_II.pdf (suggesting that changes in the Basel Capital Accord should mean that borrowers will want to negotiate to obtain the benefit of reductions in capital requirements that accrue if the borrower's risk profile improves).
242. See generally SJ BERWIN, supra note 241. The lenders can take account of the impact of capital adequacy rules that apply at the time of signing of the loan agreement by adjusting the loan pricing. See id. at 3 ("As the effect of Basel II becomes more settled and as implementation approaches, it is likely that attempts will be made to incorporate specific Basel II pricing into the provisions of the loan agreement. At that point, Basel II will effectively drop out of the increased costs clause, just as some years ago the effect of the current Basel Accord used to be excluded from the increased costs clause once it had been taken into account in the pricing of transactions.").
245. See id.
246. See, e.g., Flanagan, supra note 225, at 255:
One factor that helped keep ISDA’s membership committed to the organiza-
nancial markets some contractual provisions have more of a reg-
ulatory effect than others. For example, provisions of the LMA
agreement regulate the relationship between the agent bank
and the lenders.\footnote{247}

In cases where the market does not use standard forms, in-
ternational standard-setting bodies may encourage market par-
ticipants to develop or use standard form contracts because of
the connection between legal risk and uncertainty. For exam-
ple, commentators say that parties to swap transactions in syn-
thetic collateralized debt obligation structures are not standard-
izing their contracts.\footnote{248} In its March 2005 paper on Credit Risk
Transfer, the Joint Forum recommended that "market partici-
pants should aggressively continue their efforts towards stand-
ardization of documentation, including for CDOs and other
more complex products" in order to reduce legal risk.\footnote{249}

Standard form contracts often suit the interests of financial
firms and regulators,\footnote{250} but they may impose costs on others who
are not involved in the drafting process and who will find it dif-
cult to negotiate against the standard form provisions.\footnote{251} At
times the risk reducing aspects of standard forms may be illu-
sory: where firms are parties to transactions using different stan-

dard and its documentation projects was what the members faced if ISDA were
to fall apart. ISDA's initial documentation successes proved that industry partic-
ipants could get good documentation results through ISDA at a fraction of
their previous costs. In addition to reducing costs, ISDA's standardized docu-
ments reduced risk for everyone in the industry.

\textit{Id.}

\footnote{247. \textit{See generally Primary Documents, supra note 229.}}

\footnote{248. \textit{See, e.g., Ian Sideris & Simon Puleston Jones, How to Adapt ISDA Documents for
CDOs, Int'l Fin. L. Rev., Apr. 2005, at 78, 80 ("Ultimately, it is unlikely that a single
standard form of swap is going to emerge in the synthetic CDO market. The differing
requirements of the rating agencies, the continuing demand by investors for bespoke
products and the desire of investment banks to create new credit products through
which they can make profits in an environment of tightening credit spreads all mitigate
in favour of continuing diversity and complexity in the documentation of synthetic
CDOs.").}}
standard forms, any inconsistencies between the different forms may cause problems. The Global Documentation Steering Committee in New York works on trying to reconcile differences between standard forms, and has encouraged different organizations to take account of its work.

C. Contracts Constrain Regulation

Contracts may constrain or undermine regulation if they are used to shift risks away from regulated firms onto non-regulated entities. In recent years, banks have changed their relationships with their customers. Rather than acting as a long term lender to a business client, a bank prefers to be involved in arranging a financing facility and to sell its participation in the facility to others. One of the advantages of structuring lending in this way is that the bank's regulatory capital requirement is controlled. Purchasers of loan participations that are not subject to risk-weighted capital requirements do not have to worry about having capital to cover the credit risk inherent in the loan participations. But if the purchaser is a non-bank financial institution regulators may be concerned about the shifting of risks from a regulated part of the financial sector to a less

252. See Russo, supra note 250 ("Use of multiple master agreements allows the parties to tailor the basic terms of their financial transactions to the particular transaction. However, it also results in this documentation basis risk—the risk that transactions that hedge each other will not exactly have matching terms, because they are documented on masters that have inherent differences."); see also COUNTERPARTY RISK MGMT. POLICY GROUP, IMPROVING COUNTERPARTY RISK MANAGEMENT PRACTICES (June 1999), available at http://www.mfainfo.org/washington/derivateives/Improving%20Counterparty%20risk.pdf.


255. For example, using credit default swaps to shift the risk of debtor default.


257. See, e.g., Steven L. Schwarz, The Universal Language of International Securitization, 12 DUKE J. COMP. & INT'L L. 285, 288 (2002) ("If the originator is a bank or similar financial institution that is required to maintain risk-based capital under the capital-adequacy guidelines, securitization could also permit the originator to sell receivables (e.g., loans reflected as assets on a bank's financial statements) for which it would otherwise be required to maintain capital.") (citation omitted).
regulated or differently regulated sector. Similar issues of risk-shifting arise in the context of securitizations and CDOs. The Joint Forum concluded that this issue should be monitored.

Contracts may also constrain regulation where financial market participants successfully argue that proposed or actual regulations undermine beneficial market transactions. In the United States, national banks have been arguing that the states and municipalities do not have the power to subject them to controls on predatory lending because of preemption.

The primary abuse the North Carolina law, and other subsequent state laws, is aimed at is preventing equity stripping, which occurs when lenders charge excessive fees. The problem of excessive fees for the subprime refinancing borrower is two-fold: the fees seem painless at closing and they are forever. They are deceptively costless to many borrowers because when the borrower "pays" them, with a stroke of a pen at closing, he or she does not feel the pain of counting out thousands of dollars in cash. The borrower parts with the money only later, when the loan is paid off and the equity value remaining in his or her home is reduced by the amount of fees owed. And fees are forever because, even if a responsible lender refines a family a week later, the borrowers' wealth is still permanently stripped away.
OCC has supported this view.\textsuperscript{262} One argument that lenders have made to support their arguments for preemption is that allowing state predatory lending statutes to control the actions of national banks would impair their ability to securitize loans.\textsuperscript{263} They argue that this would ultimately deprive borrowers of credit.\textsuperscript{264}

In a securitization, the originator of income producing assets such as loans will set up a Special Purpose Entity ("SPE") to hold income-producing assets such as loans and issue securities to investors.\textsuperscript{265} If the SPE is sufficiently separate from the originator, any assets the originator transfers to the SPE will be removed from the originator's balance sheet.\textsuperscript{266} Investors in securities issued by the SPE want to be sure that creditors of the originator are unable to look to the SPE's assets in the event of the originator's insolvency.\textsuperscript{267} Investors in the originator want to be sure that there is no risk that unhappy investors in the SPE's


263. State predatory lending statutes commonly affect not just the original lender but also assignees of the loan so that remedies available against the original lender would also be available against assignees who had no opportunity to monitor compliance with the requirements of the statutes. See generally Bond Mkt. Ass'n, The Secondary Market for Subprime Mortgages: A Common Sense Approach to Addressing Assignee Liability Through Federal Legislation (Mar. 2004), available at http://www.bondmarket.com/Legislative/Subprime_Lending_Whitepaper_032904.pdf. This liability could significantly reduce the value of asset pools in securitizations:

The secondary market must currently comply with a patchwork of more than forty varying and sometimes vague and conflicting state and local anti-predatory lending laws. Such a regulatory environment negates many of the efficiencies securitization and the secondary market bring to the subprime mortgage market. Anti-predatory lending laws that assign liability to the secondary market for lending violations that cannot be detected in a review of the loan documents will ultimately limit subprime borrowers' access to credit. Id. at 2.


266. See id.

267. See id.
securities will seek recourse to the originator. Clear and certain formal legal rules about accounting consolidation, bankruptcy remoteness and the meaning of "true sale" would comfort all of the participants in securitizations. In the absence of clear rules, credit rating agencies have stepped in to define what it takes to make structured financing work by setting detailed criteria for the rating of structured finance transactions. Recently rating agencies have addressed the question of the impact of state predatory lending statutes on securitizations as part of their general focus on structured finance. Standard & Poor's considers various factors, including whether predatory lending statutes provide for assignee liability, whether the loan categories affected are clearly defined, what penalties apply and how clear the statute is (including whether there are any safe harbors).

Although this example of contracts—the securitization contracts—potentially constraining regulation (the state predatory lending statutes and also potential federal level regulation of predatory lending) is a domestic example within the United States, it is not difficult to imagine similar arguments being

268. See id.
269. See id.
270. See id.
272. See S&P LEGAL CRITERIA, supra note 265, at 104.
273. The Standard & Poor’s analysis in its focus on issues of legal certainty also has implications for possible federal rules on predatory lending. The Bond Market Association supports one bill currently before Congress. See, e.g., Micah S. Green, President, Bond Mkt. Ass'n, Testimony before U.S. House of Representatives Subcommittee on Housing and Community Opportunity, Subcommittee on Financial Institutions and Consumer Credit, Hearing on Legislative Solutions to Abusive Mortgage Lending Practices (May 24, 2005), available at http://www.bondmarkets.com/assets/files/Testimony-Subprime_05-24-05.pdf ("The Responsible Lending Act deals with the problems that arise from dozens of sometimes vague and conflicting state and local laws by creating a uniform national standard for the terms under which high-cost loans are made. Critically important, these terms are objective and measurable. Under this legislation, borrowers facing foreclosure could bring defensive claims against loan assignees under certain circumstances. Assignees could also be the subject of affirmative claims, or those brought outside of the context of defending against a specific foreclosure claim, unless they could prove that a reasonable level of loan review would not have revealed the lending violation in question. By observing an objective standard for loan review that could reasonably be expected to screen loans with potential predatory lending problems, secondary market participants can avoid potential liability. The Responsible Lending Act also provides purchasers with a 'right to cure,' or the opportunity to amend a loan and compensate the borrower when they identify loans made in violation...)
made in the EU that EU level banking rules preempt State actions to protect domestic banking customers like those the states have been taking in the United States. Eventually, the WTO services agreement may produce similar preemptive effects at the global level.

To the extent that contracts, particularly standard form contracts, can constrain or limit regulation, it is worrying that the processes which produce the standard form contracts are private and opaque to outsiders and that they do not tend to allow input from people who may be affected by them.

D. Regulation Constrains Contracts

At the same time as contracts may constrain or limit regulation, financial firms need to worry about how existing legal rules may affect the contractual arrangements they believe they have made, and about how changes to legal rules may affect their contracts. One result of such anxiety is the type of lobbying activity discussed in Section I above.

Some types of legal uncertainty may not matter if market participants can agree to ignore the uncertainty. Within a homogenous community transactions may derive their binding effect from sources other than state-centered law. But actors in the international financial markets are less homogenous than they used to be and they are more likely to resort to litigation to resolve disputes than they were in the past.


When litigation does occur, market participants frequently argue that courts should give effect to the agreements they have concluded and should interpret the law to facilitate this. Financial trade associations may submit amicus briefs in litigation to argue for the market's view. In some places governmental authorities or quasi-governmental authorities encourage the idea that courts should avoid applying the law in unexpected ways.

In the U.K., the Bank of England appointed a Legal Risk Review Committee, then a Financial Law Panel, and most recently a Financial Markets Law Committee to address issues of legal risk.

Regulation may constrain contracts by limiting what a financial firm can achieve by contract. Uncertainties about how courts and regulators will interpret contracts create legal risks that financial institutions need to address as part of their overall risk management strategy required by their regulators.

III. PRIVATE SECTOR REGULATORY ENTREPRENEURS

Whether financial transactions take place on regulated markets or not, they need institutional support, including support from rules, whether those rules are derived from statutes and regulations or from contracts. Financial trade associations act as regulatory entrepreneurs in developing rules that participants in

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277. See, e.g., Final Report of the Legal Risk Review Committee (Oct. 1992) (on file with author). The Committee noted that: "[M]arkets cannot function efficiently without a strong legal foundation. Promoting legal certainty, even though it is not the only relevant concern, is therefore of fundamental medium- to long-term importance." Id. at ¶ 1.2.

278. See id. The statement by Millett, J. in In re Charge Card Services Ltd. that "a charge in favour of a debtor of his own indebtedness to the chargor is conceptually impossible" was another factor. See [1987] Ch. 150; see also Re BCCI No. 8 [1998] A.C. 214 (Hoffman, L.) ("The doctrine of conceptual impossibility ... has excited a good deal of heat and controversy in banking circles; the Legal Risk Review Committee, set up in 1991 by the Bank of England to identify areas of obscurity and uncertainty in the law affecting financial markets and propose solutions, said that a very large number of submissions from interested parties expressed disquiet about this ruling. It seems clear that documents purporting to create such charges have been used by banks for many years.").


the financial markets follow.\textsuperscript{281} Earlier sections of this Article addressed the lobbying activities of financial trade associations and their actions in developing standard form contracts. But financial trade associations also seek to influence market behavior by the development of instruments such as guidelines and market standards that are designed to affect the behavior of market participants.\textsuperscript{282} Although market standards do not seek in themselves to produce legal effects, they may in fact produce legal effects if they are incorporated in contracts or if regulations refer to them.\textsuperscript{283}

The financial industry has produced a host of standards, codes, and guidelines covering many different subjects.\textsuperscript{284} For example, the Bond Market Association has published Practice Guidelines for trading in distressed bonds,\textsuperscript{285} and for GSE European callable securities.\textsuperscript{286} The European Securitisation Forum has published securitization market practice guidelines.\textsuperscript{287} Sometimes market standards are designed to fend off regulation.\textsuperscript{288} For example, in March 2005, during a period of national and international debates about whether credit rating

\textsuperscript{281} Some financial trade associations are recognized as self-regulatory organizations in states' formal financial regulatory systems. Others exercise rule-making functions because their membership wishes them to do so without any formal role in any state's financial regulatory structure.


\textsuperscript{283} The U.K.'s Takeover Panel was set up in 1968 as a non-governmental body to regulate takeover transactions in the U.K., administering the City Code on Takeovers and Mergers. More recently, financial regulators in the U.K. have required people authorized to carry on investment business in the U.K. to comply with the provisions of the Code and to "cold shoulder" persons who do not comply with the Code. See, e.g., FSA, Endorsement of the City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares, Consultation Paper 87 3 (Apr. 2001), available at http://www.fsa.gov.uk/pubs/cp/cp87.pdf.

\textsuperscript{284} See generally supra note 282.

\textsuperscript{285} See generally Distressed Bonds, supra note 282.

\textsuperscript{286} See generally GSE Securities, supra note 282.

\textsuperscript{287} See generally Securitisation Market Practice Guidelines, supra note 282.

\textsuperscript{288} See, e.g., Ass'n of Corp. Treasurers et al., Code of Standard Practices for
agencies should be subjected to formal regulation, a group of organizations—representing the corporate treasury function of issuers rather than ratings agencies—published a Code of Conduct for Credit Rating Agencies.\textsuperscript{289} Sometimes regulators encourage trade associations to develop solutions to problems in the market.\textsuperscript{290} Market standards may be useful in circumstances where regulatory solutions are infeasible: For example, emerging market debtors, the financial institutions that invest in their debt, and trade associations have agreed principles for the emerging debt market.\textsuperscript{291}

Private standard-setters may have significant influence on the behavior of market participants through formal recognition of their role. In 2002, for example, the EU adopted a regulation mandating the use of International Accounting Standards by publicly traded EU companies.\textsuperscript{292} International Accounting Standards are developed by the International Accounting Standards Board ("IASB"),\textsuperscript{293} a non-governmental organization which is funded by private sector firms.\textsuperscript{294} Commentators have suggested that the dependence of standards-setters on private

\textsuperscript{289} See id.

\textsuperscript{290} See, e.g., Edna Young, Fin. Crime Sector Manager, FSA, Speech at the British Bankers' Association 4th Annual Fraud Conference (Jun. 27, 2005), available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2005/0627_ey.shtml (last visited Oct. 18, 2005) ("Trade associations can play a key role in collating this information and providing advice to their members on how to manage their fraud risks more effectively. We see them as providing the lead in developing and disseminating best practice.").

\textsuperscript{291} See Inst. of Int’l Fin., Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets (Mar. 2005), available at http://www.iif.com/data/public/principles-final_0305.pdf; see also Bedford et al., supra note 211, at 6 ("An important recent development in soft law has been the Principles for Stable Capital Flows and Fair Debt Restructurings in Emerging Markets (hereafter, the Principles) agreed between some key trade associations and a group of sovereign borrowers. The Principles constitute a set of voluntary guidelines designed to add further structure and predictability to the relationship between sovereign debtors and their creditors beyond that contained in contracts.").


\textsuperscript{293} See Council Regulation No. 1606/2002, supra note 292, art. 2.

\textsuperscript{294} See International Accounting Standards Board [IASB], Organization Description, http://www.valuebasedmanagement.net/organizations_iabs.html (last visited Sept. 22, 2005) (noting that the IASB is a "privately-funded accounting standard setter").
sector funding creates conflicts of interest that raise questions about the legitimacy of the standards it promulgates. The IASB has recognized these concerns during a number of recent constitutional reviews. And, imitating intergovernmental bodies such as IOSCO, the IASB has focused on increasing the transparency of its standards-making processes.

Other private sector firms act as regulatory entrepreneurs by setting criteria for market transactions. Credit rating agencies assess the financial condition of issuers of securities in the capital markets, and their decisions about how to treat different liabilities can have an impact on the issuers’ ability to raise funds in the capital markets. Credit rating agencies also set detailed

295. See McCreevy, supra note 13, at 5 ("The standard setters are currently sponsored by voluntary contributions from contributors ranging from central banks to listed companies, which raises potential issues of conflict of interest."); see also Michael Peel, Accounting Standards Body Criticised for Secrecy, FIN. TIMES (London), Mar. 4, 2002, at 28 (describing the criticism levied against the International Accounting Standards Committee for keeping its list of donors secret); BIS, The Role of Ratings in Structured Finance: Issues and Implications, at 25 (Jan. 2005), available at http://www.bis.org/publ/cgfs23.pdf ("Potential conflicts arise from the fact that ratings are paid for by issuers rather than investors . . . .").

296. See, e.g., Letter from IASIS to Tom Seidenstein, Dir. of Operations and Secretary, IASC, Re: Comments on Identifying Issues for the IASC Foundation Constitution Review (Feb. 11, 2004), available at http://www.iaisweb.org/190IASConstitutioncomments11February2004.pdf ("[W]e recognize the importance of bringing to bear the highest calibre of technical expertise and unbiased professional judgment to standard-setting efforts. At the same time, we believe that the overall process for developing these standards must include sufficient transparency and accountability to ensure that strengths, without appropriate checks and balances, do not risk becoming weaknesses."); see also IASC FOUNDATION CONSTITUTION (July 2005), available at http://www.iasb.org/uploaded_files/documents/8_11_iascf-constitution.pdf (mandating the development of “high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements”).


298. See, e.g., S&P LEGAL CRITERIA, supra note 265, at 7 (describing criteria for structured finance transactions).

299. See, e.g., OECD, Corporate Pension Fund Liabilities and Funding Gaps, 88 FIN. Mkt. TRENDS 69, 91 (Mar. 2005) ("Rating agencies have warned that estimated deficits in company pension schemes are similar to debt. It had previously been thought that credit ratings agencies regarded pensions as long-term liabilities with little negative liquidity implications, at least in the case of those jurisdictions where pensions rank along with non-preferred and unsecured debt in the event of insolvency. Across countries, there are differences in the status of pension creditors, but this status may be subject to change in some countries. For example, making the status of pension credi-
Firms that wish to sell securities in a structured financing need to acquire a rating from a credit rating agency in order for the securities to be marketable. They therefore have to ensure that they meet the rating agencies' criteria. Rating agencies are also affecting investors' willingness to invest in structured credit products. Credit ratings are set to influence the level of capital banks are required to hold when they are used as a measure of a corporate's risk.

CONCLUSION

Contracts and regulation intersect in complex ways in the international financial markets. This Article examines some of the ways in which non-governmental actors, in particular financial trade associations, influence regulation in the international financial markets through lobbying, through the development of standard form contracts and through their own quasi-regulatory initiatives. Although some of the ways in which this influence is exercised are apparent because of disclosures by governmental and inter-governmental standard-setters and because of disclosures by the financial firms and their trade associations, others are less transparent. Larger firms with better resources are able to participate more effectively than smaller firms in these formal processes.

300. See, e.g., S&P LEGAL CRITERIA, supra note 265.


303. See, e.g., BIS, 75TH ANNUAL REPORT, 1 APRIL 2004-31 MARCH 2005, at 118 (June 27, 2005), available at http://www.bis.org/publ/arpdf/ar2005e.pdf ("[S]tructured credit products are very complex securities and the risks involved might not be fully appreciated by all market participants. The covenants of many CDO contracts can be difficult to comprehend and deal complexity has posed many modelling challenges. Although efforts have been made to develop more realistic pricing models and risk management systems, many market participants are still building up their analytical capacity. One consequence is that rating agencies have played a key role in the development of the market. However, there is relatively little experience with the performance of ratings on CDOs, and rules of thumb employed by investors in using ratings on corporate bonds may be misleading when applied to highly leveraged structured instruments.").

304. See id. at 38 (noting the increased reserves being held by banks in China and India).
and informal processes of regulation and quasi-regulation. Consumers tend to be distanced from these processes by lack of resources, by lack of expertise and because they fail to meet the eligibility criteria for participation.\textsuperscript{305} Thus, in critical ways, these governance processes do not fit well with ideas either of top-down governance or of bottom-up governance.

\textsuperscript{305} See supra note 36 and accompanying text.