

UGA International Law Colloquium
February 27, 2009

Why Do Some Regulatory Networks Fail, While Others Succeed?

David Zaring

University of Pennsylvania Wharton School of Business

The first commissioners of the SEC gave their speeches in the United States, concentrated on American stock exchanges, and evaluated the disclosures of American companies. As Commissioner James Landis said of the securities laws in 1933, “the public interest and the protection of investors must be the guiding consideration” for an agency that was needed because “some groups of persons associated with security flotations are not induced to refrain from material nondisclosure by fear either of the very real liability for compensatory damages at common law or fear of prosecution under the criminal law.”

Today, the SEC’s mission is the same, but both the investors and the security flotations are as likely to be found overseas as they are in the United States. American gross trading activity in foreign securities is \$7.5 trillion, up from \$53 billion three decades ago. Approximately two-thirds of American investors own securities of non-U.S. companies – a 30% increase from just five years ago. And foreign trading activity in U.S. securities now amounts to over \$33 trillion.

That the global strategy of the agency is new is exemplified by the SEC’s international affairs office, which was founded in 1989, some 56 years after the creation of the agency. The office has quickly become a central outfit for the formulation of regulatory policy.

All of this international activity has come in the wake of a recognition by the SEC that the global markets have created unprecedented international challenges. Capital can leave a regulatory jurisdiction, but the regulators trying to attract it or insure that it complies with local laws are less mobile. Also, the SEC is facing a future with many more competitors, both in formal and informal financial sectors. Moreover, these competitors do not only offer an alternative to the American regulatory frameworks, they interfere with it, with regulations of increasingly extraterritorial import. Finally, even the basics of the job of supervision are more difficult. There is a new speed to financial transactions that makes the monitoring of those transactions extremely difficult. And regulated industry has increasingly adopted complex and sophisticated ways of managing their balance sheets to that both exploits regulatory arbitrage and taxes the abilities of the regulators to keep up with the financial innovations.

Anne-Marie Slaughter calls this an “ineffectiveness challenge,” whereby control over a discrete territory alone cannot result in effective economic governance when domestic markets become intertwined with foreign ones. But amidst all these problems, there may

be an international solution. American federal regulators have addressed these daunting global developments by interacting with their counterparts abroad, and try to develop a multilateral regulatory regime of global scope. And they have done so in substantial numbers, through mechanisms that international lawyers have come to think of as networks. As Anne-Marie Slaughter has put it, these networks exhibit “pattern[s] of regular and purposive relations among like government units working across the borders that divide countries from one another and that demarcate the ‘domestic’ from the ‘international’ sphere.”

As the network form has developed and spread, the regulatory network has become an important tool in the arsenal of international regulation – perhaps even the primary such tool, and at any rate, a worthy alternative to either unilateralism or more institutionalized, and, perhaps, judicialized, forms of international administration.

A regulatory network like IOSCO might be expected to address common approaches to supervision, harmonized reporting requirements, and a systemic approach to information-sharing among regulations. But, so far, it is only the last of these that it has been able to pursue successfully. Its efforts to harmonize the supervisory efforts of securities regulators have foundered on gauzy unspecificities that it calls “core principles” of securities regulation. It has not yet harmonized reporting requirements, or accounting standards that would be issuers could use whether they want to list in New York, Stockholm, or Hong Kong. It is only with information-sharing commitments – and promises of future cooperation can be problematic in their own right – that the institution can claim success. And the recent financial crisis has created an incentive to act that, so far, the securities network has not availed itself of. It has had to leave accounting harmonization to the International Accounting Standards Board, a smaller, tight outfit that devised its standards more exclusively than has IOSCO. IASB’s accounting standards have roiled the world of listings, including, the SEC has finally decided, those listings in the United States. IASB has some of the hallmarks of more economic networks, where exit is unthinkable, and, accordingly, more comprehensive international harmonization is possible. The opportunities for regulatory networks, so apparent here, have been difficult for the SEC to realize. In what follows, I investigate why.