USA IN THE EMERGING SYSTEM OF GLOBAL FINANCIAL REGULATION

Vasilisa K. Kulakova

Institute of World Economy and International Relations of the Russian Academy of Sciences, Moscow, Russia

In the globalizing world of financial and economic interdependence, a system of global financial regulation is emerging, being now in the process of making. It is a multi-level system, which consists of interacting global, regional, state and sometimes local levels. This emerging system is polycentric and at the same time hierarchical which is reflected in two seemingly conflictual vectors of recent development in international financial regulation: the rise of cooperation through the mechanisms of the Group of Twenty (G-20) on the one hand, and the efforts to maintain the US leading role in global finance, on the other hand. In the circumstances of the global financial crisis of 2008, the G-20 countries initiated an international reform of financial regulation. According to G-20 decisions, international standard-setting organizations developed transnational regulatory regimes in the fields of banking, derivatives and bankruptcy resolution, and the states now implement these regimes in their jurisdictions. The so-called “soft law system”, which is not legally binding, allows the states to sustain national sovereignty in their financial policy. The United States play a leading role in the international financial reform, as well as in the shaping of the global financial regulation system. The American regulators push for extraterritorial application of the US norms and take other unilateral actions on the international arena. The article also touches upon legitimacy problems of the emerging system of global financial regulation. The most important constrains are the excessive influence of the financial industry (“regulatory capture”), the weakness of civil society participation, and also the fact that for the rest of the world the American norms lack legitimacy, as they are adopted by regulators assigned by officials elected by population of a foreign territory.

| Article history: | Abstract: In the globalizing world of financial and economic interdependence, a polycentric, multi-level, and hierarchical system of global financial regulation is emerging. The article highlights two vectors of recent development in international financial regulation: the rise of cooperation through the mechanisms of the Group of Twenty (G-20) on the one hand, and the efforts to maintain the US leading role in global finance, on the other hand. In the circumstances of the global financial crisis of 2008, the G-20 countries initiated an international reform of financial regulation. According to G-20 decisions, international standard-setting organizations developed transnational regulatory regimes in the fields of banking, derivatives and bankruptcy resolution, and the states now implement these regimes in their jurisdictions. The so-called “soft law system”, which is not legally binding, allows the states to sustain national sovereignty in their financial policy. The United States play a leading role in the international financial reform, as well as in the shaping of the global financial regulation system. The American regulators push for extraterritorial application of the US norms and take other unilateral actions on the international arena. The article also touches upon legitimacy problems of the emerging system of global financial regulation. The most important constrains are the excessive influence of the financial industry (“regulatory capture”), the weakness of civil society participation, and also the fact that for the rest of the world the American norms lack legitimacy, as they are adopted by regulators assigned by officials elected by population of a foreign territory. |
| Received: | 21 January 2016 |
| Accepted: | 10 June 2016 |
| About the author: |  |
| Candidate of Political Science, Senior Research Fellow of the Center for North American Studies, Institute of World Economy and International Relations of the Russian Academy of Sciences |  |
| e-mail: vasilisa-kulakova@yandex.ru |  |
| Key words: | financial regulation; global financial reform; network financial regulation;legitimacy; financial crisis of 2008; extraterritoriality; Dodd-Frank Wall Street Reform and Consumer Protection Act; US leadership; the Great Twenty; transatlantic relations. |  |

In the concept of network financial regulation and its limitations

Well before the financial crisis of 2008 a range of transgovernmental standard-setting/regulatory organizations – the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), the Financial Stability Board (FSB), and some others – gained importance at the international level and overshadowed the traditional Bretton Woods era international financial regulatory institutions – the International Monetary Fund (IMF) and the World Bank (WB). There are multiple interpretations of the role the network financial organizations play, as well as of the status of documents that they issue.

In the concept of network financial regulation, the BCBS, IOSCO and FSB are treated as global financial regulation already in existence.1 Recommendations developed by

---

them are regarded as a soft law system which is supposed to be able to solve the legitimacy and efficacy problems of the global financial regulation.2 There is a point of view that eventually these soft law norms tend to gain a more binding character and become more obligatory in nature.3

The transgovernmental organizations4 play less important role in other conceptions and analysis systems, in accordance to which global financial regulation is determined or should be determined either by exterritorial reach of the American5 (or American and European) financial regulatory norms, or by substituted compliance with regulatory requirements of the stronger states.6 In this framework the role of the United States of America as a leading actor in the global finance prevails.

In the global financial regulation, supranational modes of governance are not used, except for the regional level in the European Union (EU). During and after the financial crisis, the architecture has been evolving where the Group of Twenty designs general directions of the global financial reform, translates them to the standard setting organizations – the BCBS, the IOSCO, the FSB, and they develop recommendations for the states. After that, the states implement the standards in their jurisdictions, i.e. enact national legislation, and then national regulatory agencies adopt rules and regulations, enforce them, and supervise the compliance with them by financial companies. The role of states is central in this architecture.

The concept of network financial regulation and of actions taken by respective organizations is American in its very nature and reflects neo-liberal ideology. Unlike the IMF that works on the basis of an international treaty, the financial networks develop a soft law system that is not legally binding, but voluntary. This is a new quasilegal environment of the transnational financial regulation that some researchers qualify as a “law-like institution”.7 Network regulators use soft power instruments like persuasion, authority weight, and economic interest.

In the absence of binding rules, the global financial reform created transnational regulatory regimes that are based on the American model. The transnational regime of banking regulation (Basel III), the regime of derivatives regulation and that of resolution (or liquidation) of systemically important companies on the verge of bankruptcy have been elaborated, and the process of their implementation in countries began. So, these regimes are multi-level – the key points are agreed at the G-20 level, recommendations are developed at the level of standard-setting bodies, and the implementation takes place at the national level.

USA as the biggest factor in global financial regulation environment

Besides the transgovernmental organizations, the institutional environment of the emerging global financial regulation includes a vast range of actors. First, there are traditional Bretton Woods bodies of international monetary and financial regulation, the IMF and the WB. These two have an international treaty as a legal foundation for their work, but they failed to demonstrate strong leadership when the global financial crisis broke up in 2008-2009. The latter fact is supposed to contribute to the growing importance of network regulators.

Second, there is the financial industry, or transnational financial corporations, exerting big influence on the regulators at all levels,

and the situation of regulatory capture is an important factor of the whole environment. During the financial crisis, the socio-economic consequences of negative externalities became so salient for the public, that steps had to be taken by governments to reduce the financial industry’s influence on policy-making. But in the medium-term perspective we might expect it to reemerge.

Civil society groups should have constituted as a third important factor of the environment, but they are relatively weak when we consider the case of financial regulation. This, partly, is due to the technical complexity of financial regulation. But the major reason, of course, is the fact that civil society groups find it hard to compete with the financial industry, with its vast economic and political resources.

The forth factor, actually the most important one, is the factor of the United States of America, a major power exporting its national financial regulation norms and standards to the rest of the world. In its national jurisdiction, the US has carried out a strict reform of financial regulation that became a model for other countries. The Dodd-Frank Wall Street Reform and Consumer Protection Act were signed by President Obama on 21th of July, 2010, and the national regulators proceeded to develop the rules and regulations implementing the provisions of this Act. The rules adopted in US to implement Basel III are in certain aspects stricter than the international agreement itself.

In implementing national reform in the field of derivatives’ regulation the US is ahead of all other jurisdictions. The US regime for liquidation of bankrupt financial firms became a pilot for respective international liquidation regime.

The Board of Governors of the Federal Reserve System (the Fed), the Securities and Exchange Commission (SEC), and the Commodities Futures Trading Commission (CFTC) took active and effective part in developing key lines of the global financial reform during the financial crisis. The influence of the American Federal Reserve, not only as a monetary regulator but as a regulator of the banking holding companies and systemically important non-banking financial firms as well, spreads far beyond the borders of the US. Two American securities and derivatives regulatory agencies – the SEC and the CFTC – also possess some influence over international regulation in respective sectors. They continuously elaborate new and alter existing norms of global financial regulation, shaping it in a way that serves American national interests, thus enhancing American leadership in global economy and finance. To exercise their influence, American regulators use channels provided for by the Group of Twenty, financial regulatory networks as well as traditional Bretton Woods institutions. Their influence is based on the axial role of US financial system in global finance and on the status of dollar as an international reserve currency and international means of payments.

The United States played a pioneering role in the global financial reform. Early documents of the Obama’s administration on financial reform stressed the necessity of international cooperation. But later, while developing their national rules and regulations according to the Dodd-Frank Act, American regulators started contravening the Group of Twenty’s decisions concerning the harmonization of the global financial regulation. Substituted compliance is a concept intended to help harmonize international rules, while implementation of the global reform is carried out at the national level. Substituted compliance allows a foreign company to work in a host country and to comply with its home country rules and regulations, thus lifting unnecessary regulatory burden of double regulation. This principle is endorsed by international financial organizations, but is either rejected in the US – as in the case of the Fed’s regulation of foreign banking organizations operating in US, or receives limited American acceptance – as in the case of derivatives regulation by the SEC and the CFTC.

Moreover, American financial regulators insistently push forward the extraterritorial reach of their standards. The Dodd-Frank Act provides for extraterritorial implementation of the Volker rule, of the derivatives rules and

---

of its other regulations. European regulators and policymakers claim that this leads to fragmentation of transatlantic and global financial regulation, undermining its legitimacy and efficiency. But the US officials reply that as they have adopted a more stringent national standards, their extraterritorial reach will only enhance global financial stability.

States and companies can hardly afford to lose access to the American financial markets. This is the major reason for them to comply with American rules. It is important to take into consideration that the extraterritorial application of laws of a state is a mechanism to create traditional, legally binding transnational financial regulation, which could be enforced onto competitors of the United States.

In the framework of its export control policy, the US government carries out a policy of financial control which is intermittently used as an instrument of extraterritorial sanctions. When applying these mechanisms, American regulators, especially the Federal Reserve, widen their global reach. For example, in summer 2014, the Fed fined French transnational bank BNP Paribas for violating American sanctions on Iran. Together with the French banking regulator, the Fed issued a joint order to BNP Paribas to adopt a program of compliance with the American sanctions laws, when acting globally.

**Legitimacy challenges to the emerging global financial regulation**

In general, legitimacy of decisions of network financial regulators depends on states. The input legitimacy of the global financial regulation, executed through the transgovernmental networks, stems from the national financial regulators. In their home countries they are nominated by the executive and confirmed by the legislative branches of power. In the financial regulatory networks, heads and staff of national regulatory bodies cooperate, e.g. IOSCO is comprised of national securities and derivatives regulators, the BCBS – of central bankers and some other regulators of the banking activities.

The output legitimacy is determined by the efficacy of the decisions made, or augmentation of the public good, which in case of international financial regulation means global financial stability. In practice such efficacy is in question, especially in the last 2-3 years, as global financial reform loses momentum and the unification of normative base seems unreachable, but also due to the problems of redistribution and conflicts of interests.

If our intention is to measure legitimacy by transparency and openness of the system, we need to acknowledge the fact that network regulators move in this direction indeed. Regulators publish their proposals on the Internet, invite public comments, promulgate comment letters, and also inform the stakeholders on what has been changed in the original versions of the documents. Activity, principles and process of decision-making are highlighted on their websites. If the Basel I accord was concluded behind the closed doors, the development of the Basel II and Basel III was open to the public – the proposals were disclosed in advance, comments were invited and seriously considered when making the final version of the documents.

But in fact, what could have become an important contribution to enhancing of the legitimacy, becomes a limiting factor. The overwhelming majority of respondents to these calls for comment are financial companies, or other business groups. According to Pagliari and Young, in 1999-2013 civil society groups, such as consumer protection advocates, organized labour, research institutes and NGOs, wrote no more than 6% of aggregate public comment letters in response to a wide range of financial regulatory consultations in US, EU and at international level.

The most important limitation to the enhancement of legitimacy of the global financial

---


regulation stems from the fact that for the rest of the world the American norms lack legitimacy, as they are adopted by regulators assigned by officials elected by population of a foreign territory.

**Conclusion**

The United States maintain leadership in the field of international financial reform, as well as in the shaping of the global financial regulation system. During the negotiations on the Transatlantic Trade and Investment Partnership, the European Union proposed to consider legally binding treaty provisions on the unification of financial regulation standards, but the American side did not support the idea. The reason might be that in the existing “soft law system” it is easier for the US to pursue its national interest in the world of global finance.

While promoting financial reform, the USA reserves a right for itself to execute a completely independent national financial regulatory policy, based on the territorial approach, without accepting new European norms. Presumably, one of the goals of the American policy, as concerns financial reform, is to sustain hierarchy in the US-EU relations.

During the financial crisis and right after it the European Union demonstrated its intention to become a leading player in the global financial regulation as well. But the analysis of actions taken by US and EU on certain directions of financial reform showed that the EU could not catch up and start to set global agenda. The Americans maintain leadership in generating ideas and realizing them in several fields, as well as in transatlantic financial competition. It became a clear competitive advantage of the US that it has the most developed expert and technical capacity to create standards of financial regulations and to try imposing them on the rest of the world.

The main actors working to sustain American global leadership in the financial field are the major American financial regulators themselves. The Federal Reserve, the SEC, the CFTC not only exercise functions of national financial regulation and supervision, but also take an active, and often leading part in developing international norms. Their influence stretches to other countries, as the American regulators push for extraterritorial application of the US norms and take other unilateral actions in the field on international global regulation.

**References**

- **Young, Kevin; Pagliari, Stefano.** Capital United? Business Unity in Regulatory Politics and the Special Place of Finance // Regulation & Governance, 2015, DOI: 10.1111/rego.12098.
Сравнительная политика и геополитика

США в формирующейся системе глобального финансового регулирования
Василиса Константиновна Кулакова

Институт мировой экономики и международных отношений имени Е.М. Примакова Российской академии наук (ИМЭМО РАН), г. Москва, Россия

Информация о статье:
Рукопись поступила в редакцию: 21 января 2016 г.
Прием к печати: 10 июня 2016 г.

Об авторе:
k-полит.-, старший научный сотрудник Центра североамериканских исследований ИМЭМО РАН
e-mail: vasilisa-kulakova@yandex.ru

Ключевые слова: финансовое регулирование; глобальное финансовая реформа; сетевое финансовое регулирование; легитимность; финансовый кризис 2008–2009 гг.; экстерриториальное применение законодательства; Закон Додда-Франка о реформе финансового сектора и защите потребителя; лидерство США; Большая двадцатка; трансплантационные отношения.

Аннотация: В мире финансово-экономической взаимозависимости формируется полицентрическая, многоуровневая и иерархическая система глобального финансового регулирования. В данной статье освещаются два вектора развития: активизация международного сотрудничества по вопросам унификации финансовых норм в рамках Большой двадцатки, с одной стороны, и сохранение лидирующей роли Соединенных штатов в глобальных финансах – с другой. В условиях глобального кризиса 2008-2009 гг. страны Большой двадцатки инициировали международную реформу финансового регулирования. В соответствии с их решениями международные стаидастандартыстанавливающие организации, работающие по сетевому принципу, – Базельский комитет по банковскому надзору, Международная организация комиссий по ценным бумагам и др. – разработали транснациональные режимы регулирования в области банковской деятельности, торговли деривативами и ликвидации финансовых компаний-банкротов, а государства в настоящее время пытаются использовать эти режимы в своих целях. Так называемая «система мягкого права», которая не связывает государства юридическими обязательствами, позволяет им сохранять национальный суверенитет в области финансовой политики. США играет ведущую роль в международной финансовой реформе, а также оказывает значительное влияние на формирование глобальной системы финансового регулирования. Американские ведомства финансового контроля – Федеральная резервная система, Комиссия по ценным бумагам и биржам и др. – активно продвигают экстерриториальное применение американских стандартов финансового регулирования, а также предпринимают другие действия одностороннего характера на международной арене. В статье также затрагиваются вопросы легитимности формирующейся системы глобального финансового регулирования. Самые важные факторы, которые ограничивают возможности повышения ее легитимности, – это чрезвычайно сильное влияние финансовой индустрии на принятие решений в области финансового регулирования, недостаточная активность организаций гражданского общества, а также тот факт, что распространение американских норм на глобальном уровне препятствует укреплению легитимности глобальной системы финансового регулирования.

DOI: 10.18611/2221-3279-2016-7-3(24)-55-60

DOI: 10.18611/2221-3279-2016-7-3(24)-55-60