



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT
ECONOMIC AND SCIENTIFIC POLICY **A**



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The European Union's Role in International Economic Fora Paper 5: The BCBS

In-depth Analysis for the ECON Committee



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

The European Union's Role in International Economic Fora

Paper 5: The BCBS

IN-DEPTH ANALYSIS

Abstract

This paper forms part of a series of nine studies on the role of the European Union (EU) in International economic fora, prepared by Policy Department A at the request of the Committee on Economic and Monetary Affairs. It examines the set up and the functioning of the Basel Committee on Banking Supervision (BCBS), as well as the representation and the influence of the EU therein. The final section of the paper evaluates the compliance of the BCBS with the *Recommendations for International Organizations* issued by the International Law Association.

This document was requested by the European Parliament's Committee on Economic and Monetary Affairs. It is part of a series of nine papers which cover from the same scientific angle: G20, FSB, IMF, OECD, BCBS/Basel, IAIS, IOSCO, IASB, and IOPS.

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Original: EN

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Manuscript completed in March 2015
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LIST OF ABBREVIATIONS

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CRD	Capital Requirements Directive
DG	Directorate General
DG FISMA	Directorate General Financial Stability, Financial Services and Capital Markets Union (European Commission)
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN	Council of Economic and Finance Ministers
EMU	Economic and Monetary Union
EP	European Parliament
FSB	Financial Stability Board
G 20	Group of Twenty
GHOS	Group of Governors and Heads of Supervision
ILA	International Law Association
IOs	International Organisations
IOSCO	International Organization of Securities Commissions
MOU	Memorandum of Understanding
OECD	Organization for Economic Co-operation and Development
RRPs	Recommended Rules and Practices
SSM	Single Supervisory Mechanism

EXECUTIVE SUMMARY

The European Union (EU) and its Member States participate in a variety of **international financial regulatory fora**. These fora issue standards, guidelines and best practices ('**soft law**')¹, which are then implemented domestically by the member jurisdictions. During and after the global financial crisis, international standard-setting bodies have adopted a vast array of new financial rules, following the political leadership of the G 20 and with some coordination provided by the Financial Stability Board (FSB). These international rules have subsequently been implemented in several jurisdictions, including the EU and its Member States. The policy failure of the global financial crisis first and the responses of the public authorities later have brought into sharp relief the role of international standard-setting bodies in finance, raising issues concerning the **role of the EU in these bodies**, in particular its influence in standard-setting processes, as well as the effects of international rules once they are implemented domestically across jurisdictions.

The **Basel Committee on Banking Supervision** (BCBS) is the international standard-setter in banking. It comprises central banks and banking regulators from 28 jurisdictions, including the EU. The European Commission and the European Banking Authority (EBA) have observer status, whereas the European Central Bank (ECB) holds a two-seat full membership. The national authorities of nine EU Member States are also members of the BCBS, namely Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden and the United Kingdom.

This paper has three main aims:

- first, to outline the set-up and the **functioning of the BCBS**, considering its legal status, mission, governance structure, membership and 'outputs';
- second, to examine the **representation** and the **role of the EU** therein, paying particular attention to the coordination of the EU position and its effectiveness in the BCBS (that is, its ability to influence the standard-setting process);
- third, to evaluate to what extent the BCBS complies with the **recommendations for international organisations** issued by the International Law Association, albeit with the proviso that the BCBS is not an international organisation.

¹ Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century*.

INTRODUCTION

KEY FINDINGS

- International regulatory cooperation in finance is needed in order to avoid regulatory gaps and overlaps. The international financial regulatory fora that bring together national regulators mainly serve this purpose and promote cross-border cooperation in practice.
- The BCBS is one of the oldest and most well-established international financial regulatory fora. It is the international standard setter in banking.

The global financial crisis has brought into the spotlight the political salience of financial regulation². The regulation of financial services has become increasingly complex due to the globalisation of finance and the large number of international, regional, transnational and national public and private regulatory bodies involved³. The governance of financial services is characterised by two main, interrelated regulatory phenomena: the interaction between institutions and rulemaking processes across multiple arenas (national, international and transnational), and the ‘accommodation’ or ‘coexistence’ of their outputs.

The main functions of **international financial regulatory fora** are:

- i) to **promote international harmonisation**, so as to prevent regulatory gaps and overlaps of rules across jurisdictions;
- ii) to **avoid competitive distortions**, promoting a level playing field across jurisdictions;
- iii) to **foster cooperation** amongst national regulators.

International standard-setting bodies issue principles, guidelines, sound practices (i.e. ‘soft law’), which are subsequently implemented in the jurisdictions that are members of these bodies, and often also in non-member jurisdictions⁴.

The EU is one of the world’s largest financial jurisdictions and has become an increasingly important player in global financial regulation following the establishment of the Economic and Monetary Union (EMU) and the re-launch of the completion of the single financial market. After the global financial crisis, the EU has been very active in international financial regulatory fora⁵. In finance, unlike in trade policy, the EU does not have exclusive legal competences, therefore the European Commission does not have the exclusive power to represent the EU and its Member States in international regulatory fora. The mechanisms for the international representation of the EU and its Member States vary across financial services. In some cases, the Commission participates as an observer, in other cases it is a full member, together with representatives from the Member States, or some of them.

² For an overview of post-crisis regulatory changes across a variety of jurisdictions see Mayntz, *Crisis and Control: Institutional Change in Financial Market Regulation*; and Moschella, Tsingou (eds.), *Great Expectations, Slow Transformations: Incremental Change in Financial Governance*.

³ Porter, *Globalisation and Finance*.

⁴ Singer, *Regulating Capital: Setting Standards for the International Financial System*.

⁵ Mügge (2011), The European presence in global financial governance: a principal-agent perspective, pp. 383–402; Mügge (2014), *Europe’s roles in Global Finance*; Quaglia (2014a), *The European Union and Global Financial Regulation*; Quaglia (2014b), The sources of European Union influence in international financial regulatory fora, pp 327-345; Quaglia (2014c), The European Union, the USA and International Standard Setting in Finance, pp. 427-444.

The **BCBS** is the **international standard-setting body in the banking sector**, its establishment dating back to 1974⁶. It sets prudential rules for banks and promotes cooperation amongst national banking supervisors. Its most important regulatory outputs are the **Basel accords** - the Basel I accord was signed in 1988, followed by the Basel II accord in 2005 and the Basel III accord in 2010 – which set capital requirements for internationally active banks. These standards, which have become increasingly detailed over time, have *de facto* been applied by more than 100 jurisdictions worldwide and not only by the jurisdictions that are members of the BCBS. Although the BCBS does not have enforcement powers, its implementation working groups monitor how its capital rules are put into practice across jurisdictions.

As for **supervisory cooperation**, the very first document of the BCBS was the 'Concordat' in 1975⁷, revised and integrated into the '*Minimum Standards for the Supervision of International Banking Groups and their Cross-border Establishments*'⁸ in 1992. In 1997, the BCBS issued the '*Core Principles for Effective Banking Supervision*'⁹, which were subsequently revised over time, the most recent version dating from 2012¹⁰, and are included by the Financial Stability Board amongst the '*Key Standards for Sound Financial Systems*' for the financial sector assessments programme carried out by the International Monetary Fund (IMF)¹¹.

This paper first examines the set-up and the functioning of the BCBS, pointing out some distinctive features of this transgovernmental body (Chapter 1.). It then looks at the representation of the EU in the BCBS, the mechanisms for *ex-ante* and *ex-post* EU coordination, and the overall influence of the EU on the standard-setting activities of the BCBS (Chapter 2.). Finally, it assesses the compliance of the BCBS with the International Law Association's (ILA) recommendations (Chapter 3.).

⁶ Wood, *Governing Global Banking*; Kapstein (1989), *Resolving the Regulator's Dilemma: International Coordination of Banking Regulations*, pp. 323–347.

⁷ <http://www.bis.org/publ/bcbs00a.htm>.

⁸ <http://www.bis.org/publ/bcbsc314.htm>.

⁹ <http://www.bis.org/publ/bcbs30a.htm>.

¹⁰ <http://www.bis.org/publ/bcbs230.htm>.

¹¹ http://www.financialstabilityboard.org/what-we-do/about-the-compendium-of-standards/key_standards/.

1. THE SET-UP AND THE FUNCTIONING OF THE BCBS

KEY FINDINGS

- The BCBS is not an international organisation, does not issue legally binding standards and does not have universal membership.
- The BCBS issues standards, guidelines and sound practices that are implemented worldwide. The most important standards issued by the Committee have been the so-called Basel accords, setting capital requirements for internationally active banks.
- The EU has incorporated the Basel accords into legally binding legislation, the Capital Requirements Directives.

1.1. Legal status

The **BCBS does not possess any formal supranational authority** and its **decisions do not have legal force**¹². It is based in Basel (Switzerland) and the secretariat is provided by the Bank for International Settlements (BIS). It was established in 1974 as the Committee on Banking Regulations and Supervisory Practices¹³ and was later re-named as the Basel Committee on Banking Supervision¹⁴.

1.2. Mission statement and objectives

*'The BCBS is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability'*¹⁵.

Its objectives are:

- to set international standards for bank regulation and supervision and to monitor the implementation of those standards so as to avoid gaps and promote a level playing field internationally;
- to promote supervisory cooperation through the sharing of supervisory approaches and techniques and the exchange of information amongst supervisors, especially on cross border issues; and
- to cooperate with other financial sector standard setters and international bodies, particularly those involved in promoting financial stability¹⁶.

1.3. Governance structure

The members of the BCBS are the **central banks** and **banking supervisors** of the jurisdictions that are member of the **Group of Twenty (G 20)**, namely Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico,

¹² <http://www.bis.org/bcbs/charter.htm>.

¹³ <http://www.bis.org/bcbs/history.htm>.

¹⁴ For a history of the BCBS, see Goodhart, *The Basel Committee on Banking Supervision*; and Basel Committee on Banking Supervision, *A brief history of the Basel Committee*.

¹⁵ <http://www.bis.org/bcbs/charter.htm>.

¹⁶ <http://www.bis.org/bcbs/charter.htm>.

Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union, plus the Benelux countries, Spain, Sweden and Switzerland, which were already members of the BCBS before its membership was extended from the G 10 to the G 20 in 2009.

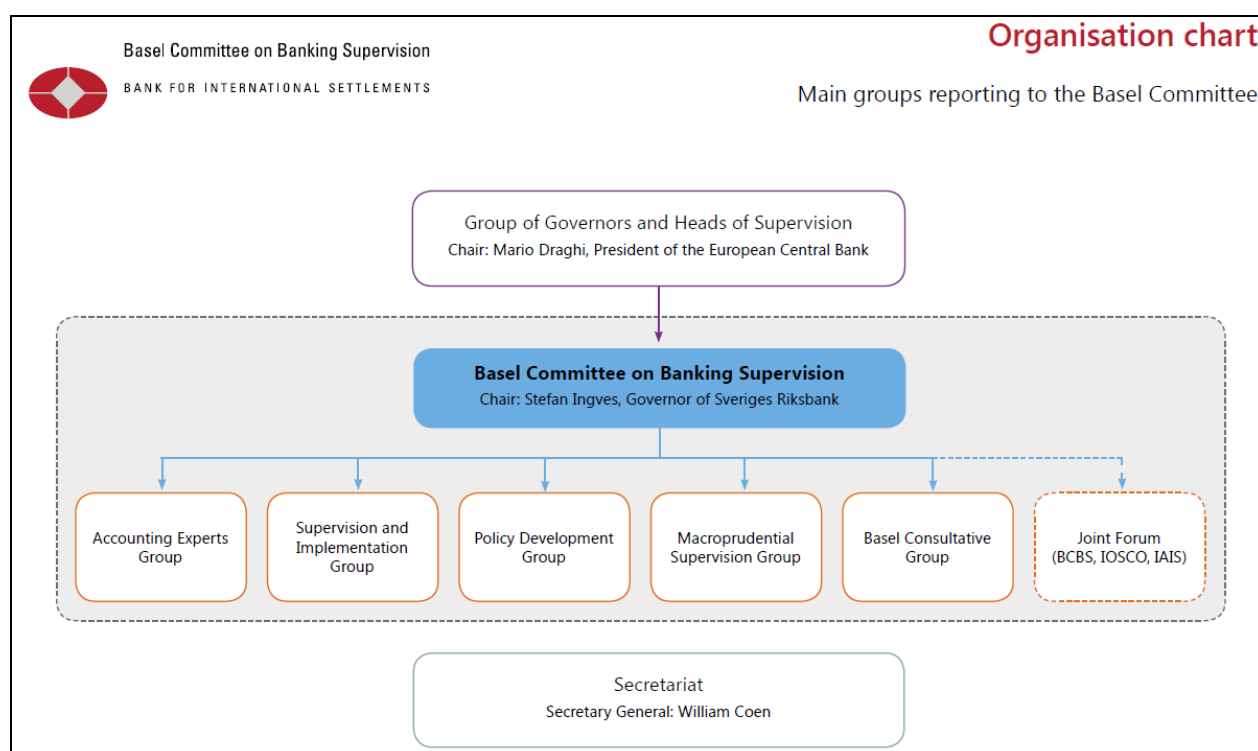
The **internal bodies** of the BCBS are:

- the **Group of Governors and Heads of Supervision** (GHOS), whereby the BCBS reports to the GHOS and seeks its endorsement for major decisions;
- the **Chairman**, who directs the work of the BCBS and is appointed by the GHOS for a term of three years that can be renewed once;
- the **Secretary General**, who is selected by the Chairman on recommendation of a selection panel comprising BCBS and/or GHOS members and a senior representative of the BIS; s/he is appointed for three years (renewable);
- the **Secretariat**, which is provided by the BIS and is composed of professionals mostly on temporary secondment from BCBS members;
- the **Groups**, which are composed of senior staff from BCBS members and report directly to the Committee;
- the **Working Groups**, which consist of experts from BCBS members that support the technical work of BCBS groups; and
- the **Task Forces**, which are generally composed of technical experts from BCBS members and are established to undertake specific tasks for a limited time¹⁷.

The Committee's work is organised under five main groups: the Supervision and Implementation Group; the Policy Development Group; the Macprudential Supervision Group; the Accounting Experts Group; the Basel Consultative Group. Reflecting its broad mandate, a number of specialised working groups report to the Policy Development Group: the Working Group on Capital deals with all issues associated with the definition of regulatory capital; the Risk Measurement Working Group deals with advanced risk measurement and management practices that are used for regulatory purposes; the Trading Book Working Group is responsible for the technical work associated with the Committee's fundamental review of the trading book capital framework; the Securitisation Working Group is currently reviewing the regulatory framework for securitisation exposures; the Leverage Ratio Working Group is undertaking the technical work associated with the leverage ratio within Basel III; the Working Group on Liquidity deals with the Committee's two main standards relating to liquidity and funding - the Liquidity Coverage Ratio and the Net Stable Funding Ratio; the Large Exposures Working Group is undertaking the Committee's current review of the large exposures framework; the Working Group on Disclosure has responsibility for Pillar 3, and ensuring disclosure initiatives are coordinated and consistent; the QIS Working Group and the Capital Monitoring Working Group are used to monitoring the evolution of capital requirements, both during the transition to Basel III and over the longer term. The Policy Development Group also has two task forces reporting to it: the Task Force on Standardised Approaches is reviewing the current standardised approaches particularly that for credit risk, and the Task Force on Interest Rate Risk is examining options for capturing interest rate risk in the banking book within the capital framework. In addition, the Research Task Force serves to the PDG. The Research Task force acts as a forum for research economists to engage in research projects on supervisory and financial stability issues, and for liaison with the academic sector. There is also a Task Force on Simplicity and Comparability¹⁸.

¹⁷ <http://www.bis.org/bcbs/charter.htm>.

¹⁸ http://www.bis.org/bcbs/groups.htm#Macprudential_Supervision_Group.

Figure: Organisational chart of the Basel Committee

Source: BCBS website, <http://www.bis.org/bcbs/organigram.pdf>.

Decisions in the BCBS are taken **by consensus**¹⁹.

The BCBS engages in **public consultations** of its draft standards, guidelines and sound practices. This is done by issuing a public invitation to provide comments in writing to the Secretariat on policy proposals issued by the Committee, within a specified timeframe. These comments are then posted on the BCBS website, unless confidentiality is requested by respondents²⁰.

As for **accountability**, the BCBS reports to the GHOS and seeks its endorsement for major decisions. The BCBS periodically reports to the G 20 on specific issues, such as the implementation of the Basel III accord. The BCBS '*decisions of public interest*' are made public through the Committee's website²¹.

The Secretariat of the BCBS is provided by the BIS, which hosts the meetings of the BCBS. The members of the working groups and task forces come from the national authorities that are members of the BCBS.

1.4. Membership

The current members of the BCBS are the central banks and banking supervisory authorities of 27 countries plus the EU²², see the following table.

¹⁹ <http://www.bis.org/bcbs/charter.htm>.

²⁰ <http://www.bis.org/bcbs/charter.htm>.

²¹ <http://www.bis.org/bcbs/charter.htm>.

²² <http://www.bis.org/bcbs/membership.htm>.

Table: Membership of the BCBS

Country	National authorities represented in the BCBS
Argentina	Central Bank of Argentina
Australia	Reserve Bank of Australia; Australian Prudential Regulation Authority
Belgium	National Bank of Belgium
Brazil	Central Bank of Brazil
Canada	Bank of Canada; Office of the Superintendent of Financial Institutions
China	People's Bank of China; China Banking Regulatory Commission
EU	European Central Bank; European Central Bank Single Supervisory Mechanism
France	Bank of France; Prudential Supervision and Resolution Authority
Germany	Deutsche Bundesbank; Federal Financial Supervisory Authority
Hong Kong	SAR Hong Kong Monetary Authority
India	Reserve Bank of India
Indonesia	Bank Indonesia; Indonesia Financial Services Authority
Italy	Bank of Italy
Japan	Bank of Japan; Financial Services Agency
Korea	Bank of Korea; Financial Supervisory Service
Luxembourg	Surveillance Commission for the Financial Sector
Mexico	Bank of Mexico; Comisión Nacional Bancaria y de Valores
Netherlands	Netherlands Bank
Russia	Central Bank of the Russian Federation
Saudi Arabia	Saudi Arabian Monetary
Singapore	Monetary Authority of Singapore Agency
South Africa	South African Reserve Bank
Spain	Bank of Spain
Sweden	Sveriges Riksbank; Finansinspektionen
Switzerland	Swiss National Bank; Swiss Financial Market Supervisory Authority
Turkey	Central Bank of the Republic of Turkey; Banking Regulation and Supervision Agency
United Kingdom	Bank of England; Prudential Regulation Authority
United States	Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation

Source: BCBS Website, <http://www.bis.org/bcbs/membership.htm>.

Observer members are: Chile (Central Bank of Chile/Banking and Financial Institutions Supervisory Agency); Malaysia (Central Bank of Malaysia); United Arab Emirates (Central Bank of the United Arab Emirates); Bank for International Settlements; **European Banking Authority** (since 2014); **European Commission**; International Monetary Fund; and Basel Consultative Group²³. Prior to the establishment of the Single Supervisory Mechanism, the **European Central Bank**, like the European Commission, sat on the BCBS as an observer²⁴.

1.5. Membership of internal bodies

The Basel Committee's working groups and task forces are in principle open for participation by staff of the members and observers of the BCBS.

The ECB and the ECB/Single Supervisory Mechanism (SSM) are full members of the main Committee, and the EBA and European Commission take part in an observer capacity. Decisions by the main Committee require the consensus of the full members, but not of the observers.

- The **European Commission** is usually represented in the meetings of the BCBS by the Director of Financial Institutions in Directorate General Financial Stability, Financial Services and Capital Markets Union (DG FISMA). The Commission moreover, according to its capabilities as to staff participation and to budget travel expenses, prioritises participation in those working groups and task forces that are of particular strategic interest concerning the development of European policies. Where the Commission decides to send an observer to a given group, the person will be chosen from DG Financial Stability, Financial Services and Capital Markets Union staff considering the level of seniority of members in the group and the specific expertise required for participation.
- The **EBA** is represented in the BCBS by the EBA Executive Director. The EBA Chair sits in the GHOS meetings of the BCBS. In the BCBS subgroups, the EBA is represented by the Director of Oversight, and heads of units and senior policy experts sit in the working groups and task forces. The EBA participates in the two main subgroups of the BCBS, in several working groups (but not all of them because of staff constraints), and chairs two task forces.
- The **ECB** holds a two-seat membership in the BCBS on account of its tasks as (i) central bank and (ii) micro-prudential supervisory authority for the banking sector in the EU countries that participate in the SSM.

This membership arrangement is in place since late 2014, when - as a result of the operationalisation of the SSM - the ECB became a competent authority for banking supervision. Previously, the ECB held only one seat and also a different status in the BCBS (i.e. observer instead of member). In accordance with the BCBS Charter, the change in the membership status of the ECB aimed to reflect the importance of the euro area as a single supervisory jurisdiction. Moreover, the two-seat representation granted to the ECB reflects the separation principle between the supervisory and monetary policy functions. The two-seat membership is not an unusual arrangement in the BCBS for central banks that in addition have a supervisory authority (see Table in Section 1.3.).

²³ http://www.bis.org/bcbs/membership_bcg.htm.

²⁴ <http://www.bis.org/bcbs/membership.htm>.

The representative of the ECB's central banking wing in the BCBS is the Executive Board member of the ECB responsible for overseeing the DG for Macro-Prudential Policy and Financial Stability; the representative of the ECB's SSM is the Executive Board member who is also the Vice-Chair of the Supervisory Board of the SSM and is responsible - with the Chair of the Supervisory Board - for those business areas dealing with banking supervision. At the technical level (working groups, task forces) of the BCBS, the institutional representation is performed by senior members of staff with specialised expertise in banking and financial stability matters. In addition, the President of the ECB is currently the Chairman of the GHOS, which is the oversight body of the BCBS.

1.6. Description of products and processes

Usually, the BCBS receives its mandate concerning standard-setting from the GHOS, which provides guidance. For guidelines and best practices, the BCBS acts on its own initiative²⁵. The work of the BCBS follows a combined top-down and bottom-up approach similar to other international institutions. Under the steering of the parent Committee, the work is carried out by technical working groups composed of staff-level representatives from member and observer institutions, and subsequently escalated to the Committee for further guidance and, ultimately, for approval.

The BCBS issues **standards** for internationally active banks. These '*standards constitute minimum requirements and BCBS members may decide to go beyond them*'²⁶. The BCBS expects its members to implement its standards by incorporating them into the national legal frameworks through each jurisdiction's rule-making process, within the pre-defined timeframe established by the Committee²⁷.

Guidelines elaborate upon the standards by providing additional guidance for the purpose of their implementation²⁸.

Sound practices generally describe actual observed practices, with the goal of promoting common understanding and improving supervisory or banking practices²⁹.

Standards, guidelines and sound practices are developed by BCBS working groups and task forces. For the main standards issued by the BCBS, namely the Basel agreements, several working groups are active at the same time, discussing various parts of the agreement. These groups and task forces report to the BCBS, which in turn reports to the GHOS and seeks its endorsement for major decisions. The BCBS holds public consultations during the standard-setting process by posting draft documents on its website and inviting responses by the interested parties. These responses are subsequently posted online, unless otherwise stated. The BCBS has implementation working groups (for example, on Basel III) that monitor how its standards are implemented across jurisdictions.

Those European bodies that are members and observers of the Committee typically do not participate in public consultation but bring their concerns to the table in the discussions of the Committee itself. By contrast, European stakeholders, including individual large banks

²⁵ In the case of Basel III, G 20 Leaders (meeting in London in April 2009) asked the BCBS in their declaration to 'review minimum levels of capital and develop recommendations in 2010 [...] and] develop and agree by 2010 a global framework for promoting stronger liquidity buffers at financial institutions, including cross-border institutions', pp. 2-3; http://www.treasury.gov/resource-center/international/g7-g20/Documents/London%20April%202009%20Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf.

²⁶ <http://www.bis.org/bcbs/charter.htm>.

²⁷ Lyngen, Basel III: Dynamics of State Implementation, *Harvard International Law Journal* 53 (2), pp. 519–536.

²⁸ <http://www.bis.org/bcbs/charter.htm>.

²⁹ <http://www.bis.org/bcbs/charter.htm>.

and banking associations, including those of smaller, not internationally active banks, regularly respond to public consultations³⁰.

The BCBS and its working groups are not open to the public and there is no public record of their meetings. However, the BCBS makes available on its website not only consultative documents, analytical reports and final standards, but also its yearly work programme, occasional speeches by BIS officials and the BCBS Chairman, and press statements to communicate decisions taken by the Committee.

The average time to agree on new standards varies. For example, the Basel III accord was agreed in about two years (2009-2010), but its predecessor, the Basel II accord, took more than four years of negotiations (1999-2005). Guidelines and sound practices are usually quicker to agree, less than a year for guidelines (e.g. Operational Risk - Supervisory Guidelines for the Advanced Measurement Approaches, 2011; Guidelines for computing capital for incremental risk in the trading book, 2009) and sound practices (e.g. Sound practices for backtesting counterparty credit risk models 2010). This is because standards usually have a 'high profile': they have a broader scope and are more detailed than guidelines. Moreover, since standards are subsequently transposed almost word by word into national legislation, the process of reaching an agreement in the 'editing process' in Basel is time-consuming.

1.7. Other relevant features and observations

There are certain distinctive features of the BCBS that differentiate it from international organisations (see also Chapter 3.):

- First, the BCBS is not an international organisation, such as the United Nations, it is a committee of banking supervisors. In the academic literature the BCBS is often described as a '**transgovernmental forum**'³¹ or a '**network of national regulators**'³². Hence, it does not have legal personality. Domestically, many of the banking supervisors sitting on the BCBS have a considerable degree of independence or autonomy from their respective political authorities and have been delegated competences concerning banking regulation and supervision³³. The BCBS is a body of independent supervisory authorities and central banks and its non-EU members are often vested with wide-ranging rule making powers that are in the EU reserved for the co-legislators.
- Second, unlike other international financial regulatory fora, for example the International Organization of Securities Commissions (IOSCO), or the International Association of Insurance Supervisors (IAIS), the **BCBS does not have a universal membership**. Hence, not all the EU Member States sit on the BCBS. However, the membership of the BCBS was extended to all G 20 members in 2009.
- Third, the BCBS is one of the oldest and most well-established financial fora, dating back to 1974. Most importantly, the **standards** issued by the BCBS, although not legally binding, tend to be rather **detailed** (e.g. the Basel II and Basel III accords

³⁰ For example, the public responses to consultation on Basel III can be found at <http://www.bis.org/publ/bcbs165/cacomment.htm>.

³¹ Verdier, Transnational Regulatory Networks and Their Limits', pp. 114-171; Pan, Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks, pp. 243-284.

³² See Zaring, Three Challenges for Regulatory Networks, pp. 211-221.

³³ Kapstein (1992); Between Power and Purpose: Central Bankers and the Politics of International Regulation, pp. 265-287.

are hundreds of pages long) and are *de facto* **accepted worldwide**, even in countries that are not members of the BCBS³⁴.

- Fourth, the Basel I accord and its successors have been implemented in the EU by incorporating them into legally binding EU legislation, the **Capital Requirements Directives**, which have been revised over time. On certain issues, the EU has 'adapted' these international standards to the specificities of the European banking systems and more generally the European economies³⁵. Indeed, two EU features are noteworthy and explain why the EU was so 'sensitive' to the application of the Basel accords, especially Basel III. Unlike other jurisdictions, such as the US, the EU has applied the Basel accords to **all banks and investment firms**, regardless of their size, and not only to internationally active banks. Moreover, unlike in the US that has a well-developed capital market, banks in the EU provide most of the credit to the real economy - hence the concern that higher capital requirements might reduce the flow of credit to the real economy.

³⁴ Ho, Compliance and International Soft Law: Why Do Countries Implement the Basle Accord?, pp. 647-688.

³⁵ For a discussion of the implementation of Basel I in the EU, see Underhill, The Making of the European Financial Area: Global Market Integration and the EU Single Market for Financial Services, in Underhill (ed.), *The New World Order in International Finance*, pp. 101-123.

On the implementation of Basel II in the EU see Christopoulos, Quaglia, Network Constraints in EU Banking Regulation: The Case of the Capital Requirements Directive, pp. 1-22.

On the implementation of Basel III in the EU see Howarth, Quaglia, (2013), Banking on Stability: The Political Economy of New Capital Requirements in the European Union, pp. 333-346.

2. THE PARTICIPATION OF THE EU IN THE BCBS: ACCOUNTABILITY AND EFFECTIVENESS

KEY FINDINGS

- The European Commission and the European Banking Authority have observer status in the BCBS. The ECB has a two-seat full membership. The national authorities of nine EU Member States are members of the BCBS.
- There is room to improve the coordination of the EU and its Member States in the BCBS. This would also increase the effectiveness of the EU's action in the BCBS.
- The main difficulties in doing so are: the (at times) different preferences of the Member States, which are due to the distinctive configurations of national banking systems across the EU; the modalities of the external representation of the EU; the need to secure some room for manoeuvre for EU/European officials negotiating in the BCBS; and the confidentiality of some of the negotiations taking place in the BCBS.

2.1. Legal basis for EU participation in the BCBS

The **legal bases** for the participation of the European Union in international standards-setting bodies such as the BCBS are

- for the **Commission**: Article 220(1), 2nd subparagraph TFEU, to be read in parallel with Article 17(1) TEU;
- for the **ECB**: Article 6 Statute of the ESCB and the ECB; and
- Article 138 TFEU on '*on matters of particular interest for economic and monetary union within the competent international financial institutions and conferences*' (in combination with Article 17 TFEU) has not been applied up to now and seems of limited relevance as BCBS is not an international organisation.

According to the BCBS rules, '*in accepting new members, due regard will be given to the importance of their national banking sectors to international financial stability. The Committee will make recommendations to its oversight body, the Group of Governors and Heads of Supervision, for changes in BCBS membership*'³⁶.

2.2. The formation of the EU position

Financial regulation is a shared EU competence, unlike in trade policy, which is the exclusive competence of the EU. Whereas in trade policy there is a formal mandate given by the Council to the Commission, which negotiates with third parties on behalf of the Member States and on the basis of the mandate received, there is **no formal EU mandate** for the negotiations in the BCBS (nor in other international financial regulatory fora).

- The **Commission's** observers in different groups and task forces report to and take instructions from their respective management in DG FISMA, in line with Commission policies.

³⁶ <http://www.bis.org/bcbs/charter.htm>.

- The **EBA's** positions with reference to issues dealt with by the BCBS are discussed by the Board of Supervisors, as reported in the minutes that are publicly available, but which tend to be rather general. Since the setting-up of the SSM, EBA adopts its decisions (including those on matters related to the activities of the BCBS) by using double majority voting.
- The positions of the **ECB** representatives are determined on the basis of internal analyses and discussions among staff participating in technical working groups and senior ECB officials (whether responsible for supervision or other central banking tasks) involved in the decision-making process of the BCBS. The internal preparations take place also via dedicated and internal contact groups (established upon Executive Board decision) and via joint preparatory meetings ahead of BCBS meetings, in which staff from both the supervisory and central bank functions take part.

There is no formal **ex-ante coordination** in the EU with reference to the BCBS. Discussions in the (European Commission) **Expert Group on Banking, Payments and Insurance**³⁷, which brings together experts from the Member States (as well as an observer from the Parliament), often refer to the activities of the BCBS that are relevant for most topics concerning banking regulation. Moreover, issues related to the BCBS are occasionally included in the agenda of this Expert Group to update the group about regulatory developments in Basel.

The **Economic and Financial Committee** (EFC)³⁸ (especially its financial services sub-committee) at times discusses issues related to the BCBS.

There is no formal mechanism for EU institutions that participate in BCBS meetings to report back. **Ex-post coordination** takes place informally in the same fora as mentioned above, namely the *Expert Group on Banking, Payments and Insurance* and the *Economic and Financial Committee* (EFC).

Beside the cooperation that takes place in the context of EU committees and fora dealing with banking supervisory matters, there are also *ad-hoc* bilateral/multilateral contacts amongst EU participants in the BCBS for the purposes of exchanging views, reaching a shared understanding on certain issues, or trying to find a common stance/agreement in preparation for a meeting. On the one hand, there are attempts, especially but not only by the European Commission observers, to informally coordinate positions with those of other participants from the EU. On the other hand, ultimately, the ECB, EBA and Member State authorities and central banks retain independent responsibility for their respective positions.

The **outcomes of EU coordination** are somewhat mixed. For example, in the negotiations of the Basel III accord, which is the most important post-crisis, standard-setting activity of the BCBS, the positions amongst the Member States represented in the BCBS were very diverse, and on certain important issues (e.g. definition of what counts as capital, leverage ratio etc.) the EU was unable to speak with one voice in the BCBS³⁹, as detailed below. By contrast, in the negotiations of the Basel II accord, the EU presented a rather cohesive position.

³⁷ http://ec.europa.eu/finance/general-policy/expert-group/index_en.htm.

³⁸ http://europa.eu/efc/index_en.htm.

³⁹ Howarth, Quaglia (2015), The Political Economy of Basel III, unpublished manuscript available upon request.

2.3. Strengths, weaknesses, conflicts of interests and alternatives

There are potentially two conflicts of interests concerning the EU's participation in the BCBS. The first potential **conflict of interests** is **amongst the EU Member States**, especially those represented in the BCBS, if Member States have different preferences on the issues discussed by the BCBS. In turn, these preferences are rooted in different configurations of national financial (especially banking) systems across the Member States⁴⁰. Although the divergence of national preferences should not be overstated, there was evidence of it during the negotiations of the Basel III accord in 2009-11. For example, EU Member States had different views about the definition of capital (i.e. what should count as capital), the level of capital, the use of a leverage ratio, liquidity rules etc.⁴¹. However, this is not always the case. For example, in the negotiations of Basel II (1999-2005) the EU was much less internally divided than in the negotiations on Basel III. Moreover, conflicting interests amongst Member States are generally less likely to emerge in the negotiations of BCBS guidelines and sound practices.

The second potential **conflict of interests** is **between the EU institutions** sitting on the BCBS (European Commission, the ECB and the EBA) on one side, **and the Member States** (or certain Member States) on the other side. This is because EU Institutions are deemed to represent the 'EU interest', which might not necessarily be in line with that of specific Member States. In these circumstances, it would be perhaps more appropriate to speak of different 'priorities', rather than different preferences altogether. For example, in the negotiations of the Basel III, it was clear at the outset to the Commission that the accord would form the basis for the revision of the Capital Requirements directive in the EU, which applies to all banks and financial institutions, not only those internationally active, as in the case of the Basel accords. Hence, one of the Commission's priorities was to make sure that the standard set by the BCBS would be suitable for the banking systems of the entire EU without penalising lending to the real economy. This was less of a priority for Member States whose banks had a sound capital position and were less involved in lending to the real economy, first and foremost the UK⁴².

The main **strengths** of the current system of EU representation in and interaction with the BCBS is the **large number of members from the EU**: in addition to the ECB, thirteen central banks and/or supervisory authorities from nine EU Member States (Belgium, France, Germany, Italy, Luxembourg, The Netherlands, Spain, Sweden and the United Kingdom), plus the European Commission and the European Banking Authority (both observers) account for 17 out of 53 seats in the Committee. This is in line with the importance of the EU's banking sector: nearly half of world assets sits in EU banks. The current system of EU participation in the BCBS is characterised by the diversity of its institutional representation, which has the benefit of allowing for a reflection of EU specificities in the making of harmonised global standards.

The main **weaknesses** of the current system is that the EU sometimes is unable to present a cohesive position and therefore it **'punches below its weight'** in the BCBS (this point is further developed below). Potentially, there could be the issue of third countries exploiting intra-EU divisions. For example, in the Basel I and the Basel III negotiations, the UK tended to side with the US on several issues⁴³. Finally, it should be pointed out that some EU

⁴⁰ For an overview of different banking systems in the EU see Hardie, Howarth, *Market-Based Banking and the International Financial Crisis*. On the influence of varieties of capitalism on international (and EU) financial regulation see Fioretos, *Capitalist Diversity and the International Regulation of Hedge Funds*, pp. 696-723.

⁴¹ On the divergent preferences of EU Member States on Basel I, see Kapstein (1992); and Wood. On Basel II, see Wood. On Basel III see Howarth, Quaglia (2015); and Quaglia (2014).

⁴² Howarth, Quaglia (2015); Quaglia (2014a).

⁴³ Howarth, Quaglia (2015); Quaglia (2014a).

Member States, mainly from Central and Eastern European countries, are not represented in the BCBS. It is true that the European Commission and more recently the EBA, which might be seen as representing the EU as a whole, participate in the BCBS, but they have observer status. That said, this does not seem to have been a problem in practice so far.

Moreover, there are some **asymmetries** in the current set up for the external representation of the EU in the BCBS. These asymmetries partly reflect the allocation of competences within the EU and the trend towards 'differentiated integration' or 'variable geometry' in the EU. The ECB and the SSM, which have voting power in the BCBS, do not include all EU Member States, only the countries in the euro area and Banking Union area. In the EBA, the SSM is a non-voting member in the Board of Supervisors, sometimes accompanied by the ECB. But in the BCBS, the ECB/SSM have voting power, which the EBA does not have. Thus, there is the possibility that if the SSM does not fully agree with the decisions taken by the EBA, it can pursue its preferences in the BCBS. The same 'two-level game' (in academic jargon) applies to EU Member States' authorities that are members of the BCBS and that might have been outvoted in the decision-making process in the EBA and the decision-making process in the ECB/SSM. This is a distinctive version of the 'hybrid' model of the external representation of the EU⁴⁴, whereby some EU Member States have their representatives next to the agents for the EU (see, for example, the EU in the G 20). The EU in the BCBS has a distinctive hybrid model of external representation because

- a) the ECB/SSM do not act as agents of the EU; and
- b) it is central banks and supervisory authorities, not national governments, that sit on the BCBS.

Conclusion

On the one hand, there is room to improve the coordination and ultimately the effectiveness of the EU in the BCBS. On the other hand, there are obstacles to this. The main '**structural**' **obstacle** is that **national financial (especially banking) systems** in Europe remain distinctive and consequently Member States have different preferences on certain issues. It is therefore difficult to forge a common position regardless of the mechanisms for coordination set in place in the EU. At the same time, there is the concern that increased EU cohesiveness in the BCBS might prompt other members to ask for a unified EU representation, excluding from the BCBS current national representatives from EU countries. This would reduce the number of European participants sitting around the table and is likely to be resisted by the EU Member States that have a seat in the BCBS. Last but not least, there is the need to allow sufficient **room for manoeuvre** to EU/European negotiators in the BCBS and ensure the **confidentiality** of some of the discussions taking place in the Committee.

2.4. Possible linkages with the European Economic Governance and the Global Economic Governance

Nowadays, the **EU is one of the largest financial jurisdictions worldwide**. Over the last decade or so, the EU devoted considerable efforts to the completion of the single financial market in Europe, promoting regulatory harmonisation within its borders and strengthening the institutional framework for financial regulation and supervision⁴⁵. The establishment of EMU gave also new momentum to financial integration in the euro area.

⁴⁴ The hybrid model of EU external representation falls in between classical Community delegation and pure intergovernmental approaches.

⁴⁵ Donnelly, *The Regimes of European Integration: Constructing Governance of the Single Market*; Mügge (2010), *Widen the Market, Narrow the Competition: Banker Interests and the Making of a European Capital Market*; Quaglia (2010).

Moreover, the EU is increasingly active in international financial fora and is one of the main interlocutors of the US in the policy debate on this subject⁴⁶.

The EU is engaged in an ongoing process of **'downloading' and 'uploading' of rules to and from international regulatory fora**. Most of the time, the EU downloads international rules (e.g. the Basel accords, or the IOSCO principles on hedge fund regulation) and commitments (such as those stated in the G 20 communiques) into more detailed EU legislation. Indeed, international standards are often rather 'general'⁴⁷ so as to ensure their applicability across a variety of jurisdictions. Sometimes, the EU is able to upload parts of its regulatory templates to the international level, as in the case of supervisory principles for insurers ('Solvency II').

EU policy-makers, like policy-makers in other jurisdictions, face a **dilemma**: How to ensure domestic financial stability, bearing in mind that financial instability does not stop at national/EU borders, and at the same time protect the international competitiveness of the financial industry based in the EU? In the case of banking regulation, the dilemma becomes a **'trilemma'**, whereby the third policy objective is to secure funding to the real economy and hence ultimately economic growth, given the fact that in Europe, banks provide most of the funding to the real economy.

International standard-setting is intended to reduce the possibility of **regulatory arbitrage** between jurisdictions and to deal with cross-border externalities. However, the setting of international standards is not straightforward because different jurisdictions might have different priorities and even if they agree on the same priority, such as financial stability in the wake of the crisis, they have dissimilar national financial systems. Hence, different sets of rules are often needed to achieve similar objectives in different jurisdictions⁴⁸, which creates potential conflicts in international standard-setting.

Regulatory disputes might also arise if international standards are applied differently across jurisdictions, or if jurisdictions issue their own national rules without sufficient coordination with third countries, especially if the rules issued have cross-border effects. Examples are the US rules for over-the-counter derivatives, which have some extraterritorial application; or equivalence rules in EU legislation, which do not imply extraterritoriality, but might nevertheless have significant effects for third-country entities and products that want to enter the EU market. By and large, jurisdictions try to upload their domestic rules as international standards because this will reduce their domestic implementation costs in the downloading stage. At any rate, jurisdictions are keen to make sure that international standards are suitable for their domestic financial systems and more broadly their national economies.

⁴⁶ Posner, Making Rules for Global Finance: Transatlantic Regulatory Cooperation at the Turn of the Millennium, pp. 665–699; Quaglia, L. (2014); Leblond, P., EU, US and International Accounting Standards: A Delicate Balancing Act in Governing Global Finance, pp. 443–461.

⁴⁷ The Basel accords are an exception in this respect, in that they tend to be very detailed, unlike the vast majority of international financial standards.

⁴⁸ Fioretos, Capitalist Diversity and the International Regulation of Hedge Funds, pp. 696–723.

2.5. Qualitative evaluation of the influence the EU has on shaping international standards

Several factors affect the ability of a jurisdiction, in this case the EU, to influence international standard setting, namely:

Domestic market size

The first factor is *'market power'*⁴⁹, that is the sheer size of the EU internal market⁵⁰. *'International standards are not legally binding, they become so only when they are adopted and enforced by national (or regional, in the case of the EU) jurisdictions. Consequently, the support of a jurisdiction with a large internal market is essential for the success of international standards. If a large jurisdiction decides not to comply with international standards, these standards will be substantially weakened because international fora cannot force the domestic adoption of international rules. Hence, third countries have a significant incentive to make sure that the preferences of jurisdictions with large domestic markets are taken into account in international standard setting'*⁵¹. *Ergo, 'jurisdictions with large markets', first and foremost the US and more recently the EU, 'have greater influence than smaller jurisdictions in international regulatory fora'.*⁵²

Domestic regulatory capacity

The second resource that the EU can deploy in international standard setting is its ***'regulatory capacity'*** defined as *'a jurisdiction's ability to formulate, monitor, and enforce a set of market rules'*⁵³. It has to do with regulatory centralisation in the EU but also with the presence or absence of regulatory templates in the EU. A jurisdiction with ***'regulatory centralisation'*** can preclude access to its markets for third country firms that do not comply with its domestic rules, including those that follow international standards instead⁵⁴. Hence, jurisdictions with high regulatory capacity are more influential than other jurisdictions in international regulatory fora. There are also first mover advantages for (large) jurisdictions that first set the rules in a certain sector because those jurisdictions are better positioned to shape international rules. Not only do these jurisdictions have the expertise to interact effectively in international financial regulatory fora, they also have domestic ***'regulatory templates'*** – i.e. coherent sets of rules concerning certain financial activities - which can provide solutions to the issues that international standards seek to address⁵⁵. There are however two caveats. If domestic rules have been proved unfit for purpose, they do not provide credible templates for international rules. Moreover, if the international rules eventually adopted differ from domestic rules, there are considerable adjustment costs involved for the 'first mover' jurisdiction, and cross-borders regulatory disputes might arise.

⁴⁹ Drezner, *All Politics is Global: Explaining International Regulatory Regimes*; see also Simmons, *The International Politics of Harmonization: The Case of Capital Market Regulation*, pp. 589–620. These authors also consider the specific features of the policy areas under discussion, such as the 'externalities' and the 'incentives to emulate' the rules of the main markets, see Simmons, p. 589 and the 'typologies of global governance processes', see Drezner, p. 64.

⁵⁰ Damro, *Market Power Europe*, pp. 682–699.

⁵¹ Drezner considers the EU as one of the 'great powers', together with the US.

⁵² Quaglia (2014b), p. 328.

⁵³ Bach, Newman, *The European Regulatory State and Global Public Policy: Micro-Institutions, Macro-Influence*, pp. 1–20, p. 831; Posner.

⁵⁴ Damro; Posner, *Making Rules for Global Finance: Transatlantic Regulatory Cooperation at the Turn of the Millenium*, pp. 665–699.

⁵⁵ Quaglia (2014b), p. 329.

External EU representation

Thirdly, the mechanisms for the external representation of the EU affect its influence in international economic and financial fora. Some authors have argued that the ‘hybrid model’ of external representation, whereby (some) Member States and EU institutions are represented in a given forum, is the least effective⁵⁶. Other scholars⁵⁷ have argued that *‘the mechanism for the external representation of the EU does not make much of a difference’ in finance ‘if there is no agreement amongst the Member States’*⁵⁸.

EU cohesiveness

It is also important to consider the degree of **‘cohesiveness’** of the EU that is *‘the EU’s ability to formulate internally and represent externally a consistent position with a single voice, even if this is not the preferred position of all the member states’*. Based on this definition, a useful distinction can be made between **‘internal cohesiveness’**, which is *‘whether the member states can formulate a common position in spite of their divergences,’* and **‘external cohesiveness’**, which is *‘whether they let EU negotiators represent them in the international arena’* and *‘whether they accept the final outcome of the negotiations without trying to carve out exceptions for themselves or torpedoing the collective position by going behind the back of the EU negotiators’*⁵⁹.

*‘In policy areas other than international financial regulation, the cohesiveness of the EU has been considered as an important variable in order to explain its external influence’*⁶⁰, bearing in mind that the ability to speak with ‘one voice’ does not mean that the EU has to speak with ‘one mouth’, as it were. Thus, the EU might be able to speak with one voice *‘even if it formally does not have a single external representation, and the Commission does not have the power and the mandate to represent the EU. Furthermore, third countries will not be able to use the strategy of “divide and rule”, which is exploit differences amongst the member states in order to weaken the EU’s position in international fora. Even if third parties do not deliberately do that, intra-EU disagreement might play out in international financial regulatory fora, reducing the influence of the EU in international standard-setting’*⁶¹.

Support of the financial industry

Another factor that can affect the influence of the EU in international standard-setting in finance is the **support of the financial industry**, even though this raises some normative issues⁶². On the one hand, different parts of the financial industry in different jurisdictions often have different, even competing, preferences on international standards, such as the Basel accords⁶³. A diversity of financial industry preferences is especially common in the EU, where the Member States retain distinctive national financial systems. Indeed, one of the main difficulties in reaching an agreement on Basel I and Basel III (see below) was due to the fact that national regulators negotiating in the BCBS were keen to make sure that the new capital rules would not unduly penalise their domestic banking sector. On the other

⁵⁶ Muegge (2011).

⁵⁷ Hodson D. (2011), *Governing the Euro Area in Good Times and Bad*.

⁵⁸ Quaglia (2014b), p. 329.

⁵⁹ All quotes in this paragraph from Conceição-Heldt, Meunier, *Speaking with a single voice: internal cohesiveness and external effectiveness of the EU in global governance*, pp. 961-979.

⁶⁰ Quaglia (2014b), p. 330.

⁶¹ Quaglia (2014b), p. 330.

⁶² For an overview of this literature, see Baker, *Restraining Regulatory Capture? Anglo-America, Crisis Politics and Trajectories of Change in Global Financial Governance*, pp. 647–663.

⁶³ Young, *Transnational Regulatory Capture? An Empirical Examination of the Transnational Lobbying of the Basel Committee on Banking Supervision*, pp. 663-688; Pagliari, Young, *Leveraged Interests: Financial Industry Power and the Role of Private Sector Coalitions*, pp. 575-610.

hand, scholars working on international financial harmonisation have pointed out the pervasive power of the 'big players'⁶⁴, such as international banks (which have considerable human and financial resources at their disposal)⁶⁵, in the making of the Basel agreements.

An assessment of the EU's influence in the BCBS

What has been the EU's influence on international standard setting in banking to date? A shorthand definition of EU's '**influence**' in the BCBS is the '*ability to affect the international standard-setting process in such a way that the final rules reflect EU preferences*'. This approach however raises the broader issues of whether this outcome is feasible and desirable, given the fact that the BCBS has more than 27 members, and its rules are ultimately applied worldwide. Here, the analysis necessarily needs to be concise for reasons of space. Hence, the focus will be on the **Basel accords**, which set key prudential rules for internationally active banks. Given the importance of these rules and their detailed content, the negotiation of these accords has tended to be **less consensual than the preparation of other soft law issued by the BCBS**. This is an important qualification because most of the discussions taking place in the BCBS on guidelines and sound practices are often consensual. It is mainly on the Basel accords that open disagreements emerge amongst the members of the BCBS (to be precise, this happened for Basel I and Basel III, much less for Basel II). The following discussion mainly focuses on the most recent accord, Basel III, though the negotiations of the other two accords are also briefly outlined to provide some background information.

In 1988, the BCBS issued the **Basel I accord on *International convergence of capital measurement and capital standards***⁶⁶, which put in place capital rules for internationally active banks. Although this is to some extent an oversimplification, the Basel I accord was mostly the outcome of an alliance of the US and the UK, which were the main promoters of international capital standards for banks⁶⁷. Indeed, '*following the Latin America debt crisis, the USA had unilaterally introduced higher capital requirements domestically. US policymakers and US banks, which worried about international competitiveness, were keen to extend capital requirements to banks in other jurisdictions*'⁶⁸. In the same period, after some domestic policy failures, the UK had also introduced a risk-based approach to capital requirements, similar to that of the US⁶⁹. '*The US and the UK decided that a bilateral approach would be instrumental in getting international negotiations off the ground. Japan and, subsequently, the European countries accepted the Anglo-Saxon proposals. The Basel I accord, however, remained sufficiently flexible in certain important respects so as to facilitate its acceptance by a large number of countries*'⁷⁰. Crucially, the accord did not provide a common definition of capital.

The negotiations on **Basel II**, the successor of Basel I, gained momentum in 1999, and the accord was eventually agreed in 2004. Unlike Basel I, Basel II contained a new set of rules that was not 'uploaded' by a particular national jurisdiction. While they partly built on Basel I, the new rules were informed by proposals and studies from large cross-border banks and banking associations⁷¹. By and large, the US and the EU had similar preferences on the

⁶⁴ Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism*.

⁶⁵ Lall, *From Failure to Failure: The Politics of International Banking Regulation*, pp. 609-638; Tsingou, *Transnational Private Governance and the Basel Process: Banking Regulation and Supervision, Private Interests and Basel II*, pp. 58-68; Underhill, Zhang, *Setting the Rules: Private Power, Political Underpinnings, and Legitimacy in Global Monetary and Financial Governance*, pp. 535-554.

⁶⁶ See <http://www.bis.org/publ/bcbs04a.htm>.

⁶⁷ Kapstein (1992, 1989); Simmons; Wood.

⁶⁸ Quaglia (2014c), p. 436.

⁶⁹ Kapstein (1992, 1989); Simmons; Wood.

⁷⁰ Quaglia (2014c), p. 436.

⁷¹ Tarullo, *Banking on Basel: The Future of International Financial Regulation*; Young.

content of the accord (with some important qualifications, such as the treatment of loans to small and medium enterprises and the use of ratings issued by credit rating agencies etc.). Unlike in the negotiations on Basel I, in the negotiations on Basel II there was no clear-cut division between the US and UK on one side and continental European countries on the other⁷². The 1990s and early 2000s were characterised by the absence of major banking crises in the US and the EU, which encouraged some general complacency about prudential rules.

The global financial crisis brought into sharp focus the inadequacy of existing capital requirements and therefore the need to revise the content of the Basel II accord. The BCBS put forward concrete proposals for the **Basel III accord** in December 2009 and the final agreement was reached in September 2010. The new rules will be phased in gradually from January 2013 until 2019. Different members of the BCBS had different preferences on certain important issues as a result of the different configuration of their national financial systems and domestic regulatory frameworks: Oversimplifying the argument, the US and the UK (joined by Switzerland and Sweden) wanted a stricter definition of capital, to be limited to ordinary shares; higher capital requirements, including capital buffers; a leverage ratio; liquidity rules; and a short transition period. Continental countries (joined by Japan) wanted a broader definition of capital, including hybrids and silent participations and lower capital requirements. They opposed the leverage ratio, asked for a modification of certain aspects of the liquidity rules, and pushed for a longer transition period⁷³. The final outcome was a compromise between the different positions. Overall, while the influence of individual European countries on issues that were important to them was significant (namely they managed to have some of their preferences incorporated in the final content of the accord, such as longer transition periods), it is somewhat more difficult to identify a 'EU position' as such because the Member States disagreed amongst themselves on some important issues, which runs counter to a precondition for EU influence as defined above.

Everything considered, the **influence of the EU** in the making of the Basel accords has been **mixed**. First, the **Member States had different preferences** on Basel I and III, thus it was difficult (also for third parties) to identify an 'EU position' as such. Second, in the negotiations on Basel I and III, the **UK tended to side with the US** on important issues (a similar trend occurred also in other international financial fora, such as in the case of hedge funds regulation). Third, the influence of the EU on the final outcome partly depended on the **position of the other main 'player', namely the US**. Overall, it was easier for the EU and the US to agree on making international prudential standards for banks more market-friendly, as was done in Basel II, than to agree on tightening up regulation, as in the case of Basel III. After the inclusion of new members from the G 20 in the BCBS in 2009, it is likely that some of the main emerging economies will play a more important role in the debate in the BCBS.

If one considers the five factors mentioned above, which can affect the influence of a jurisdiction in international standard-setting in finance, the first one, namely a large domestic market, applies to the EU, which indeed has one of the largest banking sector in the world. The second factor, namely regulatory capacity, is also well developed, especially after the near completion of the single financial market and EMU in the 2000s⁷⁴. It should however be noted that the EU, for good reasons, never developed its own capital standards independently from the BCBS. The external representation of the EU in the BCBS is not too dissimilar to that of other areas of shared EU competences, and presents the pros and cons

⁷² Tarullo; Lall; Young.

⁷³ Howarth and Quaglia (2013, 2015), Quaglia (2014).

⁷⁴ The First Banking Directive dates back to 1977 and the Second Banking Directive to 1988. Story, Walter, *The Political Economy of Financial Integration in Europe: The Battle of the System*.

mentioned above. The cohesiveness of the EU in the most contentious negotiations taking place in the BCBS (namely, the Basel accords), has often been low because of different preferences amongst the Member States and mechanisms for *ex-post* and *ex-ante*, intra-EU coordination which could be improved.

2.6. Recommendations

1. It would be **problematic** to set up a **single EU representation** because the Member States whose national authorities sit on the BCBS are unlikely to endorse it.
2. The use of a '**mandate**' binding EU institutions and maybe the EU Member States sitting on the BCBS would be rather **difficult**. Moreover, the Commission and the EBA are only observers in the BCBS; and the ECB, which is a full member, enjoys a high degree of institutional independence.
3. For the most important matters, such as Basel III (or its successor), the EU could aim to draft **agreed language** or **terms of references**, similar to those prepared for the G 20 leaders summits and the G 20 meetings respectively. The caveat is that the experience of the EU in the G 20 suggests that the process necessary in order to arrive to EU-agreed language/terms of references can be burdensome (especially for those coordinating it) and there is the risk that confidential documents might be leaked to third parties.
4. In order to improve the coordination of the EU in the BCBS, prior to the main meetings in Basel it would be advisable to have **ad-hoc ex-ante meetings** of the *Expert Group on Banking, Payments and Insurance*, the *Economic and Financial Committee* (EFC) discussing the dossiers to be dealt with by the BCBS (eventually, these issues could also be discussed in ECOFIN meetings). There could also be **ad-hoc ex-post meetings** of the same bodies mentioned above in order to report back on the discussion taking place in the BCBS. *Ex-ante* and *ex-post* meetings would be instrumental to discuss BCBS-related issues not only amongst EU institutions, but also with the Member States that sit in the BCBS and the Member States that are not represented in the BCBS.
5. It would be advisable to put in place mechanisms to further the **cooperation** amongst the three **EU institutions** participating in the work of the BCBS, bearing in mind their respective functions, competences, and institutional prerogatives.
6. Given the fact that the **ECB** has recently become a full member of the BCBS, it will be interesting to examine **how the ECB coordinates/cooperates with** the national central banks and supervisory authorities of the countries that have joined the Banking Union and are also members of the BCBS.

3. CONFORMITY OF THE BCBS WITH ILA RECOMMENDATIONS AND PRACTICES

KEY FINDINGS

- The BCBS is not an international organisation and this should be taken into account in the evaluation of its compliance with the recommendations issued by the Committee on Accountability of International Organisations.
- The BCBS complies only with some of the recommendations. It does not fully comply with provisions concerning transparency, public access to information, reporting and liaison with NGOs.

Part of the request of the European Parliament was to evaluate very briefly to what extent the BCBS/Basel comply with (exclusively) Part One, First Level (pp. 8-17) of the *Recommended Rules and Practices (RRPs)*⁷⁵ issued by the Committee on Accountability of International Organisations⁷⁶ of the International Law Association (ILA).

Several caveats are needed before undertaking this evaluation. To begin with, the **BCBS is not an international organisation (IO)**. Some of the recommendations issued by the Committee on Accountability of International Organisations should be applied to the BCBS *cum grano salis*. For others, it is difficult to evaluate their implementation by the BCBS.

All that being said, the BCBS complies only with some of the recommendations. **It does not fully comply with provisions concerning transparency, public access to information, reporting and liaisons with NGOs.**

Section One: RRP based upon principles, objectives and concepts common to all IO-s

1. Transparency in both the decision-making process and the implementation of institutional and operational decisions.

1. *IOs should, as a general rule, adopt normative decisions in a public vote:*

The BCBS does not adopt decisions in a public vote

2. *Meetings of non-plenary organs should in principle be public unless inappropriate:*

The meetings of the BCBS are not open to the public.

3. *Non-plenary organs of an IO should as a general rule grant through their Rules of Procedure an appropriate status to Member States, other States, and non-State entities particularly affected by decisions to be taken or contributing to operational activities:*

The BCBS does not have non-plenary organs as such. Its working groups and task forces are staffed by officials from the countries that are members of the BCBS and to which the standards issued will apply, subject to domestic implementation.

2. Participatory decision-making process

1. *Plenary organs of an IO should make appropriate procedural arrangements enabling all members to participate fully in the decision-making process:*

The plenary organs of the BCBS involve all the members of the BCBS and decisions are

⁷⁵ See <http://www.ila-hq.org/download.cfm/docid/6B708C25-4D6D-42E2-8385DADA752815E8>.

⁷⁶ See <http://www.ila-hq.org/en/committees/index.cfm/cid/9>.

taken by consensus, which means that a decision/standard is adopted only if all the members agree.

2. Plenary organs of an IO should periodically review the membership of non-plenary organs especially those possessing executive powers:

In the BCBS there are no non-plenary organs possessing executive powers. The composition of BCBS working groups and task forces is periodically reviewed.

3. When taking or reviewing decisions on coercive measures, organs should enable Member States whose interests are specially affected to express their views:

The BCBS does not take coercive measures, its standards/decisions are not legally binding.

3. Access to information

1. Documents of an IO should, as a general rule, be available to all Member States. Competent organs should, at regular intervals, review restrictions on access to documents:
The documents of the BCBS are available to its members.

2. IOs should as a general rule formulate and publish plans setting the general orientation of their programmes and establishing the objectives to be achieved and the strategies to be followed:

The BCBS does so occasionally.

3. When engaging in operational activities of a humanitarian, development or peacekeeping nature, [...]: not applicable to the BCBS.

4. Subject to the provisions of paragraph 7 below, IOs should ensure access by the public to information held by them (including their archives). IOs should not deny applications for access to information except for compelling reasons on limited grounds such as privacy, commercial and industrial secrecy, or protection of the security of Member States or private parties:

The BCBS makes available on its website: consultation drafts, responses to consultations and final drafts of standards, guidelines and sound practices. It does not produce minutes, but rather action points, which, like the documents concerning internal mandates, are not publicly available⁷⁷.

5. Non-plenary organs of an IO should provide information about their activities to all Member States and wherever possible should make available the text of draft decisions under consideration:

The BCBS makes publicly available and invites comments on its draft standards, guidelines and sound practices. The working groups and task forces of the BCBS make their draft text available to all the members of the BCBS.

6. When direct participation in confidential but formal consultations during private meetings is not possible, the non-plenary organ should organise a briefing for non-members:

This is done by the BCBS.

7. IOs should ensure effective protection against the disclosure of information which has come to their knowledge in circumstances imposing an obligation of confidentiality, and, when appropriate, should protect the identity of those who provide them with information:
The BCBS does so, for example in discussions concerning supervisory matters.

8. IOs should publish regular reports on the measures they have taken to implement the above provisions on public access to and the preservation of confidentiality of documents and information:

The BCBS does not do so.

⁷⁷ <http://www.bis.org/about/archive.htm>.

4. Well-functioning international civil service

1. *Each IO should secure within its Secretariat the highest standards of efficiency, competence and integrity and enforce the principles of impartiality, loyalty to the aims and purposes of the IO, functional independence and discretion, and the principles of equitable geographical representation and gender balance:*

Implementation of this recommendation by the BCBS is impossible to evaluate in the framework of the present paper.

2. *IOs should not implement the above principles in such a manner as to prejudice the proper administration of justice:*

Implementation of this recommendation by the BCBS is impossible to evaluate in the framework of the present paper.

3. *IOs should provide for effective mechanisms of supervision and control over the Executive Head and the Secretariat:*

The Secretary General of the BCBS oversees the activity of the Secretariat and reports to the Chairman; the Chairman reports to the GHOS.

5. Sound financial management

Not applicable to the BCBS

6. Reporting and evaluation

1. *IOs should publish periodic general reports on the institutional and operational activities undertaken in the period in question:*

The activities of the BCBS are reported in the BIS Annual Report⁷⁸

2. *Organs to which other organs report under the rules of the IO, should ensure that such reports are regularly received in an appropriate form and properly debated whenever required:* not applicable

3. *Prior to engaging in operational activities IO-s should articulate their objectives and the internal lines of responsibility so as to provide a reliable yardstick for subsequent evaluation:* information not available

4. *IOs should establish appropriate mechanisms such as functional operational lessons units to evaluate operational activities effectively and to contribute to more effective future activities:* information not available

5. *Subsidiary organs should be required to submit periodic reports to their parent organ:* not applicable to the BCBS.

7. The principle of good faith

IOs, their organs, and their agents are under a general legal obligation to act in all their dealings in accordance with the principle of good faith:

Implementation of this recommendation by the BCBS is impossible to evaluate in the framework of the present paper. The BCBS charter states amongst the responsibilities of the members of the BCBS 'to promote the interests of global financial stability and not solely national interests, while participating in BCBS work and decision-making'.

8. The principles of constitutionality and institutional balance

1. *Each IO is under a legal obligation to carry out its functions and exercise its powers in accordance with the rules of the organisation:* not explicitly stated in the BCBS Charter.

⁷⁸ <http://www.bis.org/publ/arpdf/ar2014e.htm>.

2. Organs of an IO in carrying out their functions must respect the institutional balance laid down in the constituent instruments of the IO: not applicable to the BCBS.

3. Organs and agents of an IO, in whatever official capacity they act, must ensure that they do not exceed the scope of their functions: not explicitly stated in the BCBS charter.

9. The principle of supervision and control

These recommendations do not apply to the BCBS, which does not have subsidiary organs taking decisions or exercising competences

10. The principle of stating the reasons for decisions or a particular course of action

1. Organs of an IO should state the reasons for their decisions or particular courses of action whenever necessary for the assessment of their proper functioning or otherwise relevant from the point of view of their accountability:

The BCBS does not seem to fully comply with this recommendation, although it issues press statements and its members give public speeches and report back to their respective national authorities.

2. With regard to decisions of a general nature, the reasons may relate to the general character of such a decision only.

3. With regard to a decision directly and immediately affecting rights and obligations of particular States and non-State entities the reasons given should set out the principal issues of law and fact upon which the decision is based - not applicable to the BCBS.

4. Non-plenary organs should reflect in their periodic reports information of a non-confidential nature forming the basis of their decisions.

11. The principle of procedural regularity

12. The principle of objectivity and impartiality

13. The principle of due diligence

Implementation of these recommendations (11.-13.) by the BCBS is impossible to evaluate in the framework of the present paper. The Charter of the BCBS does not mention procedural regularity, objectivity and impartiality, or due diligence.

Section Two: RRP for treaty organs

Not applicable to the BCBS

Section Three: RRP on the Relationship between NGO-s and IO-s.

1. IOs should establish appropriate relationships with NGOs active within their field of competence

2. IOs should as a matter of practice establish at least an NGO liaison service in order to facilitate NGO involvement in their activities

3. The Department of an IO dealing with a particular category of issues should at regular intervals convene a briefing where representatives of particular NGOs may be given an opportunity to present their views on a particular matter or a range of issues

As regards nos. 1.-3., the BCBS does not do so.

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ISBN 978-92-823-7321-7 (paper)
ISBN 978-92-823-7320-0 (pdf)

doi: 10.2861/14033 (paper)
doi: 10.2861/4 (pdf)