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The two books under review are complementary. Larisa Dragomir, a laywer working at the European Commission (DG MARKT), has written a substantive, well organised study of the construction of the European framework for banking regulation and supervision. The book by Charles Goodhart, an economist, emeritus professor of Banking and Finance at the London School of Economics and ex-official of the Bank of England, minutely documents a major link in the development of global standards for banking supervision, i.e. the establishment in 1974, the work methods, and the changing role of the Basel Committee on Banking Supervision (BCBS) in the first two decades and a half of its functioning. With all the differences in structure and academic perspective, a series of interrelated issues stand out in the cross lights: the supervisory role of private parties, the incorporation into law of highly technical standards, the decision making process within the Basel Committee, and the fugal pattern of the BCBS' and EU rulemaking.

Apart from overlapping research fields, the books have in common that, following the start of the financial crisis in August 2007, their very subject matter suddenly shifted in focus. The main area of supervisory concern broadened from risk profiles of individual financial institutions to 'systemic risk', i.e. risk of destabilising the financial system as a whole. For Dragomir this meant that she had to update her PhD thesis of 2006 in order to take into account the first legislative responses to the crisis. The exercise left double vision effects throughout her book: the initial confidence in the solidity of the EU regulatory and supervisory project acquired post-crisis a questioning accent.

Goodhart, for his part, had finished his research, and most of his writing, by the summer of 2007. He did not have to change much in the historical account. But traces of his early criticism of the BCBS' Basel II proposal - not covered in the book because considered 'too recent' and 'too contentious' for historical study - resurfaced perhaps more vividly than would have been the case without the crisis. In 2001, Goodhart had co-authored a prescient comment in which the perceived procyclicality of the proposed package - threatening to enhance booms and busts in the economic cycle - was sharply condemned: 'In so far as the purpose of financial regulation is to reduce the likelihood of a systemic crisis, these proposals will actually tend to negate, not promote this useful purpose'.

**EU regulation and supervision**

Dragomir's book tracks the dynamic developments of EU normative and institutional financial regulation at the intersection of international, European and national rulemaking processes. The focus is on banks, i.e. deposit taking and credit granting institutions, and on the design and implementation of 'prudential' norms. For the sake of delimiting her research subject, Dragomir sets out to describe 'prudential' in terms of *ex ante* measures to preserve the safety and soundness of individual financial institutions (p. 2). She demarcates them from *ex post* interventions in stressed
situations, though she admits that the divide is not absolute. The crisis then showed more divides to be porous. In an excellent discussion of conflicting prudential norms and their interaction with other types of regulation, clearly rewritten post-crisis, Dragomir points to 'the increased prudential character of non-prudential rules' (corporate governance, accounting, auditing and consumer protection), as well as the 'new qualitative dimension inherent in prudential supervision' (p. 114 and 123). This astute observation coheres with ongoing work on 'macroprudential' policy by the Financial Stability Board (FSB), the International Monetary Fund (IMF) and the Bank for International Settlements (BIS).

Dragomir approaches her subject from four different angles. She starts with presenting aspects of European banking at the beginning of the third millennium (part I). Here she tackles further questions of definition and regulatory theory. She notes, for instance, that the traditional view of the specificity of banks is reflected in the very terminology of EU legislation (p. 32). 'Non-banks', which played a crucial role in the build-up to the crisis, are partly present in negatives. A 'financial institution', which can be active, *inter alia*, in consumer credit, financial leasing, payment and investment services, but does not accept deposits, is defined as an 'undertaking other than a credit institution'. In the last part (IV) Dragomir reassesses the European dimension of supervisory liability in the light of the changed regulatory and supervisory regime she has analysed in parts II and III. Dragomir asserts that the changes have called the 'Peter Paul' case law of the European Court of Justice (ECJ) into question. The ECJ held in 2004 that EU law was 'incapable of imposing liability for defective banking supervision' (p. 308). Dragomir suggests that under the revised EU banking law depositors now may have rights, a good thing in her opinion, because this might enhance compliance with prudential regulation (p. 378).

The middle parts - II and III - form the bulk of Dragomir's study (236 pages). They are set up as a diptyque: a normative analysis of prudential rules is matched by a description of the institutions that design, implement and enforce these rules. Dragomir has succeeded in giving a solid, exhaustive overview of the intricate, multi-level rulemaking processes, the resulting and developing complex of norms and supervisory practices, as well as of the network of agencies involved. Part II starts with an historical analysis of the construction period of the EU internal market for banking and financial services (Chapter 3). Dragomir shows that, from the 1970s on, legislation has been guided by three interdependent principles, derived from the 1979 *Cassis de Dijon* case: minimum harmonisation, mutual recognition and home-country control (p. 74). In the late 1990s, and in an effort to keep up with ever more rapid change in technology and global expansion of finance and trade, the European Commission drew up a Financial Services Action Plan (FSAP) and asked ex-central banker Alexandre Lamfalussy to work out a stream-lined, multi-level procedure to speed up the necessary legislation (Chapter 4).

Dragomir records that, by 2005, the Commission's post-FSAP strategy showed no sign yet that something was amiss. The emphasis was on 'better regulation', and on 'completing unfinished business' already defined by FSAP (p. 90). When the crisis struck, it became clear that too little attention had been paid to risk-management, corporate governance, and new and complex financial instruments. The focus had been on efficiency and competition aspects, 'to the detriment of stability concerns' (p. 92). The resulting EU regulatory structure proved, in other words, no more disaster-proof than Fukushima's nuclear plant, but the EU mechanism for regulatory change turned out to be, given the post-crisis activity, firmly in place (p. 155).
The Basel II Accord of 2004 (Chapter 5) provides a link to Goodhart's work on the Basel Committee. Basel II was implemented in 2006 in the EU Capital Requirements Directive (CRD) and the recast Capital Adequacy Directive (CAD). As a lawyer, Dragomir admits to 'lacking the necessary expertise' (p. 126) to judge its 'substantive merits', in the way Goodhart had done in 2001. But she is well equipped to explain why Basel II marks a 'structural shift', not in objectives (safety and soundness of the financial system, competitive equality, addressing risks), but in supervisory strategy to achieve them. Dragomir's assessment is that with Basel II, itself symptomatic of a more general effort to seek a cooperative dialogue with the regulatees, regulated financial companies were given a pivotal and lasting role in supervisory tasks (p. 137). By the same token, supervisors moved from controlling 'compliance with capital standards' to 'continuous review of internal risk-control mechanisms' (p. 141). Basel II and CRD (articles 84-89) enable supervisors to allow companies with sufficiently sophisticated risk-management systems to use their own internal rating models to evaluate the credit risk of each of their borrowers, and thus calculate themselves the level of required risk-weighted capital.

As Dragomir briefly notes (p. 135), the idea of using companies’ internal models for regulatory purposes predates Basel II. Goodhart shows, on the basis of archival material, that, as early as 1986, a subgroup of the BCBS brought up the question of approaching banks to examine their monitoring and control systems (Goodhart, p. 227-228). The turning point, i.e. the moment when the BCBS ate 'humble-pie' and accepted that banks had become more sophisticated in assessing their internal risks than the supervisors (Goodhart, p. 247-248), came in January 1996. It coincided with the first release of the 1996 Market Risk Amendment (of the 1988 Basel I Accord), implemented in EU law in 1998, which allowed banks to use their own models to measure interest rate risk and investment risk of securities. That moment saw a change in the BCBS's relationship with banks. Contact previously had been indirect, through the Committee's members, i.e. the central bank governors of the G10 countries. But in January 1996, Tommaso Padoa-Schioppa, then chairman of the BCBS, ended up accepting, 'after careful consideration', a proposal of Charles Dallara, managing director of the Institute of International Finance (IIF), to cooperate on issues such as risk models, backtesting methods, and regulatory treatment of certain financial instruments (Goodhart, p. 415-416; Appendix A, p. 440-441). Regarding the danger that large banks thus might 'steer the regulatory process to their own advantage', Goodhart notes that he found no evidence of it for the two remaining years of his period (1974-1997); he leaves it to another historian to determine whether the same can be said of later years, or of relations between national supervisors and their regulatees (Goodhart, p. 417). In fact, there already is such an assessment. Daniel Tarullo, currently on the Board of Governors of the U.S. Federal Reserve System, wrote in 2008 that in negotiating Basel II the ‘general interest’ of effective and efficient banking regulation had been ‘subordinated at key moments’ to commercial and bureaucratic interests (Banking on Basel, Peterson Institute for International Economics, Washington, D.C., p. 7 and Chapter 4).

The Basel Committee
This January 1996 episode, marking a first step in ‘delegating’ the capital adequacy regulatory process to the industry ('delegation' is Dragomir's term, p. 137), figures in Goodhart's study at the end. What precedes it is a richly documented, detailed and in part personal account of how monetary and regulatory concerns about financial globalisation, starting in the 1960s, and punctuated by two events in the early 1970s
(the oil crisis following the Arab/Israeli war, and turmoil in the foreign exchange markets resulting from the demise of Bankhaus Herstatt), increased the need for national supervisors to cooperate. Goodhart shows how the Basel Committee set out, from its inception in 1975, to address cooperation problems between home and host supervisors of cross-border banking groups (the 'Concordat'), and how it evolved from an advisory body to the G10 central bank governors into a standard-setter for banks worldwide (p. 299). By 1997, the BCBS' ‘Core Principles of Banking Supervision’ were ready to be used by the IMF and the World Bank to monitor practices in developed and developing countries alike.

The book opens with two chapters (2 and 3, chapter 1 is the introduction) on 'how and why the BCBS was set up' (p. 7-8), and on its membership and operations. Eight more chapters (4-11) describe the main topics the BCBS worked on. I just mentioned the 1975 Concordat, the 1996 Market Risk Amendment, and the 1997 Core Principles of Banking Supervision (Chapters 4, 7 and 8). Other topics include external and foreign exchange issues, capital adequacy and the 1988 Basel Accord, liquidity, off-balance sheet exposures and derivatives, and remaining issues such as bank secrecy and crisis management (Chapters 5, 6, 9, 10 and 11). Chapters 12 and 13 cover the BCBS' relationship with banks and with other regulators, while the last three chapters plus epilogue are, in Goodhart's own words, commentaries from a legal, international relations and social science perspective.

What makes Goodhart's book special is the extensive use of the BCBS’ archives at the BIS in Basel, and of private communications and letters to the author. In spite of the fact that members of the BCBS, i.e. the rightful owners of the archives, winnowed source material considered ‘too hot for consumption’ – such as a 1975 note on ‘Techniques of support and rescue operations’ (p. 380) and the 83 informal minutes, averaging 50-100 pages each, of the BCBS’ main meetings (p. xii) – the material that was accessed certainly added to the depth and vivacity of Goodhart's account of the contacts, the diplomacy, and the ways agreements were forged.

One example is the fugal pattern, or 'obscure interaction', as Dragomir would have it (p. 95), of Basel Committee and EU rulemaking. Practical and legal questions surround participation of the EC/EU in the BCBS meetings, and the legitimacy of the production of 'soft' law in an informal, intransparent 'club' setting. Participation first came up as an issue in the 'Groupe de Contact', a 1972 initiative of the six EEC members that laid the ground work for the BCBS (Goodhart, p. 12-25). Confidentiality concerns would prohibit the free exchange of ideas between bank supervisors with an EEC representative present. But as the EEC had its own plans for banking regulation, and as the Groupe's and later the BCBS's agreements had to be translated into EEC/EU law to acquire binding force, the argument for participation won. The EU currently has observer status in the BCBS, which was extended in 2009 to include the G20 plus Hong Kong SAR and Singapore (Dragomir, p. 101 and 96). Negotiation proceedings are still undisclosed. This lack of transparency is more of a problem for Dragomir than for Goodhart, who managed to assemble enough material for the early period to track the input of at least some of the BCBS members.

I would argue that the legitimacy of Basel decisions, as they are translated into EU law, must be founded on the expertise of supervisors and legislators. Since the mid-1990s, finance has become too complex for (democratic) comfort. The technical substance and theoretical underpinning of banking rules began to be provided, as we have seen, not by the regulators or the legislative, but by the industry and the experts. This imbalance of power led to inefficient rules that only the onset of the crisis revealed. A proper response would be, among other measures, to enable supervisors
and legislators - with incentives and funds - to check the math and restore some equity in financial rulemaking. The general tendency, in the Netherlands and elsewhere, to slash supervisory budgets does not augur well.

**Interdisciplinary cooperation**

Dragomir and Goodhart managed to demonstrate, without even trying, the potential of constructive cooperation between lawyers and economists. It merits a follow-up in a structured way in academia, and elsewhere. My only regrets are addressed to their publishers. Dragomir's reference work would have benefited from less minimalist footnotes, and Goodhart's study from a list of the appendices that follow each chapter. Finding your way in the book is a bit difficult. But for anyone interested in the process of rulemaking - and I, for one, do want to know how 'sausages' are made, *pace* Bismarck - the effort is worth-while.

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