

CIGI Papers No. 189 – September 2018

The New Internationalism?

IOSCO, International Standards and Capital Markets Regulation

Cally Jordan



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CIGI Masthead

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About the Author

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Over the years, Cally has taught and visited at McGill University, the University of Florida, Duke Law School, the Center for Transnational Legal Studies (London), the Max Planck Institute for International and Comparative Law (Hamburg), the London School of Economics and Political Science, the British Institute for International and Comparative Law (London) and IUC Torino. She was the inaugural P.R.I.M.E. Finance (Lord Woolf) Fellow at the Netherlands Institute for Advanced Studies (Wassenaar, Netherlands) and a Dean's Visiting Scholar at Georgetown Law Center in Washington, DC. In 2018, she will be a visiting fellow at Harris Manchester College, Oxford, and the London School of Economics and Political Science.

Cally is the author of *International Capital Markets: Law and Institutions* (Oxford University Press, 2014). She holds degrees in both civil law and common law (LL.B./B.C.L., McGill University; D.E.A., Université de Paris I [Panthéon-Sorbonne]), which she obtained after earning a B.A. with distinction (Carleton University), and an M.A. (University of Toronto). She has practised law in Ontario, Quebec, California, New York and Hong Kong, most notably with Cleary Gottlieb (New York).

About the Program

The International Law Research Program (ILRP) at CIGI is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions among international and transnational law, Indigenous law and constitutional law.

Acronyms and Abbreviations

BCBS	Basel Committee on Banking Supervision
CESR	Committee of European Securities Regulators
CRA s	credit rating agencies
EC	European Commission
ESMA	European Securities and Markets Authority
FATF	Financial Action Task Force
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSF	Financial Stability Forum
G20	Group of Twenty
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISDA	International Swaps and Derivatives Association
NASAA	North American Securities Administrators Association
SEC	Securities and Exchange Commission

Executive Summary

The international reach of the financial crises of the last 20 years has triggered an explosion in international standards setting, creating a complex dynamic between national (or regional) regulation and international norms, and between hard and soft law. This paper explores this phenomenon as it relates to capital markets by looking at the changing role of the International Organization of Securities Commissions (IOSCO), the standard-setting process itself, issues associated with implementation of international standards and possible alternatives.

In deciding that standard setting is its primary mission, IOSCO has assumed a role internationally of “quasi-regulator” in much the same way (and for the same reasons) as the now defunct EU Committee of European Securities Regulators (CESR). Potentially, this new role puts IOSCO on a collision course with powerful state-level regulators.

A further complication is the standard-setting process itself. The academic discourse has focused on the normative force of international standards, without paying much attention to the actual content of the standards or the process by which they come into being. Hegemonic powers, of course, play a disproportionate role, but there are a large number of other factors that determine their shape and substance.

In order to shed new light on the standard-setting process, this paper takes a close look at how one specific set of standards, those relating to credit rating agencies (CRAs), has come into being. The results are surprising: in the face of a particular domestic regulatory failure, a series of international codes and principles concerning CRAs was developed by IOSCO, presumably to create a feedback loop into domestic regulation. These international standards apply virtually exclusively to three US corporations: S&P, Moody’s and Fitch, which together control more than 95 percent of the international market and 98 percent of their domestic market.

Even more curiously, the CRA codes and principles, despite their inapplicability in most parts of the world, have been widely adopted and implemented. The responsibility for this waste of time and regulatory resources can be laid, in part, at the door of the International Monetary Fund (IMF) and the World Bank. Together with IOSCO and its taskmasters, the Financial Stability Board (FSB) and the Group of Twenty (G20), the IMF and the World Bank appear to ignore the selective nature of globalization.

Yet, there remains a great demand for international financial standards, especially among smaller or emerging economies. The paper concludes with some suggestions on future courses of action in the face of the new internationalism.

Introduction

“[F]ollowing the financial crisis, [the FSB and IOSCO] have taken on a new and more opaque character, and in some cases they have attempted to arrogate to themselves regulatory powers that properly reside with sovereign governments.”¹ (Daniel Gallagher, former commissioner of the US Securities and Exchange Commission [SEC])

Crises are transformative. The regional and international reach of the financial crises of the last 20 years has triggered an explosion in international financial standards setting, creating a complex dynamic between national (or regional) regulation and international norms, between hard and soft law. This paper explores this phenomenon as it relates to capital markets, in an attempt to investigate the nature of this dynamic. The paper is organized around three main themes: the changing role of IOSCO; the process of creating international standards in the capital markets; and the implementation of international standards and possible alternatives.

1 Daniel M. Gallagher, “Closing Remarks at the SEC’s 24th Annual International Institute for Market Development” (delivered at the US SEC, Washington, DC, 16 April 2014).

The New Internationalism?

The Changing Role of IOSCO

Over the three and a half decades of its existence, IOSCO has become a focal point for the oversight and operation of capital markets around the world. IOSCO, however, is neither a regulator nor a treaty organization; it is a network or constellation of national regulators, market institutions and international financial organizations.²

IOSCO traces its beginnings to a regional North American initiative, so it is hardly surprising that the United States has played a leading role in its development. Due to the federal nature of both Canada and the United States, there are more than 60 capital markets regulators in the region, in addition to the well-known federal regulator in the United States, the SEC. The *raison d'être* of IOSCO, like that of the North American Securities Administrators Association (NASAA), was to serve as a venue for formal and informal cooperation and coordination among a large and diverse group of regulators facing the realities of rapidly integrating markets. However, the Asian, and then global, financial crises radically transformed IOSCO's primary mission into that of global financial standard setter.³

Crises have also thrust capital markets regulation from its technical penumbra into the international limelight and led to the appearance of new international institutions such as the FSB.⁴ Unlike IOSCO, both the FSB and its predecessor, the Financial Stability Forum (FSF), were political initiatives (on the part of the Group of Seven and G20, respectively). As such, the FSB and the FSF also

drew into their orbit formal treaty organizations such as the IMF and the World Bank, among others.⁵

The Objectives and Principles of Securities Regulation, one of IOSCO's very first sets of standards, appeared in 1998 in response to the Asian financial crisis; the Objectives and Principles were updated in 2010 in response to the global financial crisis of a decade later. The Objectives and Principles remain the best known and most influential of IOSCO's standards because of their use by the IMF and the World Bank as a benchmark to assess and rate national capital markets regulators and regulation around the world, pursuant to the Financial Sector Assessment Program (FSAP).⁶ In this way, the activities of IOSCO became entwined with those of the FSF/FSB, the IMF and the World Bank. IOSCO was pulled into the new international financial policy network and its role as a standard setter affirmed. Over time, IOSCO has produced numerous other sets of principles and standards at a rapidly accelerating pace,⁷ but with decidedly mixed results. Nevertheless, the ubiquity and reputation of the Objectives and Principles have lent credence to all IOSCO standards.

Over the last decade, several factors have impacted IOSCO and its activities. IOSCO's relationship with other international bodies such as the FSB, the IMF and the World Bank has firmly established IOSCO as a globally recognized institution. As well, IOSCO has joined together with similar international organizations composed of national regulators, i.e., the Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS), to form the "Joint Forum." IOSCO's relationship with front-line, state-level and regional regulators has also evolved. The polite "transatlantic dialogue" (London, New York, Washington) has become a more raucous, multilateral conversation. The rising markets of Asia and emerging economies, with their regulators now claiming membership in IOSCO,

2 Anne-Marie Slaughter, *A New World Order* (Princeton, NJ: Princeton University Press, 2009); see also Hannah L Buxbaum, "Transnational Legal Ordering and Regulatory Conflict: Lessons from the Regulation of Cross-Border Derivatives" (2016) 1:91 UC Irvine J Intl, Transnational & Comparative L 91 (for a discussion of transnational legal ordering).

3 See the IOSCO home page (www.iosco.org) where the banner reads: "The global standard setter for securities markets regulation."

4 The FSB maintains a permanent secretariat in Basel, Switzerland. For a more detailed discussion of the FSB and its predecessor, the FSF, see Cally Jordan, "Does 'F' Stand for Failure: The Legacy of the Financial Stability Forum" (2009) University of Melbourne Legal Studies Research Paper No 429.

5 On the implications of this interaction of political actors with IOSCO, see Stefano Pagliari, "The Domestic Foundations of Transnational Regulatory Networks: IOSCO and the Reassertion of National Authority in Global Securities Regulation" (Paper delivered at the Remaking Globalization Workshop at Temple University, Philadelphia, PA, 5 May 2011) [unpublished].

6 For further analysis of the FSAP, see Cally Jordan, *International Capital Markets: Law and Institutions* (Oxford, UK: Oxford University Press, 2014).

7 See Pagliari, *supra* note 5 (Pagliari argues that one of IOSCO's most significant achievements has been the promulgation of the 1998 Objectives).

have changed the balance of power and priorities within the institution. Additionally, the European Union has demonstrated heightened interest in capital markets development, for example in the 2015 Capital Markets Union initiative, the creation in 2011 of the first pan-European capital markets regulator, the European Securities and Markets Authority (ESMA), and the increasing level of EU regulatory activity. Together, these initiatives have created a challenger to US and UK hegemony. And, of course, with the exit of Britain from the European Union, the future of the European Union's de facto financial capital, London, is in doubt. Other EU centres of influence are jockeying for dominance. The result has been that, over the last few years, the European Union has shown a predilection for a kind of regulatory unilateralism once associated primarily with the United States.

Currently, IOSCO appears to see its primary role as that of a “global standard setter” rather than facilitator to and coordinator of state-level regulators. As a corollary of its increased importance in standard setting, IOSCO has been recasting its role into one of “quasi-regulator,” a trajectory once followed by ESMA's predecessor, the Committee of European Securities Regulators (CESR). Like IOSCO, CESR had no formal rule-making authority. IOSCO has adopted CESR-like functions, such as peer review (designed to boost the normative force of its standards) and the preparation of guidelines, detailed codes and policy positions operating along a spectrum of normativity. Recently, IOSCO has created a robust internal governance structure by interposing a board between members and operational committees, again echoing a formal regulatory authority such as ESMA.⁸

Unlike CESR (or ESMA), however, IOSCO does not operate in a treaty framework with associated formal judicial, legislative and executive institutions supporting it. Inevitably, issues of the accountability of IOSCO and the contestability of IOSCO initiatives must be considered.

The quasi-regulatory initiatives of IOSCO also set it on a collision course with important state-level regulators who may beg to differ on IOSCO's approach. To the extent that powerful market

regulators such as the SEC object, national interest and sovereignty issues rise to the surface. The potential for disengagement from the international arena by such powerful regulators inevitably affects IOSCO's credibility and effectiveness.

The most recent financial crisis and the closer relationship between IOSCO and international institutions such as the FSB and the BCBS have also meant that issues of systemic risk and stability have found themselves front and centre at IOSCO. Reflecting the preoccupations of the FSB and BCBS, the IOSCO Objectives and Principles were amended in 2010 to specifically include these issues. In focusing on systemic risk and stability, some commentators feel IOSCO has strayed too far from the core elements of securities regulation, investor protection and business conduct concerns. On the other hand, there is some question as to how effective one-size-fits-all IOSCO measures can be in these areas, which some consider to be inherently local and resistant to international standardization.

IOSCO finds itself in a tough place, buffeted by multiple and sometimes conflicting expectations. IOSCO ordinary members, themselves local regulators, insist that IOSCO has no ambitions to be a global regulator, and it would be unrealistic to so aspire. As an institution operating by consensus, with a large and diverse membership, IOSCO's scope of action is necessarily limited. Yet, as the focal point for international capital markets, IOSCO members are constantly forced to come to grips with issues beyond their mandate or, arguably, their competencies. The FSB, lacking technical capabilities, continues to push IOSCO, with its wealth of regulatory expertise on hand, to address certain issues. But despite efforts to bolster its internal structure, IOSCO must rely on its committees (composed of state-level regulators) to get the work done. Having been traditionally dominated by a handful of powerful jurisdictions, this process inevitably skews how issues are framed, initiatives launched and the results flowing from them. Certainly, the creation of the Emerging Markets Committee within IOSCO goes some way toward addressing this problem, but still the problems confronting smaller developed markets tend to be neglected.

⁸ See Antonio Marcacci, “The EU in the Transnational Financial Regulatory Arena” in Marise Cremona & Hans-W Micklitz, eds, *Private Law in the External Relations of the EU* (Oxford, UK: Oxford University Press, 2016) at 201–25.

In the face of increasing dissonance among major markets in terms of agreement on optimum regulatory approaches, a better path for IOSCO may be to go back to its original role as coordinator, facilitator, communicator and disseminator. International standards designed to promote substantive convergence have proven problematic (despite seemingly high levels of formal but ineffectual implementation). Efforts to develop mutual recognition regimes have been generally disappointing. Increasing unilateralism and bilateral action undermine both international standards and mutual recognition efforts. Cross-border dispute resolution and enforcement tend to be fraught.⁹

Rather than lofty aspirations of being a “global standard setter” and quasi-regulator, IOSCO may be more effective by recognizing the “selective” nature of globalization. IOSCO’s more important role may be as a communicator, a conveyor and purveyor of information. Certainly, its international standards have gone a long way to create a common international language of finance. Rather than competing with local regulators, there is great scope for IOSCO to focus on the global aspects of capital markets that are inherently cross-border, in taking up oversight of the “borderless” intermediaries and firms, for example, in the area of fintech.

Creating International Standards for Capital Markets

IOSCO is not the only international standard setter for the capital markets; the International Accounting Standards Board (IASB) and

International Financial Reporting Standards (IFRS) come to mind. Industry associations, such as the International Swaps and Derivatives Association (ISDA), also play an important role in standard setting through their rulebooks, master agreements and oversight of industry practices. IOSCO, however, identifies itself as the global standard setter for capital markets and has rapidly risen to prominence, riding on the back of the FSAP program.

In the early days, there were the IOSCO Objectives and Principles of Securities Regulation (1998) and the IOSCO International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers (1998). These two sets of standards set a pattern for later efforts. Some standards are high-level principles, like the IOSCO Objectives and Principles; others demonstrate a level of technicality worthy of complex regulation. The initial phase of IOSCO’s standard-setting activities was a time of US hegemony in capital markets regulation; for one thing, few jurisdictions had a dedicated regulatory framework for the operation of domestic capital markets.¹⁰ The imprint of US market institutions, practices and regulation on early IOSCO standards is unmistakable. The International Disclosure Standards (1998), for example, are closely modelled on Form 20-F under the US Securities Act of 1933 (the 1933 Act).¹¹ The IOSCO Objectives and Principles (1998) subsume the hidden, and rarely articulated, assumptions of the 1933 Act: the dominance of public equity markets and the retail investor; scant attention paid to private markets; little oversight of derivative products;¹² and the importance of self-regulation in the conduct of market institutions and participants.¹³

At the time, the US regulatory framework represented the gold standard, a notion that US regulators (and some financial economists) were happy to promote. International standards subsuming US regulation would represent best practice and could be emulated in emerging and other economies around the world, producing convergence to the ideal. As in the European Union, the thinking went that harmonization

⁹ The experiences of the European Union over the last 20 years, in particular, are demonstrative of these phenomena. See the discussion below in the text accompanying note 30. In the European Union, the move away from harmonizing directives to directly applicable regulations illustrates the disillusionment with mutual recognition approaches, especially with respect to cross-border dispute resolution and enforcement. The 2009 report chaired by the de Larosière Group referenced these regulatory inadequacies. See High-Level Group on Financial Supervision in the EU, *Report* (2009), online: European Commission <http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf> [de Larosière Report]. ESMA, created in response to the de Larosière Report, now has mechanisms for dealing with cross-border disputes among member-state regulators, and regulations such as the Market Abuse Regulation (EU 596/2014) attempt to address enforcement issues. See generally Stéphane Rottier & Nicolas Véron, “Not All Financial Regulation is Global” (2010) Bruegel Policy Brief Issue 7 at 9, online: Bruegel <http://bruegel.org/wp-content/uploads/imported/publications/pb_2010-07_FINREG_30082010_01.pdf>; Nicolas Véron & Guntram B Wolff, *Capital Markets Union: A Vision for the Long Term* (2015), online: Bruegel <<http://bruegel.org/2015/04/capital-markets-union-a-vision-for-the-long-term/>>.

¹⁰ The Canadian province of Ontario came close.

¹¹ *Securities Act of 1933*, 15 USC § 77a (1970).

¹² The SEC has limited jurisdiction over derivative products.

¹³ Some of these assumptions were later addressed by IOSCO through “methodologies” in the FSAP process. It is not surprising that these lacunae turned out to be the “hot buttons” of the global financial crisis.

would promote more efficient, integrated markets and reduce the costs and frictions associated with disparate regulatory frameworks. This was an appealing, if simplistic, notion.

Over time, other influences came into play. For example, the United Kingdom's reliance on voluntary codes of conduct in the financial sector¹⁴ was easily extended into the international arena where voluntary codes filled a vacuum left by the absence of a supranational regulator. In European code-based countries, where the supremacy of "written law" was firmly established, international standards may have been given considerable respect and deference, simply by virtue of being "written" and, thus, imbued with an aura of normative authority. In 2011, with the creation of ESMA, a new financial authority, the European Union began flexing its regulatory muscle, thereby exerting more influence on the creation of international standards. In CESR, the European Union also provided the model for a quasi-regulatory IOSCO.¹⁵

There is now a complex dynamic of state-level regulation, market practice, industry standards and international standard setting. The form and substance of international standards and the uses to which they are put vary widely. To the extent some international standards demonstrate the granularity and technicality of regulation, these standards may set off conflicts with state-level regulation. Other international standards demonstrate an airy vagueness that serves little practical purpose. The original standards themselves, the IOSCO Objectives and Principles, have been put to purposes never intended at the time of their formulation. Additionally, markets and regulation have changed so dramatically since 1998 that the original Objectives and Principles, even as amended in 2010, may simply no longer be pertinent.

14 For decades in the United Kingdom, voluntary codes compensated for the lack of any formal financial services regulator; the FSA was only created in 2000. In justifying the continued use of voluntary codes (as opposed to legislation), the United Kingdom turned what had been a necessity into a virtue, praising the flexibility and adaptability of voluntary codes.

15 For example, CESR.

The Problems with International Standard Setting

There has been a great demand for international financial standards. As one participant at the CIGI round table entitled "The New Internationalism? IOSCO, International Standards and Capital Markets Regulation"¹⁶ put it, if the IOSCO standards did not exist, someone would have created them. In particular, at the time that international standards began to proliferate, emerging economies in Asia and elsewhere were clamouring for them, irrespective of content (and despite complaints that the standards issued from a cabal of developed economies). Substance was irrelevant; the great need was for a clear rule and a direction to follow. Given IOSCO's consensus-based approach, high-level principles predominated.

The Form of International Standards: High Level or Technical

As IOSCO's membership expanded, the balance of power within IOSCO shifted, and with it, the centre of gravity for consensus. High-level principles also had their drawbacks. In a developed economy with a detailed regulatory framework in place, the principles could provide direction, fill gaps, and reorient policy and legislative initiatives. In other circumstances, the high-level principles could tumble into a void; without a pre-existing context and structure in which to operate, they simply deactivated.

Thus, the interest in developing more technical standards from the ground up, rather than from the top down. Other international bodies engage in technical standard setting (the BCBS, for example, or the IASB), but their focus may be narrower, simplifying the process. The sprawl and complexity of securities regulation and dynamism of markets themselves may make developing technical international standards for capital markets more challenging and, as discussed below, there is not necessarily agreement on the best approaches. Other than copying existing state-level technical regulation (which may represent a somewhat fraught political choice), a very practical question arises: who sits down to the hard slog of drafting technical standards.

16 "The New Internationalism? IOSCO, International Standards and Capital Markets Regulation" (CIGI round table hosted in Ottawa, Canada, 9 June 2017) [CIGI round table].

Additionally, international standards always raise issues of contestability and accountability. Essentially, they lack the recognized legitimacy of legislative action (which may or may not be subject to the checks and balances of democratic process). And for much of the common law world (which may be biased in favour of *ex post* judicial enforcement over *ex ante* written legislation), lack of enforcement mechanisms for international standards, especially through a court system, nags at legal sensibilities.

Filling International Standards with Content

Filling the international standards with content has been problematic. US regulation has been poured into some, such as the International Disclosure Standards (1998), at a time when international standards were a simple transatlantic conversation among a handful of highly developed economies; in most of the world, standards such as these were irrelevant. As US hegemony in the capital markets was challenged, alternative models appeared, providing a choice as to the content of international standards. And choice presents a dilemma. More fundamentally, as time went on, the decades-old fundamentals of securities regulation fell into question. Is a disclosure-based model still viable in the face of information (and misinformation) overload? Does self-regulation still work? Has securities regulation lost its way by neglecting basic issues of consumer protection in the interests of promoting efficient markets? Should issues of systemic stability be addressed at all in securities regulation? These hard questions at the state level flow through to international standard setting.

Nevertheless, there may be ways of increasing the utility of international financial standard setting and, thereby, the role of IOSCO. Demand for international standards continues, unabated, especially in emerging economies. Here IOSCO and its most powerful members, the United States and the European Union, have dropped the ball. Rather than looking to one-size-fits-all, international best practice (which has proved remarkably ineffective), IOSCO should face the reality and merits of “selective globalization.”¹⁷ Globalization is not a monolithic phenomenon, affecting all places in the world equally and in the same way. In terms of articulating the basics

— the concepts — the emerging markets are key. This, in fact, was the original motivation behind the IOSCO Objectives and Principles of Securities Regulation (1998). More attention should be paid to the margins, the smaller developed economies that may have different problems and need different solutions. Smaller economies may also produce better answers than the leviathans.

IOSCO should be more tolerant of difference and possibly even dissension; there should be the flexibility to experiment and possibly fail. Regulatory competition, too, is not necessarily a bad thing and does not always lead to a race to the bottom.

More contentious is whether some areas of regulation are inherently local. IOSCO has veered away from considering conduct of business issues and protection of retail investors. Certainly, retail investors are not part of the international financial standard-setting conversation. This may or may not be as it should be. There are those who consider these areas to be inherently local, responsive to local regulation and regulators. IOSCO need not apply.¹⁸

The discussion on international financial standards has generated a large crisis-driven literature. However, there has not been great interest in investigating, at a micro level, how particular sets of standards are put together. This exercise can produce some surprising results. To exemplify this point, there follows a case study relating to international standards applicable to credit rating agencies (CRAs).¹⁹ International standards, in this case, have been put to another, unexpected, use. Where regulatory initiatives, such as those respecting CRAs, have failed to be adopted at the state level, they may find expression in international standards, thus triggering a feedback loop back into domestic legislation.

A Case Study in Standard Setting: CRAs

IOSCO has allocated significant resources to the consideration of CRAs: three CRA codes of conduct, one after the other, in 2004, 2008 and 2015; publication of consultation reports; creation

¹⁷ A term used, if not coined, by Nicolas Véron at the CIGI round table, *ibid.*

¹⁸ Mary Condon, in particular, set forth these views at the CIGI round table, *ibid.*

¹⁹ Digging deeper into the interaction between state-level regulation and international standards, see the examples provided in Annex 1.

of a task force on CRAs; implementation studies; creation of councils of supervisors for the big CRAs; and, within IOSCO itself, a permanent committee on CRAs. The three IOSCO codes of conduct (2004, 2008 and 2015) are the most significant measures among these initiatives. They are also indicative of the changing role of IOSCO and the factors determining the form and content of international standards.

As was usual at the time, and a factor that may have contributed to its being a relatively short-lived initiative, the 2004 IOSCO CRA Code was one size fits all, “designed to be relevant to all CRAs irrespective of their size, their business model, and the market in which they operate.”²⁰ The assumptions underlying this approach (the desirability of establishing consensus and harmonization across jurisdictions through the formulation of international best practices) were flawed from the beginning, however. The 2004 IOSCO CRA Code was, in fact, hardly international at all; it was narrowly determined by the issues surrounding the three large CRAs in the United States and represented a deft play on their part to deflect domestic regulation in the face of perceived failures associated with the collapse of Enron and WorldCom.²¹

The second IOSCO CRA Code of Conduct appeared in May 2008.²² The date is significant. The preliminary shocks of what was to become the earthquake of the global financial crisis had begun to make themselves felt: Bear Stearns, a US investment bank, had tottered on the brink of collapse, engulfed in a morass of complex derivatives, all of which were dependent for their marketability on credit ratings.²³ Domestic concerns about the role of CRAs in US derivatives markets were quickly transmitted to the international arena. The focus of the 2008 IOSCO CRA Code was

“structured finance,” which produced certain kinds of derivative products, and the role of CRAs.

Consistent with the US regulatory approach, the revisions producing the 2008 IOSCO CRA Code were disclosure-based. A CRA should disclose:

- whether any one issuer, originator, arranger,²⁴ subscriber or other client produced 10 percent or more of the CRA’s annual revenue;
- whether the issuer of a structured finance product had informed the CRA that it was publicly disclosing all relevant information about the rated product, so investors and other CRAs could conduct their own analyses of these products independently of the contracted CRA;
- the attributes and limitations of each credit opinion, and the extent to which the CRA verified information provided to it by the issuer or originator of a rated security;
- the degree to which the CRA analyzed how sensitive a structured finance product’s rating was to changes in the CRA’s underlying ratings assumptions;
- the principal methodology in use when determining a rating; and
- the CRA’s internal code of conduct on its website.

These revisions reflected concerns very specific to the US derivatives markets, which had risen to prominence in the Bear Stearns fiasco. Despite this, IOSCO continued its endeavours to internationalize the issues. In May 2009, IOSCO’s CRA Committee stated that it would “seek cross border regulatory consensus through such means as the IOSCO CRA Code.”²⁵

Early 2009, however, marked a turning point. The speed and brutality of the global financial crisis, emanating as it did from the United States, shook the foundations of US hegemony in the international capital markets. The IOSCO initiatives, designed as predictive and prophylactic measures, had fallen short.

20 IOSCO, *Code of Conduct Fundamentals for Credit Rating Agencies – Consultation Report* (2014) at 2 [IOSCO (2014)], online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD437.pdf>.

21 Enron was the largest bankruptcy in US history at the time and occurred with startling rapidity. The Sarbanes-Oxley Act of 2002, from which CRAs were virtually exempt, was the legislative response to the fraud and corporate governance failures that resulted in the collapse of Enron and WorldCom.

22 IOSCO, *Code of Conduct Fundamentals for Credit Rating Agencies* (2008) [IOSCO (2008)], online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.

23 Four months after the 2008 IOSCO CRA Code of Conduct appeared, Lehman Brothers was not so lucky; it was allowed to fail, precipitating a terrifying period of worldwide financial instability.

24 “Issuers,” “originators” and “arrangers” are the main links in structured financial products using the “originate to distribute” business model.

25 IOSCO (2008), *supra* note 22.

The global financial crisis also triggered a massive regulatory response both within and without the United States. The European Union, in response to the de Larosière Report,²⁶ was moving quickly to create a new regulatory regime.²⁷ The United Kingdom was dismantling its still very new Financial Services Authority (FSA) and adopting alternative regulatory approaches. The ineffectual FSF had been replaced by the more robust FSB. International responses would no longer automatically subsume US regulatory principles. A new secretary-general, fresh from long service in Brussels, took the helm at IOSCO.²⁸

IOSCO reports reflected these developments.²⁹ Stated goals of international harmonization and consensus were proving unrealistic. In 2010, IOSCO acknowledged that “the structure and specific provisions of regulatory programs may differ.”³⁰ Nevertheless, “the objectives of the four IOSCO CRA Principles are embedded into each of the programs reviewed. Indeed, the principles appear to be the building blocks on which CRA regulatory programs have been constructed.”³¹

By 2010, international convergence of financial regulation was no longer a given. In a memorable article for the Bruegel Institute in Brussels, Stéphane Rottier and Nicolas Véron stated: “All in all, the future global financial regulatory landscape is more likely to resemble a Japanese garden, with new details and perspectives emerging at each step, than a centralized and symmetrical *jardin à la française*.”³² In particular, the European Union was turning to capital market regulation with enthusiasm and engaging in a brand of unilateralism once associated with the United States. This extended to EU influences at IOSCO.

Once dominated by the US SEC,³³ IOSCO began to demonstrate decidedly European proclivities. For example, in July 2013, IOSCO began “recommending the creation of supervisory colleges for certain globally active CRAs. Supervisory core colleges for Fitch, Moody’s and S&P held their inaugural meetings on November 5-6, 2013, in New York.”³⁴ “Supervisory colleges,” composed of groupings of national regulators, were a feature of the European regulatory response to the checkerboard of national regulators. A supervisory college would meet on a regular basis to exchange information and coordinate responses to cross-border issues.³⁵ The US SEC chaired the colleges for S&P and Moody’s, while ESMA chaired that of Fitch. According to IOSCO, the expectation was that these supervisory colleges would “operate as a forum for regulators to exchange information about these internationally active CRAs, including... compliance with local or regional laws and regulations.”³⁶ The perceived need for a college of supervisors for three US CRAs was, in itself, an indication of the underlying regulatory conflicts that were arising at a national and regional level.

In 2014, IOSCO was again looking to revise the IOSCO CRA Code of Conduct.³⁷ In February of that year, it published revisions “to take into account the fact that CRAs are now supervised by regional and national authorities.”³⁸ Maintaining the IOSCO codes as international benchmarks for CRA self-regulatory purposes remained an objective, but the primacy of local registration and oversight requirements had to be acknowledged. Domestic and regional regulation of CRAs had sprung up in the wake of the global financial crisis, creating potential conflicts with IOSCO standards. IOSCO had “surveyed its member jurisdictions on whether the IOSCO CRA Code’s provisions are the same, similar, or in conflict with member jurisdictions’ laws. [IOSCO] also sent a similar survey to 26 CRAs having principal offices in Argentina, Brazil, Canada,

26 See de Larosière Report, *supra* note 9.

27 Which resulted in a new regulatory body, ESMA, in 2011.

28 David Wright, a British citizen and former European Commission deputy director-general for all financial services policy within the Internal Market and Services Directorate General, served as IOSCO’s secretary-general from 2012 to 2016.

29 IOSCO, *A Review of Implementation of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies* (2009), online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD286.pdf>; IOSCO, *Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies* (2011), online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD346.pdf>.

30 IOSCO (2014), *supra* note 20 at 3.

31 *Ibid.*

32 Rottier & Véron, *supra* note 9 at 9.

33 Somewhat justifiably, since IOSCO had its roots in the NASAA.

34 IOSCO (2014), *supra* note 20 at 4.

35 The consolidated European exchange, Euronext, which operated in Paris, Amsterdam, Brussels and Lisbon, for example, had a college of supervisors, as did its successor, the short-lived NYSE-Euronext (where the college of supervisors concept seemed to run into difficulties with the addition of a non-European exchange and regulator).

36 IOSCO, *Supervisory Colleges for Credit Rating Agencies* (2013) at 1–3, online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD416.pdf>.

37 IOSCO (2014), *supra* note 20.

38 *Ibid* at 4.

Chile, the European Union, Japan, Mexico, or the United States. These CRAs were asked to identify any IOSCO CRA Code provisions that conflicted with the laws in their home jurisdiction, and also to identify any IOSCO CRA Code provisions they found to be repetitive, ambiguous, outdated, or that contained obsolete terminology.”³⁹

Not much time had passed, but the 2015 IOSCO CRA Code of Conduct took a different tack from previous codes. International standards were interacting with national and regional regulation, producing regulatory dissonance. Gone was the pretense of international consensus. The 2015 Code opens with a remarkable disclaimer, indicating the heightened dissension among IOSCO members about the formulation of international standards and their interaction with state-level regulation:

Certain authorities may consider rule proposals or standards that relate to the substance of this report. These authorities provided information to IOSCO or otherwise participated in the preparation of this report, but their participation should not be viewed as an expression of a judgment by these authorities regarding their current or future regulatory proposals or of their rulemaking or standards implementation work. This report thus does not reflect a judgment by, or limit the choices of, these authorities with regard to their proposed or final versions of their rules or standards.⁴⁰

The picture that emerges from IOSCO’s efforts at international standard setting for CRAs is a curious one. Great effort went into creating international standards applicable primarily to three US companies: S&P, Moody’s and Fitch (which together control 98 percent of market share domestically and 95 percent of market share worldwide), despite the proliferation of supposedly rival CRAs around the world. It is hard to escape the conclusion that these particular standards are not “international” at all. With the benefit of hindsight, it may be that pressures for these particular standards are a response to failure, for a number of reasons, to adopt regulation at the

national level in the United States. Regulatory efforts were then pursued at the international level in the face of effective domestic opposition.⁴¹

The CRAs, faced with pressures to comply with international soft law (rather than less desirable domestic hard law), readily engaged in the process, even encouraging IOSCO to formulate the 2004 CRA Code of Conduct. Compliance with international standards could serve to deflect future state-level regulatory intervention.

A different story played out in the European Union. In the absence of local CRAs, there was, not surprisingly, no regulation of them. European corporations, even today, prefer bank financing to raising capital in the debt markets (where CRAs were particularly active).⁴² The relevance of CRAs had been recognized in some EU initiatives, such as the Market Abuse Directive (2003) and the Markets in Financial Instruments Directive (2007), but in the aftermath of Enron and WorldCom in the United States, CCSR had decided no regulation was needed. Reliance would be placed on the IOSCO codes of conduct and self-regulation.⁴³ CCSR would monitor compliance and report back to the EC. Yet there was unease with the IOSCO Code approach. Accession to the 2004 IOSCO CRA Code of Conduct by the European Union contained a proviso that acceptance did not preclude comprehensive regulation in the future.

Going forward, CCSR’s investigations indicated compliance with the IOSCO codes, thus warranting no further action at the EU level.

However, the global financial crisis of 2008 provoked an abrupt about-face. Self-regulation (an Anglo-American approach with which Europeans had always been uncomfortable) was perceived to have failed. In 2008, the European Union proposed a regulatory approach based on IOSCO Principles. With the replacement of

³⁹ *Ibid.*

⁴⁰ IOSCO, *Code of Conduct Fundamentals for Credit Rating Agencies* (2015) at 1, online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf>.

⁴¹ As far back as 2003, the SEC asked, unsuccessfully, for authority to oversee and impose standards of diligence on CRAs as a consequence of the Enron and WorldCom failures. CRAs had demonstrated “a disappointing lack of diligence,” according to a 2003 SEC report on CRAs; see SEC, *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets* (2003) at 4, online: <www.sec.gov/news/studies/credratingreport0103.pdf>.

⁴² Cf. Véron & Wolff, *supra* note 9.

⁴³ Stephane Rousseau, *Regulating Credit Rating Agencies after the Financial Crisis: The Long and Winding Road Toward Accountability* (2019) Capital Markets Institute Research Paper, online: SSRN <<http://ssrn.com/abstract=1456708>>.

CESR by ESMA (a real pan-European regulatory authority) came further formal regulation. It specifically addressed the rating of *sovereign* debt (a particularly sore point in Europe in the wake of the downgrading of European sovereigns by US CRAs) and created a civil liability regime (not present in the United States). Direct supervisory authority over CRAs was given to ESMA.

The EU CRA Regulation does not remotely repeat IOSCO standards. It creates a registration system for CRAs (a very European approach) and provides for surveillance and a civil liability regime, all while espousing competitive markets for CRA services. The European Union demonstrated no reluctance to regulate once the time came and possessed a powerful central machine to do so on a supranational level. Rather than looking to soft law international standards, the European Union could create hard law norms operating on a pan-European basis. A new EU regulator was able to exercise regulatory authority in an area where it did not interfere with existing member states and in the absence of powerful industry players. The CRA Regulation, by requiring registration and EU oversight of US CRAs, does not rely on deference to foreign regulatory oversight, thus setting in motion potential conflicts at the national level and making a system of conflicts ordering imperative.

Importantly, the CRA Regulation looped back into the revised 2015 IOSCO CRA Code of Conduct. These European influences, with their different balancing of private and public interests and relative indifference to disclosure-based regulatory approaches, immediately put the 2015 revisions of the IOSCO CRA Code of Conduct at odds with US approaches.⁴⁴

Interestingly enough, there has been a remarkably high level of compliance with the IOSCO

CRA codes around the world.⁴⁵ Compliance indicates engagement in the international dialogue, irrespective of local relevance. Their inapplicability may, in fact, enhance the ease with which they are adopted. They neither change nor disrupt the status quo.

IOSCO initiatives respecting CRAs are only one set of international standards among many, and the quirkiness of their origins and development may be exceptional. They may be an outlier. A domestic regulatory failure associated with three local corporations usually does not justify the time and effort involved in creating international financial standards. However, the IOSCO CRA initiatives do demonstrate a somewhat unexpected interrelationship between state-level regulatory issues and the formulation of international standards.

The lesson to be taken away from the IOSCO CRA initiatives is that international financial standards may not be what they seem at first glance; it is worth taking a closer look, digging a little deeper and casting a more critical eye.

IOSCO Standards: Implementation and Alternatives

It is possible to trace the footprints of IOSCO international financial standards all over the world; their ubiquity is impressive. They are a testament to the power of persuasion of international financial institutions such as the IMF and the World Bank through the FSAP.

⁴⁴ These changes in influence may be at the heart of the dissonance evidenced in the 2015 IOSCO CRA Code of Conduct.

⁴⁵ IOSCO, Board, *Code of Conduct Fundamentals for Credit Rating Agencies – Final Report* (IOSCO, 2015) (“In 2009, the CRA Task Force completed a review of the level of CRA implementation of the IOSCO CRA Code and, in particular, the 2008 revisions. The results of the review showed that, among the CRAs reviewed, a number were found to have substantially implemented the IOSCO CRA Code, including the three largest CRAs – Fitch Ratings, Inc. (‘Fitch’), Moody’s Investors Service, Inc. (‘Moody’s’), and Standard & Poor’s Rating Services (‘S&P’). In addition, a large majority of the remaining CRAs had implemented the 2004 iteration of the IOSCO CRA Code but had not yet implemented the provisions added through the 2008 revisions. Only a handful of the CRAs reviewed were found to have not implemented the IOSCO CRA Code in any meaningful way” at 3).

The FSAP initiative, under the auspices of the now defunct FSF, is ultimately responsible for the worldwide dissemination of the IOSCO Objectives and Principles, as well as other IOSCO standards. To date, more than 100 jurisdictions have participated in the FSAP process. In the FSAPs, the IMF and the World Bank were charged with assessing the financial stability of economies large and small, making use of international financial standards as a diagnostic and prophylactic tool. The IOSCO Objectives and Principles were one of a dozen sets of international financial standards chosen by the FSF in 1999 for the purpose.

At the time, the FSF justified its choices as follows: “The 12 standard areas highlighted here have been designated by the FSF as key for sound financial systems and deserving of priority implementation depending on country circumstances. While the key standards vary in terms of their degree of international endorsement, they are broadly accepted as representing minimum requirements for good practice.”⁴⁶

The FSF was being somewhat disingenuous in this pronouncement; it had pulled together a collection of convenience in assembling the 12 sets of standards, plucking existing standards more or less out of the air. To illustrate the arbitrary and disparate assortment of standards used in the FSAP process, they are listed below, together with the identity of the standard setter:

- Code of Good Practices on Transparency in Monetary and Financial Policies (IMF);
- Code of Good Practices on Fiscal Transparency (IMF);
- Special Data Dissemination Standard/ General Data Dissemination System (IMF);
- Insolvency and Creditor Rights (World Bank);
- Principles of Corporate Governance (Organisation for Economic Co-operation and Development);
- International Accounting Standards (now IFRS and the IASB);

- International Standards on Auditing (International Auditing and Assurance Standards Board);
- Core Principles for Systemically Important Payment Systems (now replaced by Principles for Financial Market Infrastructures, April 2012) (Committee on Payment and Settlement Systems/IOSCO);
- The 40 Recommendations of the Financial Action Task Force (FATF)/IX Special Recommendations on Terrorist Financing (FATF);
- Core Principles for Effective Banking Supervision (BCBS);
- Objectives and Principles of Securities Regulation (IOSCO); and
- Insurance Core Principles (IAIS).

Not surprisingly, the standards were duplicative, overlapping, even contradictory, undermining their powers as diagnostic and prophylactic tools. Some standards, such as the IOSCO Objectives and Principles, were brand new and completely untested. Nevertheless, by grouping this disparate group of standards together and putting them in the hands of two powerful international institutions, all the standards were given equal legitimacy and the widest possible international reach.

It is important to keep in mind that the IOSCO Objectives and Principles had not been designed for use in the FSAP process. In fact, voices within IOSCO objected to the somewhat peremptory appropriation of the Objectives and Principles by the IMF and the World Bank and their sometimes questionable deployment in the FSAP process. Nevertheless, the FSAP machinery rolled inexorably onward, with IOSCO and its standard-setting capacities swept along with it.

The FSAP exercise is now nearly 20 years on; there are indications that the program is winding down, perhaps, like IOSCO in certain areas, having reached the point of diminishing returns. Despite the extraordinary amount of data collected and sometimes excellent work product, the FSAPs have been plagued by inconsistency and the use of international standards as blunt instruments. As expectations and requirements associated with the FSAP multiplied, capacity struggled to keep up. The exigencies of rigid scheduling made thoughtful assessments difficult.

46 Stijn Claessens, “Current Challenges in Financial Regulation” (2006) Policy Research Working Paper No 4103 at 46, online: World Bank <<https://openknowledge.worldbank.org/handle/10986/9261>>.

In addition to the widespread dissemination of IOSCO standards, in part through the FSAP process, there is also a remarkably high level of compliance or formal adoption, irrespective of suitability to local circumstances. There may be any number of reasons for this: emerging economies signalling their participation in the international discourse and readiness to participate in international markets; developed economies such as Canada showing leadership and support for the “internationalist” cause; the hard and soft coercive powers of the FSAP process and its often very public ratings or scorecards; IOSCO assessment and compliance reviews, as in the G20/FSB example. The hard law of one state is subsumed into soft law international standards and subsequently transformed back into state-level hard law elsewhere.

Over time, however, the weaknesses of this transformative process break through the surface of formal convergence and compliance. Aging international standards may not keep pace with market change, or may never have been appropriate for certain economies in the first place. Dissatisfaction with the inadequacies of international standards as they operate in a domestic context may arise. IOSCO’s quasi-regulatory posturing may translate into an increasing granularity in the standards as they take on an increasingly regulatory texture. Shifting balances of power in dominant regulatory paradigms may create dissonance with existing international standards, or the hard law that has been developed from them at the state level.⁴⁷ Unhappiness with the substantive content of international standards may prompt a return to unilateralism or bilateralism in regulatory efforts. International standards may lose their legitimacy and persuasiveness by the coerciveness of the implementation processes at work, their palpable inappropriateness in many contexts, or the perception of wasted time and regulatory effort in active international engagement.

All of these issues raise two fundamental questions: Are there alternatives to IOSCO standards? Can IOSCO deploy its resources in other, potentially more productive, ways?

At a very basic level, perhaps IOSCO should simply defer to local regulators and resist the

temptation to engage in international standard setting. Certainly, the creation of international standards applicable to three US corporations appears an unwarranted waste of international effort. In other areas, such as business conduct rules and investor protection measures, perhaps local regulators do it better. And doing it differently from one market to another might make eminent sense. Experimentation (and possible failure, innovation and recalibration) could be enhanced. Regulatory competition is no bad thing; smaller jurisdictions look to larger ones and each other for models and ideas. Areas of the market could be left to soft law and market practices (provided they are not abusive or exploitive, of course).

“Selective globalization” requires the exercise of greater differentiation and discernment. The demand for models and standards is there, in particular among smaller economies and emerging markets, but perhaps they should be tailored to these economies and markets. To satisfy the demand for granularity, modest initiatives in specific model laws might be an avenue to pursue, provided it is done with an openness to innovation and a sensitivity to differences in legal tradition and culture. In addition, there is still much scope for bilateralism and regional initiatives. Among developed economies, the slow, iterative process of market/regulator collaboration (despite its risks of regulatory capture) should not be discounted.

IOSCO may not be the vehicle to promote such initiatives, but it is well-placed to act as a hub or coordinator.

Prospects for the Future

There is no doubt that the days of a simplistic belief in the inevitability of regulatory convergence to international best practices or standards have passed. The world is too complex a place. Markets are too diverse and change too rapidly. US hegemony in the capital markets is being challenged.

International standards themselves are no longer viewed as necessarily embodying international best practices. Differing motivations go into their formulation and subsequent expression at a state level. Commercial and political rivalries

⁴⁷ Buxbaum, *supra* note 1.

continue to play out in the international arena, leaving many economies as bystanders. National pushback against international standards and their originators and purveyors, such as the comments expressed at the beginning of this paper by former SEC Commissioner Gallagher, may in fact be indicative of other, deeper political convictions. IOSCO itself is acknowledging the difficulties in consensus building and espousing deference to the primacy of national and regional regulation (for example, in the 2015 IOSCO CRA Code of Conduct). Where international standards demonstrate a regulatory granularity, they risk finding themselves at odds with state-level regulation and even business practices. State-level regulators and courts may need to fall back on older techniques associated with conflicts ordering, rather than relying on international convergence and harmonization.

This may not be the end of internationalism, but may represent the emergence of a new internationalism.

Conclusion

Elements of the IOSCO Principles, expressed through the 2008 CRA Code, have been woven into the EU CRA Regulation. Some language is virtually identical. To this extent, IOSCO acts as an international forum designed to facilitate coordinated responses to regulation of financial markets.

Where the IOSCO Principles form a background to the EU CRA Regulation, but the language differs, it is often the case that the EU CRA Regulation uses either mandatory language or provides a more specific standard. This is not necessarily inconsistent with the IOSCO CRA Code, which considered the possibility of “gold-plating”: “[t]he Code Fundamentals offer a set of robust, practical measures that serve as a guide to and a framework for implementing the Principles’ objectives....However, the measures set forth in the Code Fundamentals are not intended to be all-inclusive: CRAs and regulators should consider whether or not additional measures

may be necessary to properly implement the Principles in a specific jurisdiction.”⁴⁸

Gold-plating was, and still is, prevalent in the UK approach to implementing EU directives. However, once tolerated under EU financial directives in deference to the United Kingdom’s importance as a European financial centre, gold-plating is now openly discouraged. It resulted in unwelcome divergence, fragmentation and regulatory conflicts within the European Union.

As the IOSCO CRA Code evolved over time, it collided with the adoption of widespread state regulation in the aftermath of the global financial crisis. The 2015 IOSCO CRA Code now includes an express acknowledgement that many CRAs are subject to regulation.⁴⁹ Equally, the latest IOSCO CRA Code reflects, to a much greater extent, the detailed regulatory language of the EU CRA Regulation, although less emphatic and necessarily less directive.

At heart, the IOSCO CRA Code was drafted to serve as a model for CRA self-regulation, its target being the CRAs themselves, which were expected to voluntarily adopt their own codes or be subject to market discipline. State regulation, such as the EU CRA Regulation, has wider objectives. Thus, while the influence of the IOSCO CRA codes can be seen in terms of expectations placed on CRAs, the CRA Regulation establishes a supervising authority with powers to exercise oversight over CRAs,⁵⁰ require disclosure and impose sanctions.⁵¹ Likewise, the CRA Regulation’s civil liability regime is beyond the scope of the IOSCO CRA Code. Finally, the CRA Regulation serves as a form of market intervention, both in its mechanisms aimed at promoting competition⁵² and by forcing foreign CRAs to set up subsidiaries established in the European Union. Those were never goals of the IOSCO CRA Code, and it is to be expected that

48 IOSCO, Technical Committee, *Code of Conduct Fundamentals for Credit Ratings Agencies* (2008) at 2, online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.

49 See IOSCO, *Code of Conduct Fundamentals for Credit Ratings Agencies: Final Report*, FR05/2015 (2015), s 3.1, online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf>, reproduced in the section entitled “Representation of Endorsement” above.

50 See e.g. EC, *Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies*, [2009] OJ, L 302/1, arts 23c, 23d.

51 *Ibid*, art 36a.

52 Consider *ibid*, art 8d.

it will remain so, considering the idiosyncratic political interests that animate such policies.

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Annex 1: EU and IOSCO Standards on CRAs

As part of the research for this paper, the author prepared a detailed, section-by-section correlation between the IOSCO Principles and various codes on CRAs and the EU legislative response. The tables demonstrate the transformation of soft law IOSCO standards into the hard supranational law of the European Union. As well, the tables show the way in which, to a limited extent, EU legislation has influenced the further development, and greater quasi-regulatory nature, of IOSCO CRA standards.

A close examination of the EU legislative response to IOSCO CRA standards also shows the extent to which the European Union has departed from IOSCO standards. The European Union has rejected the self-regulatory and voluntary code approach upon which the IOSCO standards are based. Unlike the IOSCO standards that focus on the internal governance of CRAs, the EU approach creates a registration system for regulatory purposes under the oversight of a pan-European regulatory authority and a civil liability regime. The objective is not primarily coordination and regulatory convergence; rather it is an expression of unilateral regulation with an extraterritorial effect, with decidedly political overtones.

The following excerpts from the larger study are illustrative of the complex interaction of a set of IOSCO standards with a jurisdictionally based legislative response.

Background: Two Phases of EU CRA Regulation

The Self-regulatory Approach

The background to EU regulation of CRAs begins with development of the IOSCO Code of Conduct. In 2003, IOSCO's Technical Committee published a Statement of Principles Regarding the Activities of Credit Rating Agencies.¹ The IOSCO Principles were intended to create a self-regulatory framework for CRAs. In 2004, following publication of the principles, IOSCO developed a voluntary code of

conduct to "serve as a guide to and a framework for implementing the Principles' objectives."²

The first phase of the European Union's approach to regulation adopted self-regulation by CRAs based on the 2004 Code; the European Parliament passed a resolution that called for the EC to assess the need for legislation regulating the operation of CRAs.³ After a request by the EC, CESR, in its advisory capacity, provided a report on CRAs.⁴ CESR concluded that "the substance of the IOSCO Code is the right answer to the issues raised by the Commission's mandate...as it will improve the quality and integrity of the rating process and enhance the transparency of CRAs' operations."⁵ Implementation of the 2004 IOSCO Code was to be monitored by CESR (which, as an advisory and coordinating body, had no rule-making authority). The EC Communication of 2006 accepted CESR's position, but also noted that a failure by CRAs to comply with the IOSCO Code, or changing circumstances, could lead to a comprehensive legislative response.⁶

ESMA and the CRA Regulation

The second phase of EU regulation of CRAs was the enactment of a comprehensive legislative response. In the aftermath of the global financial crisis, a consensus emerged that the self-regulatory approach had failed.⁷ This led to the EC proposing the adoption of a regulation on CRAs in 2008.⁸ Ultimately, the European Parliament adopted a

1 IOSCO, Technical Committee, *Statement of Principles Regarding the Activities of Credit Rating Agencies* (2003) [IOSCO, *Statement of Principles*], online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD151.pdf>.

2 IOSCO, Technical Committee, *Code of Conduct Fundamentals for Credit Ratings Agencies* (2004), online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>.

3 European Parliament, *Report on Role and methods of rating agencies* (2003/2081(INI)) (2004) at para 16.

4 ESMA, *CESR's technical advice to the European Commission on possible measures concerning credit rating agencies*, CESR/05-139b (2005).

5 *Ibid* at 50.

6 Raquel García Alcubilla & Javier Ruiz del Pozo, *Credit Rating Agencies on the Watch List: Analysis of European Regulation* (Oxford, UK: Oxford University Press, 2012) at 47–48.

7 See Tim Wittenberg, "Regulatory Evolution of the EU Credit Rating Agency Framework" (2015) 16 *European Business Organization L Rev* 669 at 671; Mads Andenas & Gudula Deipenbrock, "Credit Rating Agencies and European Financial Market Supervision" (2011) 8:3 *Intl & Comp Corp LJ* 1 at 4–5.

8 Wittenberg, *supra* note 7.

series of regulations to implement the proposal. The first, in 2009, set up a CRA regulatory scheme based on IOSCO Principles.⁹ The second established ESMA, a pan-European regulator, to replace CESR.¹⁰ The third amended the CRA Regulation to vest ESMA with supervisory power over CRAs.¹¹ The fourth, most recent, regulation added further amendments to the CRA Regulation, including specific references to the rating of sovereign debt¹² and creation of a civil liability regime.¹³

The EU CRA Regulation does not simply replicate IOSCO's Code in legislative form. The CRA Regulation sets up a system of registration that, in turn, serves as "the principle prerequisite for CRAs to issue ratings intended to be used for regulatory purposes in the EU."¹⁴ Thomas Möllers and Charis Niedorf argue that "[t]he core of the Credit Rating Regulation is the requirement of registration in Art.14 Credit Rating Regulation and the registration procedure."¹⁵ Tim Wittenberg observes that the structure of the regulation "can broadly be grouped into three areas comprising the (1) conduct of business, (2) surveillance and (3) civil liability of CRAs."¹⁶ While the conduct of business portion of the regulation takes inspiration from IOSCO Principles and Codes, it also has the objective of combatting the oligopolistic tendency in the CRA market by introducing measures aimed at stimulating competition.¹⁷

The Interaction of IOSCO Principles and EU CRA Regulation

The backdrop to the European Union's adoption of state regulation of CRAs was IOSCO's self-regulatory code. Note, however, that in addition to spurring a legislative response from the European Union, the global financial crisis's revelation of still existent problems in the CRA industry led to IOSCO updating its code of conduct. A new, revised version was published in 2008.¹⁸ Thus, by the time of the EU CRA Regulation in 2009, it was the 2008 Code that provided the model for self-regulation. IOSCO has since substantially revised its code again in 2015,¹⁹ creating for the first time the possibility of a feedback loop from the EU CRA Regulation to the code.

Following the structure of the IOSCO Principles, all versions of the IOSCO Code have been divided into four areas of concern: quality and integrity of the rating process, independence and conflicts of interest, transparency and timeliness of ratings disclosure, and confidential information.

The following sections track specific provisions from the 2008 IOSCO CRA Code to the European Union's CRA Regulation²⁰ and, where significant, material changes in the 2015 IOSCO CRA Code. The charts are not exhaustive, simply illustrative.

9 EC, Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, [2009] OJ, L 302/1 [CRA Regulation].

10 EC, Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, [2010] OJ, L 331/84.

11 EC, Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies, [2011] OJ, L 145/30.

12 *Ibid*, arts 1(3)(v), 1(10)(b), 1(11).

13 EC, Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies, [2013] OJ, L 146/1. For a summary of the civil liability regime, see Nina Dietz Legind & Camilla Hørby Jensen, "The European Regulation of Credit Rating Agencies" (2014) 30 *Law in Context* 114 at 142–44.

14 Andenas & Deipenbrock, *supra* note 7 at 7.

15 Thomas MJ Möllers & Charis Niedorf, "Regulation and Liability of Credit Rating Agencies: A More Efficient European Law?" (2014) 11:3 *European Company and Financial L Rev* 333 at 337, online: SSRN <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2551868>.

16 Wittenberg, *supra* note 7 at 685.

17 See *ibid* at 686–88.

18 IOSCO, Technical Committee, *Code of Conduct Fundamentals for Credit Ratings Agencies* (2008) [2008 Code], online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.

19 IOSCO, *Code of Conduct Fundamentals for Credit Ratings Agencies: Final Report*, FR05/2015 (2015) [2015 Code], online: <www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf>.

20 CRA Regulation, *supra* note 9 as amended.

Quality and Integrity of the Rating Process

IOSCO 2008 CRA Code ²¹	EU CRA Regulation ²²
Quality of Information	
<p>1.1 A CRA should adopt, implement and enforce written procedures to ensure that the opinions it disseminates are based on a thorough analysis of all information known to the CRA that is relevant to its analysis according to the CRA's published rating methodology.</p> <p>1.7 A CRA should adopt <i>reasonable measures</i> so that the information it uses in assigning a rating is of sufficient quality to support a credible rating. If the rating involves a type of financial product presenting limited historical data (such as an innovative financial vehicle), the CRA should make clear, in a prominent place, the limitations of the rating.</p> <p>2015 Code:</p> <p>1.3 A CRA should adopt reasonable measures designed to ensure that it has the appropriate knowledge and expertise, and that the information it uses in determining credit ratings is of sufficient quality and obtained from reliable sources to support a high-quality credit rating.</p> <p>1.4 A CRA should avoid issuing credit ratings for entities or obligations for which it does not have appropriate information, knowledge, and expertise.</p>	<p>Art. 8(2) A credit rating agency shall adopt, implement and enforce adequate measures to ensure that the credit ratings and the rating outlooks it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to the applicable rating methodologies. It shall adopt <i>all necessary measures</i> so that the information it uses in assigning credit ratings and rating outlooks is of sufficient quality and from reliable sources.</p> <p>Annex 1, Section D, I.4 In a case where the lack of reliable data or the complexity of the structure of a new type of financial instrument or the quality of information available is not satisfactory or raises serious questions as to whether a credit rating agency can provide a credible credit rating, the credit rating agency <i>shall refrain</i> from issuing a credit rating or withdraw an existing rating.</p>
<p>1.2 A CRA should use rating methodologies that are rigorous, systematic, and, where possible, result in ratings that can be subjected to some form of objective validation based on historical experience.</p> <p>2015 Code:²³</p> <p>1.7-2 A CRA should establish and implement a rigorous and formal review function responsible for <i>periodically</i> reviewing the methodologies and models and significant changes to the methodologies and models it uses.</p> <p>1.13 A CRA should establish and maintain a review function made up of one or more senior managers responsible for conducting a rigorous, formal, and periodic review, <i>on a regular basis pursuant to an established timeframe</i>, of all aspects of the CRA's credit rating methodologies (including models and key assumptions) and significant changes to the credit rating methodologies.</p>	<p>Art. 8(3) A credit rating agency shall use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing.</p> <p>Art. 8(5) A credit rating agency shall monitor credit ratings and review its credit ratings and methodologies on an ongoing basis <i>and at least annually</i>, in particular where material changes occur that could have an impact on a credit rating....<i>Sovereign ratings shall be reviewed at least every six months.</i></p> <p>Art. 8(7) Where a credit rating agency becomes aware of errors in its rating methodologies or in their application it shall immediately:</p> <ul style="list-style-type: none"> (a) notify those errors to ESMA and all affected rated entities explaining the impact on its ratings including the need to review issued ratings; (b) where errors have an impact on its credit ratings, publish those errors on its website.

²¹ 2008 Code, *supra* note 18 [emphasis added].

²² CRA Regulation, *supra* note 9 [emphasis added].

²³ 2015 Code, *supra* note 19 [emphasis added].

Independence and Conflicts of Interest

IOSCO 2008 CRA Code	EU CRA Regulation
Mitigation of Conflicts	
<p>2.3 The determination of a credit rating should be influenced only by factors relevant to the credit assessment.</p> <p>2.4 The credit rating a CRA assigns to an issuer or security should not be affected by the existence of or potential for a business relationship between the CRA (or its affiliates) and the issuer (or its affiliates) or any other party, or the non-existence of such a relationship.</p>	<p>Art. 6(1) A credit rating agency shall take all necessary steps to ensure that the issuing of a credit rating or a rating outlook is not affected by any existing or potential conflicts of interest or business relationship involving the credit rating agency issuing the credit rating or the rating outlook, its shareholders, managers, rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the credit rating agency, or any person directly or indirectly linked to it by control.</p> <p>Art. 6(2) In order to ensure compliance with paragraph 1, a credit rating agency shall comply with the requirements set out in Sections A and B of Annex I.</p> <p>Annex 1, Section B, 3c A credit rating agency shall ensure that fees charged to its clients for the provision of credit rating and ancillary services are not discriminatory and are based on actual costs. Fees charged for credit rating services shall not depend on the level of the credit rating issued by the credit rating agency or on any other result or outcome of the work performed.</p>

Transparency and Timeliness of Ratings Disclosure

2008 IOSCO CRA Code	EU CRA Regulation
Structured Finance Ratings	
<p>3.5 b. A CRA should differentiate ratings of structured finance products from traditional corporate bond ratings, preferably through a different rating symbology. A CRA should also disclose how this differentiation functions. A CRA should clearly define a given rating symbol and apply it in a consistent manner for all types of securities to which that symbol is assigned.</p> <p>2015 Code:</p> <p>3.15 When rating a structured finance product, a CRA should publicly disclose or distribute to its subscribers (depending on the CRA's business model) sufficient information about its loss and cash-flow analysis with the credit rating, so that investors in the product, other users of credit ratings, and/or subscribers can understand the basis for the CRA's credit rating. The CRA should also publicly disclose or distribute information about the degree to which it analyzes how sensitive a credit rating of a structured finance product is to changes in the assumptions underlying the applicable credit rating methodology.</p> <p>2.9 A CRA should disclose in its credit rating announcement whether the issuer of a structured finance product has informed the CRA that it is publicly disclosing all relevant information about the obligation being rated or if the information remains non-public.</p>	<p>Art. 10(3) When a credit rating agency issues credit ratings for structured finance instruments, it shall ensure that rating categories that are attributed to structured finance instruments are clearly differentiated using an additional symbol which distinguishes them from rating categories used for any other entities, financial instruments or financial obligations.</p> <p>Art. 8b(1) The issuer, the originator and the sponsor of a structured finance instrument established in the Union shall, on the website set up by ESMA pursuant to paragraph 4, jointly publish information on the credit quality and performance of the underlying assets of the structured finance instrument, the structure of the securitisation transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures.</p>

Representation of Endorsement	
<p>2015 Code:</p> <p>3.1 A CRA that is subject to a CRA registration and oversight program administered by a regional or national authority should not state or imply that the authority endorses its credit ratings or use its registration status to advertise the quality of its credit ratings.</p>	<p>Art. 10(6) A credit rating agency shall not use the name of ESMA or any competent authority in such a way that would indicate or suggest endorsement or approval by ESMA or any competent authority of the credit ratings or any credit rating activities of the credit rating agency.</p>

Confidential Information

2008 IOSCO CRA Code	EU CRA Regulation
Related Entities	
<p>3.17 CRA employees should not share confidential information entrusted to the CRA with employees of any affiliated entities that are not CRAs. CRA employees should not share confidential information within the CRA except on an “as needed” basis.</p> <p>2015 Code:</p> <p>3.19 A CRA should establish, maintain, document, and enforce policies, procedures, and controls to protect confidential and/or material non-public information, including confidential information received from a rated entity, obligor, or originator, or the underwriter or arranger of a rated obligation, and non-public information about a credit rating action (e.g., information about a credit rating action before the credit rating is publicly disclosed or disseminated to subscribers).</p> <p>a. The policies, procedures, and controls should prohibit the CRA and its employees from using or disclosing confidential and/or material non-public information for any purpose unrelated to the CRA's credit rating activities, including disclosing such information to other employees where the disclosure is not necessary in connection with the CRA's credit rating activities, unless disclosure is required by applicable law or regulation.</p>	<p>Annex 1, Section C, 3. Credit rating agencies shall ensure that persons referred to in point 1:</p> <p>...(c) do not share confidential information entrusted to the credit rating agency with rating analysts and employees of any person directly or indirectly linked to it by control, as well as with any other natural person whose services are placed at the disposal or under the control of any person directly or indirectly linked to it by control, and who is not directly involved in the credit rating activities.</p>

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