

OVERCOMING THE HARD LAW/SOFT LAW DICHOTOMY IN TIMES OF (FINANCIAL) CRISES

Rolf H. Weber*

Abstract

Traditional legal doctrine calls for hard law to regulate markets. Nevertheless, in financial markets, soft law has a long tradition, not at least due to the lack of multilateral agreements in this field. On the one hand, the recent financial crisis has shown that soft law does not suffice to avoid detrimental developments; on the other hand, a straight call for hard law would not be able to manage the recognized regulatory weaknesses. Therefore, emphasis should be put on the possibilities of combining hard law and soft law; specific areas allowing realizing such kind of “combination” are organizational issues, transparency requirements, and dispute settlement mechanisms.

Keywords: Hard Law, Soft Law, Dichotomy, Financial Markets, Global Financial Crisis

* *Rechtswissenschaftliches Institut, Universität Zürich, Rämistrasse 74 / 57, Zürich, CH-8001, Switzerland*
Email: rolf.weber@rwi.uzh.ch

1 International Financial Regulation

1.1 Notion of International Financial Regulation

The number of definitions trying to describe international financial regulation is very large.¹ In principle, regulation is the normative intervention of a competent body in the economic activities of individuals and firms, including the licensing of public services and the direct rulemaking in economic activities.² Therefore, financial regulation can be enacted by public bodies (such as parliaments, executive authorities, and international organizations) as well as by self-regulatory agencies.

In recent years, not only new rules (for example encompassing capital adequacy, liquidity, fit and proper principles, “too-big-to-fail” measures) but also new regulators have emerged, mainly on a “half-governmental level”, since – as explained below – the traditional rulemaking by international bodies and state legislators did not meet the expectations and requirements of the market participants.³

¹ For an overview see R. H. WEBER, Mapping and Structuring International Financial Regulation – A Theoretical Approach, *European Business Law Review* 2009, at pp. 651-653; see also CH. TIETJE, *Architektur der Weltfinanzordnung*, *Beiträge zum Transnationalen Wirtschaftsrecht*, No 109, May 2011.

² See generally J. W. ANDERSON, JR., *Regulatory and Supervisory Independence: Is There a Case for Independent Monetary Authorities in Brazil?*, *Law and Business Review*, Vol. 10, 2004, at p. 253.

³ CH. BRUMMER, *Why Soft Law Dominates International Finance – And not Trade*, *Journal of International Economic Law*, Vol. 13, 2010, at p. 623.

1.2 Sources of International Financial Law

As mentioned, international financial law is often implemented through inter-agency institutions with ambiguous legal status,⁴ such as the Bank for International Settlement (BIS), the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS) or the Financial Stability Board (FSB). The key elements of the respective regulations consist in the referral to best practices that promote sound regulatory supervision though rules of thumb,⁵ comprising core principles of inter-agency organizations (apart from the BIS and the IOSCO mainly the FSB).⁶ Furthermore, regulatory reports and observations generating normative undercurrents help define the appropriateness of national regulatory approaches; in addition, measures of information sharing and enforcement cooperation can improve the procedural level of the regulations.⁷

⁴ See R. H. WEBER/D. ARNER, *Towards a New Design for International Financial Regulation*, *University of Pennsylvania Journal of International Law*, Vol. 29, 2007, at pp. 393-401; BRUMMER, *supra* note 3, at pp. 623, 627.

⁵ D. ZARING, “Best Practices”, *New York University Law Review*, Vol. 81, 2006, at p. 294.

⁶ For further details see E. HÜPKES, *The Financial Stability Board (FSB) and Its Role in the International Financial Architecture*, in: R. Sethe et al. (eds.), *Kommunikation, Festschrift für Rolf H. Weber*, Bern 2011, at pp. 859 et seq.; see also D. ARNER/M.TAYLOR, *The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?*, *Asian Institute of International Financial Law Working Paper*, No 6, June 2009, at pp. 2-13.

⁷ BRUMMER, *supra* note 3, at pp. 628-630.

The mentioned legal sources are of informal quality helping to spur agreement between countries, thereby limiting the risks of often uncertain costs and benefits accompanying the adoption of any regulatory standard.⁸ This informal quality has partly been an “escape” since the globalization of the financial markets might have undermined the authority and control of national authorities.⁹

2 Underlying Elements of Crises

The economic causes for the financial crisis of 2007/09 have already been thoroughly described;¹⁰ therefore, the following description of underlying elements of crises looks from a different angle.

2.1 Geographical Perspective

Traditionally, financial regulation is national. Domestic regulatory needs fall into the competence (and sovereignty) of the nation state. Experience during the last 20 years, however, has shown that the traditional regulatory regime does not comply with general policy-oriented needs causing the need to complement it with self-regulatory measures.¹¹

Externalities: Actions and inactions of states may have positive or negative “effects” in other states. The most well-known example is the impact of national tax laws on internationally active individuals.¹²

Public goods: From an economic point of view, public goods are non-excludable and non-rival in consumption; examples relevant for financial markets in a legal perspective are international payment systems, financial stability, and global economic growth.¹³

Economies of scale and scope and network externalities: With the growing number of cross-borderly active enterprises the need increases to have “harmonized” rules.¹⁴

Regulatory competition: The competitive drafting of legislative acts has some merits (efforts are spent in designing appropriate regulations),

however, such kind of competition tends to turn into a “race to the bottom”.¹⁵

Fragmentation: The existence of many national regulators leads to a fragmentation of rules which makes the cross-border business more demanding and the supervision about compliance with the rules more difficult.¹⁶

From a geographical angle, the following developments determine the (cross-border) exchange of financial services:¹⁷

Globalization: More and more international financial market entities offer their services internationally and, therefore, are looking for harmonized rules.

Technological advances: The development in new technologies allows offering the services more easily also at foreign locations.

Financial innovation: Experience has shown that financial products are becoming more sophisticated, based on difficult mathematical formula.

If the regulator does not take into account the changing environment, the rules will likely not be (or only partly be) accepted anymore by their addressees.

2.2 Substantive Perspective

The modern socio-legal theory has tried to develop models which ideally should show different types of crisis.¹⁸

A first type of crisis can occur due to endogenous risks leading to a “heteronomisation” of systemic operations; in such a situation, “shock-absorbers” must be installed.¹⁹

A second type of crisis can result from regulatory interference, in particular since financial regulation is reactive by nature. Any regulation jeopardizes, in case of compliance with it, the profit maximization of any given firm. Furthermore, the occurrence of cyclical communication transfers between two systems may cause an oscillation effect.²⁰

A third type of crisis can occur from the parasitic use of specialised inter-systemic communication loops in a combined way by two or more of the functional sub-systems of the society.²¹

⁸ CH. BRUMMER, How International Financial Law Works (and How it Doesn't), The Georgetown Law Journal, Vol. 99, 2011, at pp. 257, 261.

⁹ BRUMMER, supra note 8, at p. 266.

¹⁰ For an excellent overview see R. M. LASTRA/G. WOOD, The Crisis of 2007-09: Nature, Causes and Reactions, Journal of International Economic Law, Vol. 13, 2010, at pp. 531-550.

¹¹ For further details see J. P. TRACHTMAN, The International Law of Financial Crises: Spillovers, Subsidiarity, Fragmentation and Cooperation, Journal of International Economic Law, Vol. 13, 2010, at pp. 720-727.

¹² See GROUP OF THIRTY, Financial Reform: A Framework for Financial Stability, Washington D.C. 2009, at p. 9.

¹³ See I. KAUL ET AL. (eds.), Providing Global Public Goods, Managing Globalization, Oxford 2003.

¹⁴ See J. P. TRACHTMAN, International Regulatory Competition, Externalization and Jurisdiction, Harvard International Law Journal, Vol. 34, 1993, at p. 47.

¹⁵ TRACHTMAN, supra note 11, at pp. 723-724; E. M. GRAMLICH, Cooperation and Competition in Public Welfare Policies, Journal of Policy Analysis and Management, Vol. 6, 1987, at p. 417.

¹⁶ R. H. WEBER, New Rule-Making Elements for Financial Architecture's Reform, Journal of International Banking Law and Regulation, Vol. 25, 2010, at pp. 512, 515-516.

¹⁷ See TRACHTMAN, supra note 11, at pp. 727-730.

¹⁸ M. AMSTUTZ, Eroding Boundaries: On Financial Crisis and an Evolutionary Concept of Regulatory Reform, in: P. F. Kjaer/G. Teubner/A. Febbrajo (eds.), The Financial Crisis in Constitutional Perspective. The Dark Side of Functional Differentiation, Oxford 2011, at pp. 224 et seq.

¹⁹ AMSTUTZ, supra note 18, at pp. 228-229.

²⁰ AMSTUTZ, supra note 18, at pp. 232-233.

²¹ AMSTUTZ, supra note 18, at pp. 239-240.

Obviously, theory must try to draw conclusions from the respective approaches. As far as endogenous factors are concerned, the financial system should be shaped in a way that their impact can be minimized.²² Furthermore, financial institutions are to be tied into compliance structures requiring them to conduct the businesses with certain regulatory (conditional and/or teleological) “programmes”.²³ In addition, the functionality calls for internal and external architectural elements, governing the structure of the institution as such as well as its standing in a given market.²⁴

3 Hard Law v. Soft Law Controversy

3.1 Problem Setting

As set out, in recent years not only new rules but also new regulators have emerged, mainly on a “half-governmental” level; this alternative has been provoked since established international bodies were not capable to react as quickly as necessary and state regulators only have limited competences in cross-border matters.²⁵ Therefore, contrary to international trade (WTO) and monetary affairs (IMF) directing global coordination through formal organizations, international financial law arises through inter-agency institutions not always having a very clear legal status.²⁶ Consequently, the legal framework has its foundation on relatively shaky ground and the stability and predictability of the legal framework for business activities might be more uncertain than in case of established international law.

This rule-making approach on a “half-governmental” level has revitalized the relatively old discussion in international economic law²⁷ to what extent “hard law” is necessary and (looking from the other side of the medal) to what extent “soft law” could exercise a replacing function.²⁸

3.2 Hard Law as Expression of a Robust System

As mentioned, contrary to international financial regulation, trade and monetary matters are governed by international treaties. These agreements between countries are the result of usually long going negotiations and often need the approval by national decision-making bodies.²⁹

The provisions of multilateral treaties in international economic law, mainly on international trade and monetary affairs, are (at least in principle) designed to align incentives with the public interest and to prevent regulatory capture. Often these rules are (partly) tested in practice. Furthermore, multilateral treaties usually encompass a dispute settlement mechanism ensuring accountability and enforceability of the rules, i.e. sanctioning a non-compliant behaviour of a member country.³⁰ Therefore, the legal framework of the WTO and the IMF is called member-driven, rule-unitary, comprehensive and nearly universal.³¹ Important elements of such kind of international regulations are the (unanimous) consensus building and the settlement and enforcement scheme. In short words, such model is seen as a robust system.

Legal doctrine has developed some main characteristics being relevant in a robust regulatory system:³²

The legal system must be rule-oriented, focusing on the importance of predictability and stability of the provisions for all participants in the concerned contractual arrangement.³³

Incentives for countries and other relevant institutions need to be aligned with the public interest, i.e. rules should be designed in a way that the behaviour of the “ruled” entities takes the public interest appropriately into account.³⁴

A dispute settlement mechanism or at least an effective self-enforcement mechanism is to be established and implemented as central pillar of the system in order to keep the countries or other relevant institutions accountable for their behaviour.³⁵

Effective global regulation can help to avoid internal regulatory capture of the legislator by protectionist groups.³⁶

²² Therefore, organizational elements are of importance; see below IV.1. and AMSTUTZ, supra note 18, at pp. 246-247 and 259.

²³ AMSTUTZ, supra note 18, at pp. 250 and 260-261.

²⁴ See J. H. WALSH, Institution-Based Financial Regulation: A Third Paradigm, Harvard International Law Journal, Vol. 49, 2008, at pp. 381 et seq.; AMSTUTZ, supra note 18, at p. 251 and 263-264.

²⁵ See above I.1.

²⁶ BRUMMER, supra note 3, at p. 623.

²⁷ The term “soft law” was introduced by R. J. DUPUY, Declaratory Law and Programmatic Law: From Revolutionary Custom to “Soft Law”, in: R. A. Akkerman/P. J. Krieken/C. O. Pannenberg (eds.), Declarations on Principles, Leyden 1977, at p. 252.

²⁸ D. THÜRER, Soft Law, in: R. Wolfrum (eds.), The Max Planck Encyclopedia of Public International Law, 2008, online edition, available at <http://www.mpepil.com>; E. FERRAN/K. ALEXANDER, Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board, Legal Studies Resource Paper Series, No 36, 2011, at p. 1.

²⁹ BRUMMER, supra note 3, at p. 624.

³⁰ R. M. GADBAW, Systemic Regulation of Global Trade and Finance: A Tale of Two Systems, Journal of International Economic Law, Vol. 13, 2010, at p. 551.

³¹ GADBAW, supra note 30, at p. 563.

³² The subsequent discussion follows GADBAW, supra note 30, at pp. 568-572, without taking up its description entirely.

³³ See J. H. JACKSON, The World Trading System: Law and Policy of International Economic Relations, Cambridge 1997, at pp. 85-88.

³⁴ K. W. DAM, The GATT: Law and International Organization, Chicago 1970, at p. 6; GADBAW, supra note 30, at p. 568.

³⁵ For further details see below IV.3.

³⁶ H. SIEBERT, Rules for the Global Economy, New Jersey 2009, at p. 76; GADBAW, supra note 30, at p. 570.

A multilateral treaty should encompass a comprehensive coverage in the world; if important countries are not ratifying the treaty a substantial risk exists that its effects will be jeopardized.

Transparency is a prerequisite for good governance (historically seen as a constitutional instrument for empowering the people as opposed to entrusting a monarch with absolute sovereignty), i.e. transparency is the “best of all disinfectants”.³⁷

Adequate governance principles are to be developed, often based on a decision-making model of consensus.³⁸

Such kind of robust system is indeed stable, but also confronted with the weakness that no progress can (anymore) be achieved if the member states or other competent bodies are not prepared to apply sufficient negotiation flexibility. The problem is particularly apparent within the WTO: The Doha-Round has almost come to a stand-still since the member states stick to their own positions without thoroughly trying to find compromises. This (negative) effect is less obvious with the IMF, perhaps due to the urgent needs to quickly adapt rules to the critical environment of the financial markets: Whereas five years have elapsed between the collapse of the fixed-rate Bretton Woods regime (1973) and the respective amendment of the Articles of Association of the IMF, the member countries rapidly agreed to a making available of additional funds for the IMF through an increase of the subscription obligations after the outbreak of the financial crisis 2007/08. Eventually, a new level of a relatively robust structure of governance principles could be realized in the G-20 framework.³⁹

3.3 Soft Law as New “Force”

3.3.1 Acknowledgement of a New Legal Category

Contrary to hard law, soft law consists of rules issued by public or private bodies that do not comply with procedural formalities necessary to give the rules a specific legal status.⁴⁰ In view of the complex operations of international relations and the ongoing transformation of lawmaking processes it seems to be implied that the evolution of new forms of legal

regimes becomes more important. Therefore, during the last few decades, legal doctrine has developed a new notion of law, commonly called soft law, describing something between traditionally introduced law by a legislator (hard law) and no law.⁴¹ In various fields of the society and economy the term soft law is now acknowledged as valuable notion even if some uncertainties relating to its enforceability do remain.

In principle, the often expressed assumption that hard law is qualitatively better than soft law does not anymore hold in today’s environment in general, but also regarding international financial markets in particular. The notion that legalization entails a specific form of discourse, requiring justification and persuasion in terms of applicable rules and pertinent facts is not only an element of hard law, but also of soft law.⁴² Therefore, soft law can entail several functions previously tied to hard law, for example the notion of coordinating device and the objective of loss avoidance as efficiency means.⁴³

This appreciation is not a new result derived from “legislative” reactions to the financial crises, but corresponds to manifold ideas developed in legal philosophy: Several authors see the quality of soft law as even reaching a higher level of “compliance” than the traditional “legalistic” law making.⁴⁴ (i) Hart has described the process of formalization and institutionalization or codification of general standards as secondary norms; civil society actors can monitor the rules of formalization by applying different instruments depending on their grade of specification.⁴⁵ (ii) Linked to the increasing influence of civil society, Foucault calls for an “art of government” in order to mirror the epistemic networks and autonomous self-regulation against the public interest.⁴⁶ (iii) Teubner expresses the idea that the unity of regulatory regimes is significant for the perception of phenomena at the supra-, infra-, and trans-state levels, forecasting a new evolutionary stage in which law will become a system for the co-ordination of actions within and between semi-autonomous and societal subsystems.⁴⁷ (iv) Slaughter develops principles for government networks, being set out as relatively loose, co-operative arrangements across borders between and among like agencies that seek to respond to global issues and managing to close caps through co-ordination, thereby creating a

³⁷ L. D. BRANDEIS, *What Publicity Can Do*, in: *Other People’s Money And How the Bankers Use It*, New York 1914, at p. 92; see CH. KAUFMANN/R. H. WEBER, *The Role of Transparency in Financial Regulation*, *Journal of International Economic Law*, Vol. 13, 2010, at pp. 779 et seq.

³⁸ GADBAW, *supra* note 30, at p. 572.

³⁹ See R. H. WEBER, *Multilayered Governance in International Financial Regulation and Supervision*, *Journal of International Economic Law*, Vol. 13, 2010, at pp. 683, 703.

⁴⁰ J. E. GERSEN/E. A. POSNER, *Soft Law: Lessons from Congressional Practice*, *Stanford Law Review*, Vol. 61, 2008, at p. 573; see also A. T. GUZMAN/T. L. MEYER, *International Soft Law*, *Journal of Legal Analysis*, Vol. 2, 2010, at pp. 171, 179-183.

⁴¹ The text of this subchapter is partly based on R. H. WEBER, *Regulatory Models for the Online World*, Zurich 2002, at pp. 79-87.

⁴² K. W. ABBOTT/D. SNIDAL, *Hard and Soft Law in International Governance*, *International Organization*, Vol. 54, 2000, at p. 429.

⁴³ See GUZMAN/MEYER, *supra* note 40, at pp. 188 et seq.

⁴⁴ See also WEBER, *supra* note 16, at p. 518.

⁴⁵ H. L. A. HART, *The Concept of Law*, 2nd ed. Oxford 1997, at pp. 79-81.

⁴⁶ M. FOUCAULT, *Naissance de la biopolitique*, Cours au Collège de France 1978/79, Paris 2004.

⁴⁷ G. TEUBNER, *Recht als autopoietisches System*, Frankfurt a.M. 1989, at pp. 81 et seq., 118 et seq.

new sort of power, authority and legitimacy;⁴⁸ Slaughter advocates the establishment of such government networks since they permit the realization of co-ordination on a global level and create a new authority responsible and accountable for the development of rules.⁴⁹

3.3.2 Characteristics of Soft Law

Contrary to hard law, soft law consists of rule issued by public or private bodies that do not comply with procedural formalities necessary to give the rules a specific legal status.⁵⁰ Looking at the sources of international financial law in particular, the reasoning for the increased importance of soft law can be seen in the fact that the implementation of rules developed by inter-agency organizations and private associations are usually lowering the costs and increasing the flexibility.⁵¹ Insofar, it is fair to say that soft law leads to more extensive capacity building: Its enabling functionality in financial markets serves to ease the co-ordination process while at the same time providing directionality to the provision of cross-border standards; soft law quality allows regulators to enter into agreements by varying scope and specificity, and then to clarify (or change) the expectations of the concerned parties.⁵²

Being a regulatory model which develops and establishes rules independently of the principle of territoriality and which is responsive to changes in the concerned environment, soft law as law of the involved organizations follows the principle of subsidiarity, meaning that governments only intervene if the participants of the concerned community are not able to find suitable solutions themselves.⁵³

As mentioned, the informal quality of soft law has partly also been an “escape” since the globalization of the financial markets has undermined the authority and control of regulators. In particular, three main elements are of importance:⁵⁴ (i) Over the last twenty years, deregulation has been easing governmental regulations over both capital and financial products. (ii) Advances in information and computer technologies have spurred capital mobility by heightening investor participation in foreign markets. (iii) Financial innovation has served to

enhance cross-border capital flows, in particular through the issuance of new financial instruments and sophisticated techniques such as securitization.

Referring to rules considered by the “governed” persons to be adequate guidelines, the legitimacy of soft law is based on the fact that private incentives lead to a need-driven rule-setting process.⁵⁵ Soft law is justified if it is more efficient than hard law and if compliance with rules of the community is less likely than compliance with self-regulatory rules.⁵⁶ Such kind of soft law approach can be backed by a governmental framework if a state is of the opinion that some basic rules should not be left to the private actors; in this case, legal doctrine calls the “legislative” approach as being a form of “co-regulation”.⁵⁷

3.3.3 Benefits and Risks of Soft Law

Compared to hard law, soft law involves various benefits.⁵⁸ Rules created by the participants of a specific community are in general more efficient because they respond to real needs, mirror the technology, and provide the opportunity to flexibly adapt the legal framework to the changing environment. Since soft law is not imposed by an authority, but negotiated by the involved community, the likelihood is high that such rules enjoy broad acceptance. Furthermore, effective soft law induces the concerned persons/entities to be open to a permanent consultation process in respect of the development and implementation of the private rules. With regard to the lack of having realized an extensive participation by heads of states, soft law provides a cheaper means of agreement-making.⁵⁹

Consequently, soft law being independent of the governmental norm-setting organizations and the mechanisms of governmental legislation as well as being equipped with a greater flexibility than hard law achieves better efficiency and cost-effectiveness. A private or inter-agency process laying down a set of rules also might realize new solutions more quickly than hard law.⁶⁰

In contrast, soft law also carries some risks since the “legislative” process of developing self-regulatory rules is not always transparent and not every relevant

⁴⁸ A.-M. SLAUGHTER, *A New World Order*, Princeton/Oxford 2004, at p. 14.

⁴⁹ SLAUGHTER, *supra* note 48, at pp. 12-13 and 262-263; see also A.-M. SLAUGHTER/D. ZARING, *Networking Goes International, An Update*, *Annual Review of Law and Social Science*, 2006, at p. 215.

⁵⁰ For further details see T. L. MEYER, *Soft Law as Delegation*, *Fordham International Law Journal*, Vol. 32, 2008, at p. 897; P.-H. VERDIER, *Transnational Regulatory Networks and Their Limits*, *Yale Journal of International Law*, Vol. 34, 2009, at p. 167.

⁵¹ See below III.3.c).

⁵² BRUMMER, *supra* note 8, at p. 284.

⁵³ BRUMMER, *supra* note 8, at p. 284.

⁵⁴ BRUMMER, *supra* note 8, at p. 266.

⁵⁵ On the notion of self-regulation in more detail see A. CAMPBELL, *Self-Regulation and the Media*, *Federal Communications Law Journal*, Vol. 51, 1999, at pp. 758 et seq.; J. BLACK, *Constitutionalizing Self-Regulation*, *The Modern Law Review*, Vol. 59, 1966, at pp. 32 et seq.

⁵⁶ L. J. GIBBONS, *No Regulation, Government Regulation, or Self-Regulation: Social Enforcement of Social Contracting for Governance on Cyberspace*, *Cornell Journal of Law and Public Policy*, Vol. 6, 1997, at p. 509.

⁵⁷ W. HOFFMANN-RIEM, *Regulierung der dualen Rundfunkordnung – Grundfragen*, Baden-Baden 2000, at pp. 154-157; M. SENN, *Non-State Regulatory Regimes, Understanding Institutional Transformation*, Berlin 2011, at pp. 43, 139-148, 230.

⁵⁸ See WEBER, *supra* note 41, at pp. 83-85.

⁵⁹ GERSEN/POSNER, *supra* note 40, at p. 589.

⁶⁰ MEYER, *supra* note 50, at p. 897.

group is necessarily involved. Furthermore, some participants may spend significant resources on the development, implementation, and monitoring of codes and standards, while others simply profit from their existence (“free-rider problem”).⁶¹ Hard law has also the advantage of democratic legitimacy and enforceability since it implicates a previous legislative process. In contrast, soft law is often unevenly enforced; non-compliance with “private rules” does not necessarily lead to sanctions.⁶²

Notwithstanding the mentioned risks of soft law, the advantages of having efficient and flexible rules in an area where government regulations are hard to be established should not be underestimated. Soft law, however, must fit into the overall legal environment envisaging to realize a non-discriminatory and socially acceptable legal framework.⁶³

4 Combining Hard and Soft Law?

As shown, hard law and soft law have their merits. Therefore, the question should be tackled how the best use of these two forms of law can be made and which circumstances require which model of law.

4.1 Organization

Soft law can fulfil similar functions as hard law if the degree of “organization” of the market participants is high since in such a situation the implementation (and enforcement) of international standards is facilitated. Standards as such do not have a status as actual legal source because they lack legitimate authority of adoption. Nevertheless, past experience has shown that the implementation of autonomous soft law and non-state standards based on the principle that they are considered by the market participants as benchmark for the behaviour can lead to a gradual process of institutionalization.⁶⁴

Therefore, representatives of states and international organizations have increasingly recognized that soft law released by private market participants is usually modern and dynamic; it also allows the implementation of adequate decision-making structures.⁶⁵ Sufficient coverage with adequate reputational and retaliatory tools can generate a sufficient degree of compliance. Reputational constraints can come from the fact that for instance illegitimacy itself creates “costs”, i.e. members in standard-setting bodies must keep reputational discipline by refraining from overtly biased or self-serving decision-making.⁶⁶ If reputation

is seen as an important factor in the business environment, market participants will act according to (aligned) incentives with the public interest. In fact, neither regimes nor states have a fixed nature or self-evident objective.⁶⁷ Consequently, the degree to which rules are binding should not be conflated with whether they imply a formal legislative obligation. Insofar, hard law and soft law are not dichotomous or qualitatively different forms of regulatory control.⁶⁸

However, soft law cannot meet the requirements of a reasonable financial markets’ regulation encompassing a protection against extraneous values. This issue concerns the relationship between the system’s own design and the environment in which it operates.⁶⁹ Insofar, new dimensions of global administrative law are to be explored, covering aspects of accountability, institutional differentiation and elaborated procedural techniques.⁷⁰

4.2 Transparency

During the last few years the international regulatory system has undergone a significant evolution and accepted increasing prominence of public notice and consent procedures.⁷¹ As a consequence, transparency and accountability requirements are to be improved; if the exercise of free activities is linked to a transparent behaviour and to responsibility, the likelihood is increasing that voluntary compliance by private actors with soft law is also increasing.⁷² Understood in this sense, soft law is able to fulfil the efficiency requirements needed to establish an adequate legal framework.⁷³

Transparency could also lead to the disclosure of regulatory programmes developed by private market participants. Such kind of programmes should be three-dimensional:⁷⁴ The first dimension refers to the institutional aspects, i.e. procedural and decision-making topics. In its second dimension, transparency is understood as the substantive backbone of international financial regulation. The third dimension is accountability of actors as an essential element for rebuilding confidence in the financial system.

Experience shows that financial crises regularly provoke a call for more transparency.⁷⁵ However, too

⁶¹ See WEBER, *supra* note 1, at p. 651.

⁶² See WEBER, *supra* note 41, at p. 85.

⁶³ BRUMMER, *supra* note 8, at p. 310.

⁶⁴ WEBER, *supra* note 16, at pp. 517-518.

⁶⁵ M. KOSKENNIEMI, *The Fate of Public International Law: Between Techniques and Politics*, *The Modern Law Review*, Vol. 70, 2007, at p. 1.

⁶⁶ BRUMMER, *supra* note 8, at p. 309.

⁶⁷ GUZMAN/MEYER, *supra* note 40, at pp. 173-178.

⁶⁸ BRUMMER, *supra* note 8, at p. 306.

⁶⁹ AMSTUTZ, *supra* note 18, at p. 259.

⁷⁰ See B. KINGSBURY/L. CASINI, *Global Administrative Law Dimensions of International Organizations Law*, *New York University Public Law and Legal Theory Papers*, No 168, 2009, at pp. 10 et seq.

⁷¹ M. S. BARR/G. P. MILLER, *Global Administrative Law: The View from Basel*, *The European Journal of International Law*, Vol. 17, 2006, at pp. 20-31, 41.

⁷² R. WOLFRUM, *Legitimacy in International Law from a Legal Perspective: Some Introductory Considerations*, in: R. Wolfrum/V. Röben (eds.), *Legitimacy in International Law*, Heidelberg 2008, at pp. 6-24.

⁷³ BRUMMER, *supra* note 8, at pp. 309-311.

⁷⁴ KAUFMANN/WEBER, *supra* note 37, at p. 781.

⁷⁵ KAUFMANN/WEBER, *supra* note 37, at p. 788.

much transparency may overburden addressees thus making it impossible for them to adequately process all the information available and may even result in the so-called “Cassandra effect” or in “ignoring the prospect of future changes about the actual character of which we know nothing”.⁷⁶ Therefore, more transparency should not necessarily imply increasing the amount of information but rather its quality.⁷⁷

4.3 Dispute Settlement

The establishment of an effective dispute settlement mechanism with the objective to improve soft law reputation is of major importance. Using the example WTO, experience shows that the possibility of invoking the dispute settlement proceedings tends to lead to better voluntary compliance with the rules.⁷⁸ As far as the IMF is concerned, the honouring of loan commitments by member states is hardly subject to dispute resolution, but at least the risk is pertinent that the IMF is not easily disbursing any further loan; nevertheless, the announcement of a country’s failure in a dispute settlement mechanism could lead to an increasing compliance with soft law.⁷⁹

Dispute settlement mechanisms can equally be necessary to clarify which international law obligations are eventually incomplete or inadequate; insofar the dispute settlement can establish the predicate for, and limit the scope of, retaliation. The suitable forum for complaints in this context is not yet available in the financial market, however, it would be worth to consider establishing such kind of new body dealing with the settlement of disputes.

The implementation of dispute settlement mechanisms also is a pre-condition for the introduction of sanctions; examples could be the imposition of some sort of disciplinary and enforcement powers, attaching costs to the failure of complying with applicable rules. However, such a “sanctioning” is only possible if adequate mechanisms allow the concerned entities to get hold of the relevant information constituting the basis for getting redress.⁸⁰

5 Outlook

Overcoming the dichotomy of hard law and soft law should be an important objective in international financial regulation. This appreciation is not new; already some time ago, theoretical analyses came to the conclusion that collective awareness and attention can be mutually beneficial in rule-making processes; cooperative arrangements could in fact create a reasonable international framework.⁸¹ Possible approaches for a harmonization of rule-making processes should consider that states may be prepared to participate in hybrid forms of regimes (possibly through delegated experts) and they are often also inclined to transpose transnational rules into their legal framework.⁸² The minimum level of a combined hard law/soft law can be seen in generally accepted standards relating to the usual behaviour of the “reasonable man”, understood as an expression of common sense.⁸³

In all regulatory segments, the institutional actors play a key role in the rule-making processes; institutions structure incentives in human exchange whether political, social or economic.⁸⁴ Furthermore, institutional change shapes the way societies evolve through time; actors also institute processes by producing and disseminating rules that determine the behavioural patterns of the “participants”.⁸⁵ In this connection, the term of polycentric regulations occurring in multiple sites, shaped by practical issues and events, has been developed.⁸⁶ This form of regulation encompassing hard law and soft law is moving the decision-making processes to the most concerned “participants” of a specific market segment, thereby realizing an adequate balance between the different interests’ patterns.

⁷⁶ For these effects see R. H. WEBER, *Kassandra oder Wissensbroker – Dilemma im “Global Village”*, in: J. Becker/R. M. Hilty/J. F. Stöckli/T. Würtenberger (eds.), *Recht im Wandel seines sozialen und technologischen Umfeldes*, Festschrift für Manfred Rehinder, Bern 2002, at p. 407.

⁷⁷ An illustrative example is the US Sarbanes-Oxley Act that was enacted following the collapse of Enron: It imposes detailed disclosure obligations on companies and yet it has not lived up to the expectation of inducing the most substantial change in business practices since Franklin D. Roosevelt; see B. KUSCHINEK, *The Sarbanes Oxley Act: “Big Brother is Watching You” or Adequate Measures of Corporate Governance Regulation?*, Rutgers Business Law Journal, Vol. 5, 2008, at p. 65.

⁷⁸ K. ALEXANDER/R. DHUMALE/J. EATWELL, *Global Governance of Financial Systems: The International Regulation of Systemic Risks*, Oxford 2006, at p. 89.

⁷⁹ BRUMMER, *supra* note 8, at p. 289.

⁸⁰ R. H. WEBER, *Accountability in the Internet of Things*, Computer Law & Security Review, Vol. 27, 2011, at p. 137.

⁸¹ J. G. RUGGIE, *International Responses to Technology: Concepts and Trends*, International Organization, Vol. 29, 1975, at pp. 557, 562, 570.

⁸² M. KOSKENNIEMI, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law*, Report of the Study Group of the International Law Commission, Geneva 2006, at pp. 65-67 and 99-101.

⁸³ A. D. MILLER, *The “Reasonable Man” and Other Legal Standards*, California Institute of Technology, Social Science Working Paper No 1277, September 2007.

⁸⁴ WEBER, *supra* note 16, at p. 516; D. C. NORTH, *Institutions, Institutional Change and Economic Performance*, Cambridge 1991, at p. 3.

⁸⁵ WEBER, *supra* note 1, at p. 682.

⁸⁶ J. BLACK, *Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes*, Regulation & Governance, Vol. 2, 2008, at p. 139; WEBER, *supra* note 16, at p. 516.